

**STATE OF OREGON  
DEPARTMENT OF  
CONSUMER & BUSINESS SERVICES  
INSURANCE DIVISION**



REPORT OF FINANCIAL EXAMINATION

OF

**PACIFICSOURCE COMMUNITY HEALTH PLANS, INC.  
SPRINGFIELD, OREGON**

AS OF

DECEMBER 31, 2013

STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**PACIFICSOURCE COMMUNITY HEALTH PLANS, INC.  
SPRINGFIELD, OREGON**

**NAIC COMPANY CODE 12595**

DECEMBER 31, 2013

## TABLE OF CONTENTS

|   |           |
|---|-----------|
| <b>SALUTATION .....</b>                                       | <b>3</b>  |
| <b>SCOPE OF EXAMINATION .....</b>                             | <b>4</b>  |
| <b>COMPANY HISTORY .....</b>                                  | <b>5</b>  |
| <i>Capitalization.....</i>                                    | <i>6</i>  |
| <i>Dividends and Other Distributions.....</i>                 | <i>6</i>  |
| <b>CORPORATE RECORDS .....</b>                                | <b>6</b>  |
| <i>Board Minutes.....</i>                                     | <i>6</i>  |
| <i>Articles of Incorporation.....</i>                         | <i>7</i>  |
| <i>Bylaws .....</i>   | <i>7</i>  |
| <b>MANAGEMENT AND CONTROL .....</b>                           | <b>7</b>  |
| <i>Board of Directors .....</i>                               | <i>7</i>  |
| <i>Officers.....</i>  | <i>8</i>  |
| <i>Conflict Of Interest.....</i>                              | <i>8</i>  |
| <i>Insurance Company Holding System .....</i>                 | <i>9</i>  |
| <b>INTERCOMPANY AGREEMENTS.....</b>                           | <b>11</b> |
| <b>FIDELITY BOND AND OTHER INSURANCE.....</b>                 | <b>12</b> |
| <b>TERRITORY AND PLAN OF OPERATION .....</b>                  | <b>13</b> |
| <b>GROWTH OF THE COMPANY .....</b>                            | <b>14</b> |
| <b>LOSS EXPERIENCE .....</b>                                  | <b>14</b> |
| <b>REINSURANCE .....</b>                                      | <b>15</b> |
| <i>Assumed .....</i>  | <i>15</i> |
| <i>Ceded.....</i>   | <i>15</i> |
| <b>ACCOUNTS AND RECORDS.....</b>                              | <b>15</b> |
| <b>STATUTORY DEPOSIT .....</b>                                | <b>16</b> |
| <b>COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS.....</b> | <b>16</b> |
| <b>SUBSEQUENT EVENTS.....</b>                                 | <b>16</b> |
| <b>FINANCIAL STATEMENTS.....</b>                              | <b>17</b> |
| <b>NOTES TO FINANCIAL STATEMENTS .....</b>                    | <b>22</b> |
| <i>Note 1 – Invested Assets.....</i>                          | <i>22</i> |
| <i>Note 2 – Other Invested Assets.....</i>                    | <i>22</i> |
| <i>Note 3 – Goodwill .....</i>                                | <i>23</i> |
| <i>Note 4 – Actuarial Reserves.....</i>                       | <i>23</i> |
| <b>SUMMARY OF COMMENTS AND RECOMMENDATIONS .....</b>          | <b>24</b> |
| <b>CONCLUSION .....</b>                                       | <b>24</b> |
| <b>ACKNOWLEDGMENT .....</b>                                   | <b>25</b> |
| <b>AFFIDAVIT .....</b>  | <b>26</b> |

**SALUTATION**

May 5, 2015

Honorable Laura N. Cali, Commissioner  
Oregon Insurance Division  
State of Oregon  
350 Winter Street NE  
Salem, Oregon 97301-3883

Dear Commissioner:

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

**PACIFICSOURCE COMMUNITY HEALTH PLANS, INC.**  
**110 International Way**  
**Springfield, Oregon 97477**

**NAIC Company Code 12595**

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

## SCOPE OF EXAMINATION

We have performed our single-state, full-scope examination of PacificSource Community Health Plans, Inc. The examination was conducted in conjunction with the examination of its parent health care service contractor, PacificSource Health Plans, and a separate report of examination will be prepared for that entity. The last examination of this life and health insurance company was completed as of December 31, 2010. This examination covers the period of January 1, 2011 to December 31, 2013.

