STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER

TARGET FINANCIAL EXAMINATION
OF
SOUNDPATH HEALTH, INC.
FEDERAL WAY, WASHINGTON

NAIC CODE 12909

December 31, 2011

Order No. 13-198
Soundpath Health, Inc.
Exhibit A

SALUTATION

Seattle, Washington
November 6, 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, a target examination was made of the corporate affairs and financial records of

Soundpath Health, Inc.

of

Federal Way, Washington

hereinafter referred to as "SPH," 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 SPH as of December 31, 2011.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Target Financial Examination of Soundpath Health, Inc., of Federal Way, Washington. This report shows the financial condition and related corporate matters based on the targeted, limited scope of the financial examination as of December 31, 2011.

Patrick H. McNaughton

Patrick H. McNaughton
Chief Examiner

7-1-13

Date

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SCOPE OF THE EXAMINATION

A targeted, limited scope examination was called on April 12, 2012 based on the financial results of the Company as of December 31, 2011. The primary objective of the examination was to review the Company's financial solvency by conducting a focused review of the books and records targeting:

- Financial reporting accuracy of certain material 2011 NAIC Annual and Quarterly Statement and OIC monthly financial statement balances, including, Capital and Surplus Accounts, Statement of Revenue and Expense and Cash Flow Statements.
- Reserve adequacy and accuracy as of December 31, 2011.
- Calculations, proper accounting treatment, and classification of all reinsurance transactions.
- All off-balance sheet transactions and unrecorded assets, liabilities, or expenses.
- Significant transactions that have occurred between SPH and its affiliates and all third parties.

This examination covers the period January 1, 2011 through December 31, 2011 and 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 November 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. In addition, the examiners reviewed the Company's filed 2011 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).

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

SUMMARY OF TARGETED AREAS

The following summarizes the review and results of the targeted areas under examination:

1. **Financial Reporting Accuracy of Certain Material 2011 NAIC Annual and Quarterly Statement and OIC Monthly Financial Statement Balances, Including Capital and Surplus Accounts, Statement of Revenue and Expense, and Cash Flow Statements**

   The examination team reviewed significant transactions that occurred in 2011 such as leases that the Company entered into with Marquette Equipment Finance, LLC (Marquette) and reinsurance transactions with The Physicians Trust to assess whether the Company properly reflected the transactions in its general ledger and financial statements. Our review indicated that the transactions were not properly reflected as noted below:

The Company entered into operating lease transactions in order to capitalize primarily non-admitted assets as well as certain marketing and commission expenses. These transactions did not meet the criteria as operating leases per SSAP No. 22. They should have been classified using the financing method under SSAP No. 22. Our review indicated that the Company had significant internal control deficiencies over its general ledger reporting as well as the accuracy and integrity of its financial statements. For example, we determined that the Company entered into two lease transactions with Marquette in September 2011 and the transactions were not recorded correctly in the general ledger, its September 30, 2011 NAIC Quarterly Statement, or the OIC monthly financial statements until December 31, 2011. (See Instruction No. 3.)

Our review of the Marquette leases disclosed that the Company overstated its 2011 broker commission expenses by $475,000 and its interest expenses by $20,167. This caused SPH capital and surplus to be understated by $495,167 as of December 31, 2011. This was part of accounting irregularities committed by a former officer of the Company. The Company ultimately recorded the transactions appropriately in 2012. (See Instruction No. 2.)

We reviewed the reinsurance arrangement that the Company had with The Physicians Trust (TPT) and concluded that the treaty was with a fictitious company that was created by a former officer of the Company as part of a large scheme of accounting irregularities. Our analysis of the circumstances that led to establishment of the reinsurance agreement indicated that the Company failed to properly establish sufficient internal controls to provide adequate oversight in this area. In conjunction with the TPT agreement, the Company executed many transactions including reporting reinsurance expense of $421,872, reinsurance recoverable of $285,539, paid TPT $391,833 for 2011 premiums, and received $255,500 from TPT for claims that were subject to the fictitious reinsurance arrangement. SPH made and received payments and posted reinsurance transactions in its general ledger based on a fictitious agreement with insufficient documentation to support the transactions. The lack of adequate controls allowed such transactions to continue until the fictitious reinsurance agreement and the accounting irregularities were exposed in April 2012. (See Instruction No. 2.)

