



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**THE SURPLUS LINE ASSOCIATION OF OREGON
PORTLAND, OREGON**

AS OF

DECEMBER 31, 2010

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SALUTATION

July 19, 2011

Honorable Scott L. Harra, Acting Director
Department of Consumer and Business Services
State of Oregon
350 Winter Street NE, Room 440
Salem, Oregon 97301

Dear Director:

In accordance with your instructions and guidelines in the National Association of Insurance Commissioners (NAIC) Examiners Handbook, pursuant to ORS 731.300 and 731.302, respectively, we have examined the business affairs and financial condition of the

THE SURPLUS LINE ASSOCIATION OF OREGON
7360 SW Hunziker, Suite 105
Portland, Oregon 97223

hereinafter referred to as the "Association." The following report is respectfully submitted.

SCOPE OF EXAMINATION

This is the first financial examination of the Association conducted by the Insurance Division of the Department of Consumer and Business Services. This financial examination of the Association as of December 31, 2010, covers the five year period then ended. Material transactions or events occurring subsequent to the examination cut-off date were reviewed and noted during the examination.

Accounting methods, records, and other supporting evidence were examined and tested by appropriate methods to the extent deemed necessary and appropriate for the type, volume and complexity of the accounting system and operations utilized by the Association.

HISTORY

The Surplus Line Association of Oregon was originally formed in 1939 at the direction of the Insurance Commissioner of Oregon as an unincorporated Association of Surplus Line Brokers. Its purpose was to assist the Insurance Division in regulating the surplus line market and collecting taxes on the surplus line business written in Oregon.

In August of 1980, the Association was incorporated as a non-profit corporation.

MANAGEMENT AND CONTROL

Board of Directors

The Board of Directors is comprised of five directors. Each Board member serves a three year term.. Board members are not eligible for re-election or appointment to the Board sooner than one year following the end of that member's previous service as a Board member. All directors must be Oregon residents according to its Bylaws.

The Association's Board of Directors as of December 31, 2010, is below:

<u>Name and Address</u>	<u>Title</u>	<u>Term</u>
Jeff Langfeldt Portland, OR	President	2009 – 2011
Nancy Schultz Hillsboro, OR	Vice President	2010 – 2012
Tom Sawyer Portland, OR	Secretary Treasurer	2011 – 2013
Jenny Lupescu Portland, OR	Director	2011 – 2013
Dianna Del Collo Portland, OR	Director	2010 – 2012

Officers

Association officers serving at December 31, 2010, were:

<u>Name</u>	<u>Title</u>
Jeff Langfeldt	President
Nancy Schultz	Vice President
Tom Sawyer	Secretary Treasurer

Larry Boyd, Executive Director, manages the daily operations for the Association.

CONFLICT OF INTEREST

The Association has a formal conflict of interest policy. They never required, however, directors, officers and key employees to annually sign conflict of interest statements. **I recommend that The Surplus Line Association of Oregon require its staff, officers and Board of Directors annually complete a conflict of interest statement. This recommendation is supported by ORS 735.430(3).**

CORPORATE RECORDS

Articles of Incorporation

The Articles of Incorporation conformed to Oregon statutes. No amendments were made to the Articles of Incorporation during the period under review.

Bylaws

The Bylaws conformed to Oregon statutes. No amendments were made to the corporate Bylaws during the period under review.

Board of Director Minutes

Board minutes for the examination period were reviewed. Overall, the minutes supported the transactions of the Association and the actions taken by its Board of Directors and Executive Director. A quorum met at all meetings.

FIDELITY BONDS AND OTHER INSURANCE

Insurance coverage was reviewed for adequacy of limits and retentions and the solvency of the insurers providing the coverages. A renters policy covers the Association for losses caused by employee dishonesty up to \$200,000. A directors and officers policy covered losses up to \$3,000,000 after a \$1,000 retention. Other insurance coverages in force at December 31, 2010, were:

Renters
Commercial umbrella
Directors & officers

These coverages were adequate.