We conducted our examination pursuant to ORS 731.300 and in accordance with ORS 731.302(1), which allows the examiners to consider the guidelines and procedures in the NAIC *Financial Condition Examiners Handbook*. The handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with statutory accounting principles, annual statement instructions, and Oregon statutes and administrative rules.

All accounts and activities of the Company were considered in accordance with the risk focused examination process.

## COMPANY HISTORY

Central Oregon Independent Health Systems was incorporated in Oregon on June 5, 1995, by Central Oregon Independent Practice Association (COIPA) and Central Oregon Hospital Network (CoNET) to administer a fully capitated contract for the Oregon Health Plan through the Division of Medical Assistance Programs (DMAP).

On April 24, 1998, the Company received a certificate of authority as a for-profit health care service contractor pursuant to ORS Chapter 750, at which time it was qualified by the Centers for Medicare and Medicaid Studies (CMS) as the first Provider Sponsored Organization in the nation to write Medicare+Choice business. Beginning in 2001, the Company expanded its operations and began offering commercial health plans in the large-group employers market, expanding into small-group employers during 2004. Effective January 1, 2004, all DMAP business was transferred to a newly formed subsidiary, Clear Choice Individual Health Solutions (now called PacificSource Community Solutions, Inc.).

The Company formed a shell subsidiary on December 12, 2005, as a for-profit stock corporation, to facilitate the conversion of the Company from a health care service contractor authorized to transact health insurance under ORS Chapter 750 to a life and health insurer authorized under ORS Chapter 731. The new Company, Clear Choice Health Plans, Inc., was granted a Certificate of Authority on June 23, 2006, and the conversion was completed effective March 15, 2007. On June 23, 2009, the Company amended its Articles of Incorporation to change its name to Clear One Health Plans, Inc.

On January 26, 2010, PacificSource Health Plans filed a Form A with the Oregon Insurance Division and the Department of Consumer and Business Services (DCBS) to acquire the Company and its subsidiaries. The acquisition was approved by order on March 17, 2010,

and on May 21, 2010, Clear One became a wholly-owned direct subsidiary. On January 28, 2011, the Company amended its Articles to change its name to PacificSource Community Health Plans, Inc.

### **Capitalization**

The Company's Articles of Incorporation, under Article III, authorize the issue of up to ten million (10,000,000) shares of common stock. The Articles were silent regarding par value. The Company reported 1,721,988 shares were issued and outstanding as of March 31, 2010. As part of the May 21, 2010, acquisition by PacificSource Health Plans, each issued and outstanding share of common stock was converted into the right to receive \$26.00 in cash, without interest.

Following the acquisition, the Company reported 1,000 shares of common capital stock issued and outstanding with a stated book value of \$10,272,763. This value did not change during the period under examination.

### **Dividends and Other Distributions**

The Company did not pay any dividends or make any other distributions during the period examined.

## **CORPORATE RECORDS**

### **Board Minutes**

In general, the review of the Board meeting minutes of the Company indicated the minutes support the transactions of the Company and clearly describe the actions taken by its directors. A quorum, as defined by the Company's Bylaws, met at all of the meetings held during the period under review.

Neither the Company's Articles nor its Bylaws authorize any committee. However, the parent company's Board has created committees that oversee and support the PacificSource Group; an Audit Committee, an Executive Committee, a Finance Committee, a Board Governance Committee, a Long Range Planning Committee, and a Subsidiaries Committee.

The minutes indicated the Board directly approves the CEO's compensation through an executive session of the Board and indirectly approves the compensation of senior executives through approval of an annual budget. This process complies with the provisions of ORS 732.320(3).