In addition, the review of the deferred tax assets (DTA) determined that the Company incorrectly implemented SSAP No. 10R by basing the calculation on 15 percent of its modified surplus rather than 10 percent. According to SSAP No. 10R, basing the calculation on 15 percent is reserved for companies with a risk based capital (RBC) ratio of 300 percent or more. SPH had an RBC ratio of 257.4 percent as of December 31, 2011. (See Instruction No. 4.)

2. Reserve Adequacy and Accuracy

The OIC health actuary reviewed the reserves as of December 31, 2011 and concluded that the reserves were in compliance with statutory requirements.

3. Calculations, Proper Accounting Treatment, and Classification of all Reinsurance Transactions

The OIC reinsurance specialist reviewed the Company's quota share (QS) reinsurance arrangement with The Canada Life Assurance Company (Canada Life) where the Company cedes certain capitated business to Canada Life. Our review of the QS reinsurance arrangement revealed that the arrangement lacked insurance risk transfer and therefore is considered deposit–type reinsurance as outlined by SSAP No. 61(17). Although there was no impact on SPH capital and surplus, the

Company's RBC ratio would be significantly lower than the current RBC ratio if the transactions were accounted for correctly. (See Instruction No. 1.)

4. All Off-Balance Sheet Transactions and Unrecorded Assets, Liabilities or Expenses

The review of the lease transactions disclosed that the Company had significant internal control deficiencies relating to its general ledger transactions and financial statements. For example, the Company failed to disclose and report correctly the lease transactions in its September 30, 2011 NAIC Quarterly Statement and the OIC monthly financial statements for several months. The Company failed to properly account for the lease transactions and failed to report significant liabilities related to the Marquette leases. Also, the Company failed to report significant marketing and commission expenses during the same period.

The Company understated its assets and liabilities by significant amounts and its financial statements as mentioned above did not present fairly the financial position of the Company. Off balance sheet transactions create distortions in the presentation of and reliance on financial statements. (See Instruction Nos. 2, 3.)

5. Review Significant Transactions Between the Company, its Affiliates, and all Third Parties

The examination team reviewed significant transactions between the Company and affiliates such as the Claims Delegations Agreements and the Administrative Services Agreements between the Company, Physicians of Southwest Washington, LLC (PSW), and Northwest Physicians Network, LLC (NPN) to assess whether the charges are fair and reasonable and properly supported.

The results of this review disclosed that the support documentation for the charged expenses and the charged amounts were adequately supported and fair and reasonable. However, we noted that the Company had significant internal control deficiencies relating to filing significant agreements with the OIC in compliance with RCW 48.31C.050(2). (See Instruction No. 5.)

INSTRUCTIONS

1. 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 considered deposit-type reinsurance as outlined by SSAP No. 61(17)[1].

The Company is instructed to comply with SSAP No. 61(17), by recording the arrangement as Deposit Accounting and following the guidance of Deposit Accounting as prescribed in the SSAP No. 61(51). Also, the Company is instructed to comply with RCW 48.43.097 by filing its financial

[1] This instruction was also included in the OIC's previous full scope financial examination report as of December 31, 2010.

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. Accounting Irregularities

A former officer of the Company directed Marquette to send partial lease proceeds to Trucaris, a company controlled by the former officer of the Company, which was part of larger accounting irregularities. This involved a fictitious reinsurance arrangement with a non-existent reinsurer named The Physicians Trust. The Company posted payments and receipts in its general ledger under the fictitious reinsurance arrangement. Also, the accounting irregularities involved fictitious broker commissions and interest payments.

In April 2012, the accounting irregularities were exposed and the Company recovered $631,500 from Trucaris. This was determined to be a full accounting of all outstanding amounts based on our review.

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. (See Examination Adjustment No. 2.)

3. Leases

In September, October, and November 2011, the Company entered into four leases with Marquette in order to capitalize certain nonadmitted assets, marketing, and commission expenses. The Company was required to collateralize the leases from its holdings of government bonds.

Lease	Lease No. 1	Lease No. 2	Lease No. 3	Lease No. 4
Date	September 16, 2011	October 31, 2011	September 16, 2011	November 2, 2011
Property	Electronic data processing equipment and furniture.	Interest in connection with support services, implementations integration, customization, consulting, training, and other services.	Broker commissions and agents' balances.	Marketing materials/expenses and other property.
Amount	$328,675	$482,617	$1,500,000	$1,069,480
Duration	60 months	60 months	60 months	36 months

The Company failed to report the leases correctly using the financing method in its September 30, 2011 NAIC Quarterly Statement and in its OIC monthly financial statements for several months. Also, the Company did not file a report with the OIC disclosing the material transactions as required by RCW 48.44.530. As of December 31, 2011, the leases were recorded properly under the financing method in compliance with SSAP No. 22.