TERRITORY AND PLAN OF OPERATION

Under the provisions of ORS 735.430, The Surplus Line Association of Oregon shall be the advisory organization of surplus line licensees to: (a) facilitate and encourage compliance by resident and nonresident surplus line licensees with the laws of this state and rules of the Director of the Department of Consumer and Business Services relative to surplus line insurance; (b) provide means for the examination of all surplus line coverage written by resident and nonresident surplus line licensees to determine whether the coverages comply with the Oregon Surplus Line Law; (c) communicate with organizations of admitted insurers with respect to the proper use of the surplus line market; (d) receive and disseminate to resident and nonresident surplus line licensees information

relative surplus line coverages; and (e) receive and collect on behalf of the state premium receipts tax for surplus line insurance.

GROWTH OF THE ASSOCIATION

The following exhibit illustrates the Association's growth during the examination period. Amounts were derived from the Associations' financial statements.

<u>Year Ending</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Net Assets</u>
8/31/2006	\$3,629,132	\$221,616	\$3,407,516
8/31/2007	3,776,275	15,313	3,760,962
8/31/2008	3,134,849	7,003	3,127,846
8/31/2009	2,414,577	7,924	2,404,556
12/31/2010*	2,977,914	7,832	2,970,082

*Per examination

The financial statements prepared during 2006 through 2009 were based on a fiscal year basis, which started in September 1 and ended August 31 the following year. In 2009 the Association converted to a calendar year basis of accounting, so the 2010 financial statements are presented as of December 31, 2010, for the preceding 12 months.

The examiner reviewed the balances reflected by the Association during the 4-month period of September 1, 2009 to December 31, 2009, and determined the balances were reasonable.

ACCOUNTS AND RECORDS

Basis of Accounting

The Association maintains its financial statements on a Generally Accepted Accounting Principles (GAAP) basis of accounting. As mentioned above, prior to 2010 the Association financial statements followed a fiscal year basis. Starting in January 1, 2010, the financial statements follow a calendar year.

Income Tax Status

The Association is exempt from income taxes under Section 501(c)(6) of the Internal Revenue Code. It elects to pay the federal and state proxy tax on lobbying expenses. Tax returns are subject to examination by taxing authorities for the current and prior three years.

THE SURPLUS LINE ASSOCIATION OF OREGON
BALANCE SHEET
AS OF DECEMBER 31, 2010

<u>ASSETS</u>	<u>Annual Statement</u>	<u>Examination Adjustments</u>	<u>Net Admitted Assets</u>
Cash	\$ 228,725	\$ 0	\$ 228,725
Accounts receivable	103,923		103,923
Corporate stocks	2,130,802		2,130,802
Corporate bonds	201,860		201,860
US Treasury and Agency securities	302,818		302,818
Prepaid rent	1,065		1,065
Office equipment (-less depr \$77,562)	<u>8,721</u>	<u>0</u>	<u>8,721</u>
Total Assets	<u>\$2,977,914</u>	<u>\$ 0</u>	<u>\$2,977,914</u>
 <u>LIABILITIES & SURPLUS</u>			
Proxy Tax Payable	\$ 7,832	\$ 0	\$ 7,832
Surplus	<u>2,970,082</u>	<u>0</u>	<u>2,970,082</u>
Total Liabilities & Surplus	<u>\$2,977,914</u>	<u>\$ 0</u>	<u>\$2,977,914</u>

THE SURPLUS LINE ASSOCIATION OF OREGON
INCOME STATEMENT
For the Year Ended December 31, 2010

INCOME

Stamping fees	\$ 453,617
Interest and dividends	55,647
Realized and unrealized gain on securities	275,287
Investment advisory fees and taxes	(24,068)
Other	<u>252</u>
Total Income	\$ 760,735

EXPENSES

Salaries	\$ 158,462
Payroll Tax	15,276
Health insurance	9,233
Retirement plan	3,750
Computer programming and maintenance	72,178
Legislative expenses	37,683
Rent	24,440
Travel – executive director	5,397
Conferences & meetings	5,402
Telephone	3,262
Professional fees	3,421
Insurance	8,271
Depreciation	4,558
Dues & subscriptions	5,685
Supplies	3,930
Delivery & postage	2,373
Taxes, licenses	7,743
Miscellaneous	(1,647)
Total Expenses	<u>\$ 369,417</u>

Net Income \$ 391,318

Surplus Account	
Surplus - January 1, 2010	\$2,578,765
Net income	<u>391,318</u>
Surplus - December 31, 2010	<u>\$2,970,082</u>

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Cash & Investments

Cash and investments comprise 96% of total assets. The goal of investing is for the aggregate rate of return of assets to exceed by 4% the rate of inflation as measured by the Consumer Price Index. To achieve this, the Board of Directors requires no less than 90% of the fund assets be invested in liquid securities, defined as securities that can be quickly converted to cash.