#### **Articles of Incorporation**

The Articles of Incorporation were filed on December 12, 2005, and last amended on January 11, 2011. The Articles of Incorporation conformed to the Oregon Insurance Code.

#### **Bylaws**

The Bylaws were last amended and restated effective April 12, 2011. The Company's Bylaws conformed to Oregon statutes.

### **MANAGEMENT AND CONTROL**

#### **Board of Directors**

The Bylaws, in Section 3, state the business and affairs of the corporation shall be managed by the Board. The authorized number of directors of the corporation shall be no fewer than five (5), the specific number to be set by resolution of the Board. Directors shall be elected at the annual meeting of shareholders. As of December 31, 2013, the Company was governed by a six member Board of Directors as follows:

| <u>Name and Address</u>                  | <u>Principal Affiliation</u>          | <u>Member Since</u> |
|--|---------------------------------------|---------------------|
| Patricia P. Buchanan*<br>Eugene, Oregon  | Physician<br>River Road Medical Group | 2010                |
| John C. DeWenter<br>Springfield, Oregon  | Attorney                              | 2010                |
| Priscilla J. Gould<br>Eugene, Oregon     | Retired                               | 2010                |
| Vern L. Katz<br>Eugene, Oregon           | Physician                             | 2010                |
| Divya Sharma<br>Bend, Oregon             | Physician                             | 2012                |
| Charles R. Zachem, III<br>Eugene, Oregon | Physician                             | 2010                |

\*Chairman

The Company complied with its Articles and Bylaws, and with the provisions of ORS 732.305.

### Officers

Principal officers serving at December 31, 2013, were as follows:

| <u>Name</u>           | <u>Title</u>                              |
|-----------------------|---|
| Kenneth P. Provencher | President and Chief Executive Officer     |
| Sujata Sanghvi        | Exec. VP and Chief Administrative Officer |
| Peter F. Davidson     | Exec. VP and Chief Financial Officer      |
| Dan Stevens           | VP and Chief Operations Officer           |
| Kristin E. Kernutt    | Secretary                                 |
| Tom Ewing, MD         | Exec. VP and Chief Medical Officer        |