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. Also, the Company is instructed to comply with RCW

48.44.530 by filing a report with the OIC disclosing material transactions. (See Examination Adjustment No. 2.)

4. Deferred Tax Assets (DTA)

The Company incorrectly overstated its DTA by $229,612 based on incorrect implementation of SSAP 10R. The error was caused when the Company based the DTA calculation on 15 percent of its modified surplus rather than 10 percent even though its RBC ratio as of December 31, 2011 was 257.4 percent. Per SSAP 10R, a calculation based on 15 percent of modified surplus is limited to companies with RBC ratios of 300 percent and above.

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. (See Examination Adjustment No. 1.)

5. Non-Compliance with Holding Company Regulation

The Company did not file timely several intercompany agreements as required by RCW 48.31C.050. The following agreements were either never filed or filed untimely with the OIC:

- The Company failed to file the Administrative Services Agreement for Claims Processing between the Company and PSW effective March 1, 2007[2]. Also, an amendment to this agreement effective January 1, 2011 was filed with the OIC on February 3, 2012.
- The Company failed to file the Claims Delegation Agreement effective March 1, 2007 between the Company and PSW[2].
- The Company failed to file with the OIC the Claims Delegation Agreement effective March 1, 2007 between the Company and NPN[2].
- The Administrative Service Agreement for Care Management between the Company and NPN was not filed timely with the OIC[2]. The agreement was filed with the OIC on May 12, 2011 with an effective date of January 1, 2010. Also, an amendment to the agreement effective February 1, 2012 was filed with the OIC on January 27, 2012.
- The Contractor and Participant Medicare Advantage Agreements (Founders Agreements) with PSW and NPN effective March 1, 2007 were not filed with the OIC.
- The Company failed to file with the OIC an amendment to the Contractor and Participant Medicare Advantage Agreements with PSW effective January 1, 2010.
- The Company failed to file with the OIC the Credentialing and Utilization Management Delegation Agreement effective March 1, 2007 between the Company and NPN.
- The Company failed to file with the OIC the NPN and PSW 2009 Regulatory Amendments to the Claims Delegation Agreement.

RCW 48.31C.050(2) requires the Company to notify the OIC in writing of its intention to enter into such transactions prior to the effective date.

The Company is instructed pursuant to RCW 48.31C.050(2)(d) to properly file all intercompany management agreements with the OIC before implementation.

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[2] This instruction was also included in the OIC's previous full scope financial examination report as of December 31, 2010.

6. Custodial Agreements

In conjunction with the Marquette lease transactions, the Company was required to collateralize the leases from its holdings of government bonds. SPH held the collateral at Central Trust & Investment Company (Central Trust) and U.S. Bancorp Investments, Inc. (USBI). The Company indicated that its custodial agreements with Central Trust and USBI complied with the FCEH even though they did not contain most provisions as required by the FCEH and RCW 48.13.480. Without a properly executed custodial agreement that contains the required provisions as outlined in the FCEH and RCW 48.13.480, the Company's assets can be at risk in a dispute.

The Company is instructed to execute revised or amended custodial agreements that comply 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).

7. Annual Statements Errors

The results of our review of the Company's accounting transactions disclosed several instances in which the Company's 2011 NAIC Annual Statement did not conform to the AP&P and the NAIC Annual Statement Instructions.

- The Company incorrectly included First American Prime Obligations and First American Treasury Obligations Money Market Funds on Schedule E - Part 1 - Cash. These amounts should have been classified as Short Term Investments 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.
- In the General Interrogatories of the 2011 NAIC Annual Statement, the Company reported zero for assets on deposit with a state regulatory body instead of the book value of $5,445,729.
- In the General Interrogatories of the 2011 NAIC Annual Statement, the Company incorrectly stated that it was not a member of an insurance holding company.

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

NONE

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 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 the Company to access the higher premium rates under 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, 2011, the Company had 1,200,000 shares of common stock with a $10 par value authorized with 910,000 shares issued and outstanding. The minimum capital requirement of $3 million pursuant to RCW 48.44.037 was met with $4.1 million in capital and surplus as of December 31, 2011.