Aggregate Fund Asset Allocation Guidelines (at market value)

<u>Asset Class</u>	<u>Minimum</u>	<u>Maximum</u>	<u>Preferred</u>	<u>December 31, 2010</u>
Large Cap Equities	0%	70%	50%	55%
Small Cap Equities	0%	25%	10%	15%
International Equities	0%	50%	25%	15%
Fixed Income	0%	50%	25%	15%
Cash and Equivalents	0%	0%	0%	0%

SUMMARY OF COMMENTS AND RECOMMENDATIONS

The following recommendation was made as a result of this examination.

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- 5 I recommend that The Surplus Line Association of Oregon require its staff, officers and Board of Directors annually complete a conflict of interest statement. This recommendation is supported by ORS 735.430(3).

CONCLUSION

During the five year period covered by this examination, the Association's surplus decreased from \$3,407,516, as presented in the August 31, 2006, financial statements, to \$2,977,914, as shown in this report of examination. Comparative assets, liabilities and surplus are shown below:

<u>Year Ending</u>	<u>December 31, 2010</u>	<u>August 31, 2006</u>	<u>Change</u>
Assets	\$2,977,914	\$3,629,132	(\$651,218)
Liabilities	<u>7,832</u>	<u>221,616</u>	<u>(213,784)</u>
Surplus	<u>\$2,970,082</u>	<u>\$3,407,516</u>	<u>(\$437,434)</u>

SUBSEQUENT EVENT

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, H.R. 4173) was passed in 2010. Contained in the act is “Subtitle B – State based Insurance Reform” which became effective July 21, 2011. This subtitle is also referred to as the “Nonadmitted and Reinsurance Reform Act of 2010” (NRRA).

The act sets specific regulations that apply to the taxation of multi-state surplus line policies, the qualification of insurers and exemption from any diligent search requirement for qualified “Exempt Commercial Purchasers” of insurance. The bill urges, but does not require, states to adopt a “clearing house” approach to redistribute premium taxes collected on policies with multi-state exposures.

For policyholder convenience, multi-state surplus line policies will be taxed and regulated by only one of the states where exposures exist. The responsible state is the “Home State” as defined in the federal bill. As the number and related premiums for policies with multi-state exposures is not known, the financial impact on the Oregon Surplus Line Association operations is not possible to calculate. It is generally thought that the percentage of policies impacted will not exceed 10%.

ACKNOWLEDGMENT

The cooperation and assistance extended by the officers and employees of the Association during the examination process are gratefully acknowledged.

In addition to the undersigned, Timothy Hurley, CFE, insurance examiner with the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in this examination.

Respectfully submitted,

Mike P. Phillips, CFE, CPA, AES
Supervising Insurance Examiner
Insurance Division
Department of Consumer and Business Services
State of Oregon

AFFIDAVIT

STATE OF OREGON)
) ss
County of Marion)

Mike P. Phillips, CFE, CPA, AES, being duly sworn, states as follows:

1. I am authorized to represent the State of Oregon in the examination of The Surplus Line Association of Oregon.

2. The State of Oregon, Department of Consumer and Business Services, Insurance Division is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.

3. I have reviewed the examination work papers and examination report, and the examination of The Surplus Line Association of Oregon, was performed in a manner consistent with the standards and procedures required by the Oregon Insurance Code.

The affiant says nothing further.

Mike P. Phillips, CFE, CPA, AES
Supervising Insurance Examiner
Insurance Division
Department of Consumer and Business Services
State of Oregon

Subscribed and sworn to before me this _____ day of _____, 2011.

Notary Public in and for the State of Oregon

My Commission Expires: _____