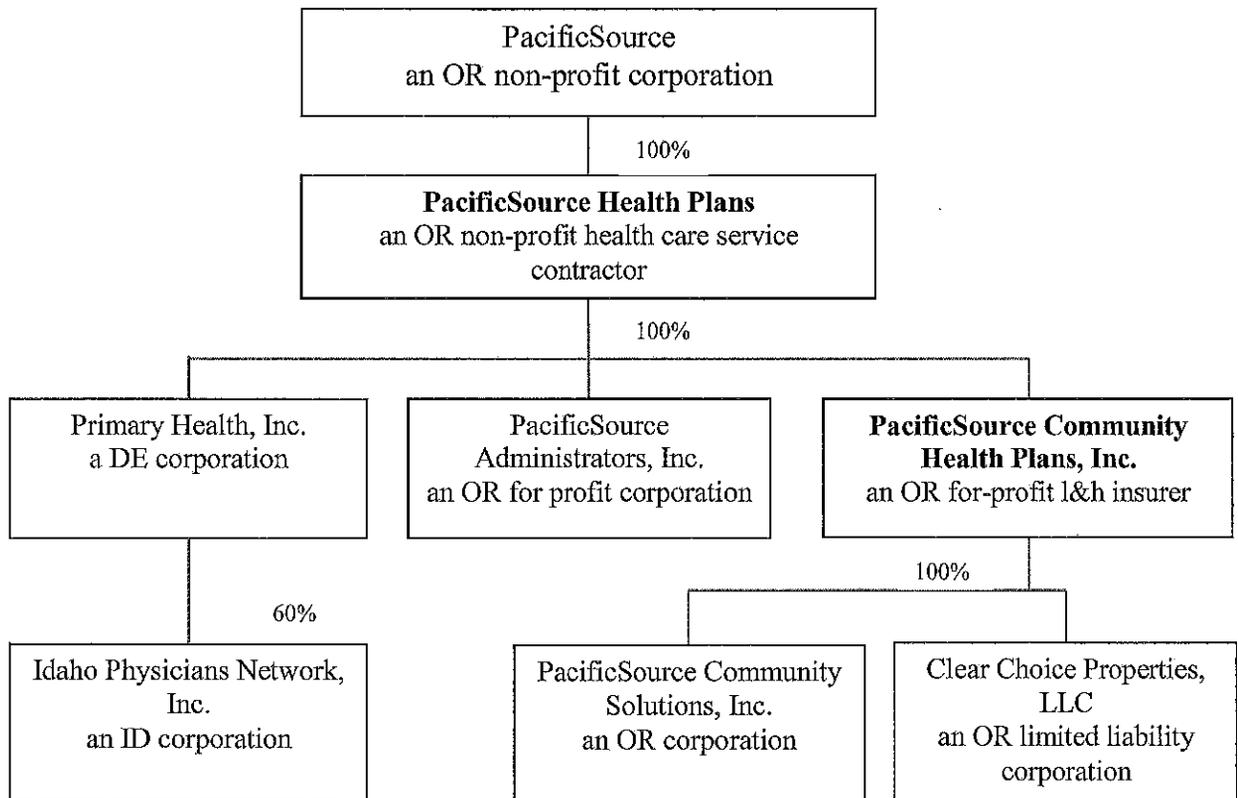
### Conflict Of Interest

The Company's Board adopted a formal statement of policy concerning conflict of interest for all directors, officers and responsible employees. Board members, senior officers and key employees are required to annually sign a conflict of interest declaration. From a review of

the completed conflict of interest questionnaires, the Company's personnel performed due diligence in completing the conflict of interest statements. No material conflicts of interest were noted.

**Insurance Company Holding System**

The following organizational chart shows the relationship between the related entities of the Company:



During 2013, PacificSource Health Plans formed a non-profit public benefit corporation named PacificSource to become the holding company parent of the Plan and its subsidiaries.

In addition to the Company, it controls the following entities:

PacificSource Health Plans is an Oregon domiciled non-profit health care service contractor and owner of 100% of the outstanding common stock of the Company. It owns 100% of the following entities:

Primary Health, Inc. (PHI), a Delaware stock corporation, operates as a holding company to hold 60% of Idaho Physicians Network.

PacificSource Administrators, Inc. (PAI), dba Manley Services, an Oregon for-profit corporation, is a third-party administrator formed by the acquisition of Manley Services, Select Benefit Administrators, and Riverside Benefit Administrators. It specializes in reimbursement administration including Flexible Spending Account (FSA) and Health Reimbursement Account (HRA) plan management, COBRA administration, and self-insured plans.

Idaho Physicians Network, Inc. (IPN) is an Idaho for-profit corporation owned 60% by PHI and 40% by independent physician shareholders. IPN is a provider network for some of Idaho's largest health plans. IPN was incorporated on July 6, 1993, and now works with 75 national and regional based insurance companies, third-party administrators, as well as local and state insurers.

The Company owns 100% of the following entities:

PacificSource Community Solutions, Inc., (PCS) is an Oregon corporation 100% owned by PCHP and was formed in 2003 to contract with the Division of Medical Assistance Programs (DMAP) for the Oregon Health Plan.

Clear Choice Properties, LLC, an Oregon limited liability corporation formed in 2007 for the purpose of holding and managing the land and office building located in Bend, OR. PCHP is the single member of this company.

## INTERCOMPANY AGREEMENTS

With the creation of the new insurance company holding system, agreements in place between the PacificSource Health Plans and its subsidiaries were replaced with new agreements with PacificSource. Most of these became effective January 1, 2014. During the period under examination, the following agreements were in place between the Company and its parent, affiliates and subsidiaries:

### Administrative Services Agreement – PCS

Effective May 22, 2010, and last amended on January 1, 2013, PacificSource Health Plans agreed to provide the Company executive oversight, information systems advisory services, claims processing advisory services, accounting and financial management services and support, legal services, marketing and sales services and support, administrative services, health services support, provider network support, and other services required. The Company agreed to compensate PCS a monthly base fee, plus the actual cost of third-party services PCS obtains for the Company's benefit. All amounts are due by the 15<sup>th</sup> of the following month. This agreement was terminated by both parties effective December 31, 2013.