Territory and Plan of Operations

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

Growth of Company

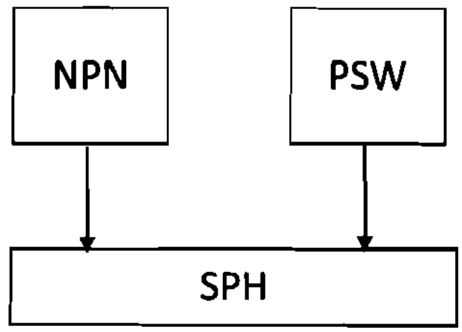
The Company's growth, as reported in its filed NAIC Annual Statements, is illustrated below:

Year	Admitted Assets	Liabilities	Capital & Surplus
2011	$20,939,593	$16,867,796	$4,071,797
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

Year	Total Revenue	Net Underwriting Gain (Loss)	Net Investment Gain (Loss)	Net Income
2011	$50,118,448	($1,454,939)	$239,861	($1,330,213)
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

As of December 31, 2011, SPH was owned by two IPAs, NPN and PSW, each owned 50 percent of the Company. The following organization chart is taken from SPH's filed 2011 NAIC Annual Statement:



Intercompany Agreements

As of December 31, 2011, the Company had the following intercompany agreements in force:

- **Founder Agreements with its founders, NPN and PSW effective March 1, 2007**

  The Founder Agreements provided that NPN and PSW receive 85 percent of 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.

- **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. On January 1, 2009, the agreement was amended by changing the fee structure to a flat fee of $18.50 per member per month for members not assigned to PSW or NPN networks. January 1, 2011, the agreement was amended and a new sliding scale fee schedule was added to the agreement.

- **Claims Delegation Agreement with NPN**

  The agreement provided 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.

- **Administrative Services Agreement with NPN for Care Management**

  The agreement provides that SPH agrees to reimburse NPN eight dollars per member per month to provide care management services to certain SPH members effective January 1, 2010.

The above agreements were either filed untimely or never filed with the OIC. (See Instruction No. 5.)

MANAGEMENT AND CONTROL

Board of Directors (BOD)

Directors as of December 31, 2011:

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, 2011:

Christine M. Tomcala	Chief Executive Officer (CEO)
Zachary A. Smulski	Chief Financial Officer (CFO)
William N. Young	Chief Medical Officer (CMO)
Leonard B. Alenick	Secretary
Laurence C. Schadt	Treasurer

Conflict of Interest

The Company requires an 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, officers, and key employees that could possibly be interpreted as a conflict of interest. No conflicts of interest were disclosed in the statements that were submitted to the BOD for the period of examination.

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

Except for the accounting irregularities reported above, 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. This included approval by the BOD to enter into the Marquette lease transactions, however BOD minutes did not reflect specific approval of the TPT transactions. All BOD meetings were conducted with a quorum present. The Bylaws were amended and restated in April 2012.

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, 2011. 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 and SSAP No. 54; reviewing historical paid claims and loss ratios; checking the consistency of the incurred and claims paid data from the Company's system with the figures reported in the 2011 NAIC Annual Statement; and estimating claims unpaid for the valuation date of December 31, 2011. The OIC health actuary concluded that the reserves were in compliance with statutory requirements.

REINSURANCE

The Company is a party to the following reinsurance agreements:

- Stop-loss reinsurance agreement with Physicians Insurance A Mutual Company effective January 1, 2008. The Company terminated the agreement effective December 31, 2011. The reinsurance agreement was reviewed and found that it complied with Washington State reinsurance statutes.

- Stop-loss reinsurance agreement with HM Life Insurance Company effective January 1, 2012. The reinsurance agreement was reviewed and found that it complies with Washington State reinsurance statutes.

- Quota share reinsurance agreement with The Canada Life Assurance Company effective April 1, 2011 to cede 90 percent of its capitated business. Effective October 1, 2011, the Company decreased the quota share percentage to 25 percent. The reinsurance agreement was reviewed and found that it did not comply with Washington State reinsurance statutes due to the lack of insurance risk transfer. (See Instruction No. 1.)

STATUTORY DEPOSITS

The Company maintained the following statutory deposit as of December 31, 2011:

State	Type	Book Value	Fair Value
Washington	Cash and Bonds	$5,445,729	$5,658,598

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 Moss Adams, LLP (Moss Adams). The Company received an unqualified opinion for all years under review.