### Administrative Service Agreement – CCP

Effective May 1, 2008, Clear Choice Properties, LLC agreed to manage and operate the offices located in Bend, OR, and the Company agreed to provide administrative services, including general management services, building management, accounting and financial services, corporate reporting, and insurance. In exchange, CCP agreed to pay the Company a monthly set fee, plus direct costs for specified operations. This agreement was terminated by both parties effective December 31, 2013.

### Commercial Lease

Effective April 30, 2008, and amended on March 1, 2009, the Company entered into a lease agreement as tenant with Clear Choice Properties, LLC, as landlord, for the commercial office building located in Bend, OR. The Company pays a monthly guaranteed minimum monthly rent over a ten-year lease term. All taxes, insurance costs, utility charges, tenant's share of operating expenses and any other sum tenant is required to pay shall be deemed "Additional Rent." Rent shall be due and payable on or before the first day of each month. Effective December 31, 2013, the Company transferred and assigned the lease agreement to PacificSource.

### Tax Allocation Agreement

Effective January 1, 2010, PacificSource Health Plans entered into an agreement with each of its subsidiaries as the agent for purposes of filing a consolidated tax return and making payments. Each subsidiary agreed to pay the Plan its federal tax liability as calculated under the Income Method as described in IRC 1.1152-1, in a manner consistent with tax elections, methods of accounting and other positions taken by the Plan or its subsidiaries. All payments were to be settled within 90 days of filing the tax return. It was the intention of this agreement that it applied to state and local income and franchise taxes of the parties.

Effective December 31, 2013, the Tax Allocation Agreement was replaced and superseded by a new agreement with PacificSource acting as agent for the holding company system. The terms were similar to the provisions in the previous agreement.

### **FIDELITY BOND AND OTHER INSURANCE**

The examination of insurance coverages involved a review of adequacy of limits and retentions, and the solvency of the insurers providing the coverages. The insurance coverages are provided through insurance policies issued by unaffiliated carriers. Coverage

protected PacificSource Health Plans and all subsidiary companies as a named insured. The group as a whole is insured up to \$1,300,000 per occurrence, after a \$25,000 deductible per single loss, against losses from acts of dishonesty and fraud by its employees and agents. Fidelity bond coverage was found to meet the minimum coverage recommended by the NAIC.

Other insurance coverages in force at December 31, 2013, were found to be adequate, and are as follows:

|                                |                                   |
|--------------------------------|-----------------------------------|
| Commercial property            | Managed care errors and omissions |
| Commercial liability           | Director's and officer's          |
| Commercial auto                | Fiduciary                         |
| Umbrella/catastrophe liability | Workers' compensation             |

### **TERRITORY AND PLAN OF OPERATION**

The Company has Certificates of Authority in the States of Idaho, Montana, Oregon and Washington. The Company is a HMO/PPO health insurer with a Medicare contract, operating under the name PacificSource Medicare. It offers Medicare Advantage plans, with and without Part D prescription drug coverage, in Oregon and Idaho.

The Company reported total enrolled members over the past five years as follows:

| <b><u>Line of Business</u></b> | <b><u>2013</u></b> | <b><u>2012</u></b> | <b><u>2011</u></b> | <b><u>2010</u></b> | <b><u>2009</u></b> |
|--------------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Indiv. hospital & medical      | -                  | -                  | -                  | 2,685              | 2,039              |
| Group hospital & medical       | 7                  | 10                 | 110                | 4,731              | 7,764              |
| Medicare supplement            | -                  | -                  | -                  | -                  | -                  |
| Dental                         | -                  | -                  | -                  | -                  | -                  |
| Medicare                       | 36,500             | 18,349             | 10,686             | 9,455              | 10,529             |
| Other                          | -                  | -                  | -                  | -                  | -                  |
| Total enrollment               | <u>36,507</u>      | <u>18,359</u>      | <u>10,796</u>      | <u>16,871</u>      | <u>20,332</u>      |

In 2013, the Company reported direct business in the following States:

| <u>State</u> | <u>Direct Premiums Written</u> |
|--------------|--------------------------------|
| Idaho        | \$140,138,212                  |
| Montana      | -                              |
| Oregon       | 162,423,105                    |
| Washington   | -                              |
| Total        | <u>\$302,561,317</u>           |

### GROWTH OF THE COMPANY

Growth of the Company over the past five years is reflected in the following schedule.