SUBSEQUENT EVENTS

- As of December 31, 2011, the Company withheld a $1.2 million capitation payment from NPN. 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.
- Compliance Officer and General Counsel, Mike Jensen, resigned in February 2012 and was replaced by Robin Larmer on April 11, 2012.
- Christine Turner was appointed as a Chief Operating Officer 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 increased 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 May 18, 2012, the Company filed a request for hearing on the findings of the December 31, 2010 OIC Financial Examination report.
- On June 26, 2012, PSW purchased 81,900 shares of SPH stock from NPN. The purchased shares represent nine percent of the issued and outstanding common stock of SPH. Prior to the transaction, PSW and NPN each owned 50 percent of the issued and outstanding stock of SPH; as a result of the transaction, PSW has become the majority shareholder of SPH.
- On August 20, 2012, The Everett Clinic informed the Company of its plan to terminate its relationship with SPH effective December 31, 2012.

FINANCIAL STATEMENTS

The following financial statements show the financial condition of SPH as of December 31, 2011:

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

Soundpath Health, Inc.
Assets, Liabilities, Capital and Surplus
December 31, 2011

	Balance Per Company	Examination Adjustments	Balance Per Examination	Notes
Assets				
Bonds	$10,443,475	$0	$10,443,475	
Common stocks	1,266,732		1,266,732	
Cash and short-term investments	562,976		562,976	
Subtotals, cash and invested assets	**12,273,183**	**0**	**12,273,183**	
Investment income due and accrued	82,152		82,152	
Uncollected premiums and agents' balances in course of collections	217,462		217,462	
Accrued retrospective premiums	1,685,000		1,685,000	
Amounts recoverable from reinsurers	3,837,153		3,837,153	
Other amounts receivable under reinsurance contracts	632,002		632,002	
Current federal and foreign income tax recoverable and interest thereon	12,128		12,128	
Net deferred tax asset	688,837	(229,612)	459,225	1
Electronic data processing equipment and software	90,834		90,834	
Receivables from parent, subsidies and affiliates	43,051		43,051	
Health care and other amounts receivable	1,377,791		1,377,791	
Aggregate write-ins for other than invested assets	0	631,500	631,500	2
Total Assets	**$20,939,593**	**$401,888**	**$21,341,481**	
Liabilities, Capital and Surplus				
Claims unpaid	$7,230,134	$0	$7,230,134	
Unpaid claims adjustment expenses	17,028		17,028	
Aggregate health policy reserves	740,722		740,722	
Premiums received in advance	108,151		108,151	
General expenses due or accrued	528,168		528,168	
Ceded reinsurance premiums payable	4,514,297		4,514,297	
Amounts withheld or retained for the account of others	400,227		400,227	
Borrowed money and interest thereon	3,077,027		3,077,027	
Liability for amounts held under uninsured plans	252,042		252,042	
Total Liabilities	**16,867,796**	**0**	**16,867,796**	
Aggregate write-ins for special surplus funds	229,612		229,612	
Common capital stock	9,100,000		9,100,000	
Unassigned funds (surplus)	(5,257,815)	401,888	(4,855,927)	1, 2
Total capital and surplus	**4,071,797**	**401,888**	**4,473,685**	
Total Liabilities, Capital and Surplus	**$20,939,593**	**$401,888**	**$21,341,481**	

Soundpath Health, Inc.
Statement of Revenue and Expenses
For the Year Ended December 31, 2011

	Balance Per Company	Examination Adjustments	Balance Per Examination	Notes
Member months	**137,074**		**137,074**	
Net premium income	$48,823,287	$421,872	$49,245,159	2
Change in unearned premium reserves and reserve for rate credits	1,295,161		1,295,161	
Total revenues	50,118,448	421,872	50,540,320	
Hospital and Medical:				
Hospital/medical benefits	77,825,273		77,825,273	
Other professional services	1,980,618		1,980,618	
Emergency room and out-of-area	1,283,281		1,283,281	
Prescription drugs	7,328,640		7,328,640	
Incentive pool, withhold adjustments and bonus amounts	(808,500)		(808,500)	
Subtotal	87,609,312	0	87,609,312	
Less:				
Net reinsurance recoveries	46,945,467	(285,539)	46,659,928	2
Total hospital and medical	40,663,845	285,539	40,949,384	
Claims adjustment expenses	3,537,568		3,537,568	
General administrative expenses	7,385,322	(495,167)	6,890,155	2
Increase in reserves for life and accident and health contracts	(13,348)		(13,348)	
Total underwriting deductions	51,573,387	(209,628)	51,363,759	
Net underwriting gain or (loss)	(1,454,939)	631,500	(823,439)	
Net investment income earned	217,604		217,604	
Net realized capital gains or (losses)	22,257		22,257	
Net investment gains or (losses)	239,861	0	239,861	
Net gain or (loss) from agents' or premium balances charged off	(115,135)		(115,135)	
Net income or (loss) after capital gains tax and before all other federal income taxes	(1,330,213)	631,500	(698,713)	
Net Income (loss)	**($1,330,213)**	**$631,500**	**($698,713)**	
CAPITAL AND SURPLUS ACCOUNT				
Capital and surplus prior reporting year	**$5,822,333**	**$0**	**$5,822,333**	
Net income (loss)	(1,330,213)	631,500	(698,713)	
Change in net deferred income tax	(583,166)	(229,612)	(812,778)	1
Change in nonadmitted assets	162,843		162,843	
Net change in capital and surplus	(1,750,536)	401,888	(1,348,648)	
Capital and surplus end of reporting period	**$4,071,797**	**$401,888**	**$4,473,685**	

Soundpath Health, Inc.
Five Year Reconciliation of Surplus
For the Years Ended December 31,

	2011	2010	2009	2008	2007
Capital and surplus prior reporting year	$5,822,333	$5,635,964	$3,404,670	$3,839,146	$0
Net income or (loss)	(1,330,213)	(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	(583,166)	10,067	(207,068)	287,337	
Changes in nonadmitted assets	162,843	181,598	658,012	(383,967)	(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	(1,750,536)	186,369	2,231,294	(434,476)	3,839,146
Capital and surplus end of reporting year	$4,071,797	$5,822,333	$5,635,964	$3,404,670	$3,839,146

Soundpath Health, Inc.
Analysis of Changes in Financial Statements Resulting from the Examination
December 31, 2011

	Balance Per Company	Balance Per Examination	Notes	Increase (Decrease) in Surplus	Total
Capital and surplus, December 31, 2011 - per NAIC Annual Statement					$4,071,797
Net deferred tax assets	$688,837	$459,225	1	($229,612)	
Net premium income	48,823,287	49,245,159	2	421,872	
Net reinsurance recoveries	46,945,467	46,659,928	2	(285,539)	
General administrative expenses	7,385,322	6,890,155	2	495,167	
Change in surplus					401,888
Capital and surplus, December 31, 2011 - per Examination					$4,473,685

NOTES TO THE FINANCIAL STATEMENTS

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

1. Deferred Tax Assets

The Company incorrectly overstated its DTA by $229,612 that resulted when the Company based the DTA calculation on 15 percent of its modified surplus rather than 10 percent. A calculation based on 15 percent is reserved for companies with an RBC ratio of 300 percent and above. However, the Company's RBC ratio as of December 31, 2011 was 257.4 percent. (See Instruction No. 4.)

2. Accounting Irregularities

SPH capital and surplus was understated by $631,500 as a result of the accounting irregularities that took place in 2011. The understatement resulted from the following:

- The Company incorrectly overstated its reinsurance expenses by $421,872 and reinsurance recoverables by $285,539 in conjunction with the TPT fictitious reinsurance arrangement. The net effect to SPH's capital and surplus was an understatement of $136,333.
- The Company incorrectly overstated its broker commission expenses by $475,000 and overstated its interest expense by $20,167. The net effect to SPH's capital and surplus was an understatement of $495,167.

SPH's capital and surplus was understated by $631,500 as of December 31, 2011. (See Instruction No. 2.)

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Soundpath Health, Inc., and its affiliates during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; 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; and Katy Bardsley, CPA, 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,

Constantine Arustamian

Constantine Arustamian, CFE, AIE, CPA, CPCU, ARC, ARM, ARe, AIS, AIAF, API
Examiner-in-Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON }
}**ss**
COUNTY OF KING }

Constantine Arustamian, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Soundpath Health, Inc. 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.

Constantine Arustamian

Constantine Arustamian, CFE, AIE, CPA, CPCU, ARC, ARM, ARe, AIS, AIAF, API
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me this 1st day of July, 2013.

Colleen Jansen

Notary Public in and for the
State of Washington

COLLEEN JANSEN
COMMISSION EXPIRES
NOTARY
PUBLIC
5-17-16
STATE OF WASHINGTON