Amounts were derived from Company's filed annual statements, except in those years where a report of examination was published by the Oregon Insurance Division.

| <u>Year</u> | <u>Assets</u> | <u>Liabilities</u> | <u>Capital and Surplus</u> | <u>Net Income (Loss)</u> |
|-------------|---------------|--------------------|----------------------------|--------------------------|
| 2009        | 82,725,937    | 38,292,120         | 44,433,817                 | (8,498,354)              |
| 2010*       | 82,444,314    | 36,166,015         | 46,278,299                 | (1,285,227)              |
| 2011        | 69,646,870    | 24,306,822         | 45,340,048                 | (1,453,212)              |
| 2012        | 70,426,166    | 26,417,247         | 44,008,919                 | (4,113,176)              |
| 2013*       | 78,810,779    | 37,340,974         | 41,469,805                 | (6,603,241)              |

\*Per examination

### LOSS EXPERIENCE

The following exhibit reflects the annual underwriting results of the Company over the last five years. The amounts were compiled from copies of the Company's filed annual statements and, where indicated, from the previous examination reports.

| <u>Year</u> | (1)<br><u>Total Revenues</u> | (2)<br><u>Total Hospital and Medical</u> | (2)/(1)<br><u>Medical Loss Ratio</u> | (3)<br><u>CAE and General Expenses</u> | (2)+(3)/(1)<br><u>Combined Loss Ratio</u> |
|-------------|------------------------------|--|--------------------------------------|--|---|
| 2009        | 146,917,782                  | 134,268,262                              | 91.4%                                | 25,553,694                             | 108.8%                                    |
| 2010*       | 134,271,927                  | 118,086,878                              | 87.9%                                | 19,904,066                             | 102.8%                                    |
| 2011        | 121,838,427                  | 107,515,650                              | 88.2%                                | 16,987,668                             | 102.2%                                    |
| 2012        | 165,545,526                  | 156,391,480                              | 94.5%                                | 16,490,943                             | 109.7%                                    |
| 2013*       | 300,412,124                  | 281,783,363                              | 93.8%                                | 27,169,544                             | 102.8%                                    |

\*Per examination

A combined loss incurred and expense to premium ratio of more than 100% would indicate an underwriting loss. The Company reported underwriting losses in each of the last five years.

## **REINSURANCE**

### **Assumed**

None.

### **Ceded**

At December 31, 2013, the Company was covered by an HMO Specific Excess Loss Reinsurance agreement with Zurich American Insurance Company (NAIC #16535, authorized in Oregon since December 31, 1998). Under the policy, the reinsurer reimbursed the Company for unlimited losses per member for each individual risk, after retention of \$300,000. It was determined the reinsurance agreement clearly specified the risk taken by the reinsurer, with no unusual provisions reducing the reinsurer's risk.

The reinsurance agreement contained a proper insolvency clause in accordance with ORS 731.508(3) as required to take reserve credits for reinsurance ceded.

In view of the Company's reported surplus of \$41,469,805 at December 31, 2013, it appears the Company does not maintain risk on any one subject in excess of ten percent of its surplus to policyholders, in compliance with ORS 731.504.

## **ACCOUNTS AND RECORDS**

In general, the Company's records and source documentation supported the amounts presented in the December 31, 2013, annual statement and were maintained in a manner by which the financial condition was readily verifiable pursuant to the provisions of ORS 733.170.

### **STATUTORY DEPOSIT**

The Company reported \$1,522,738 in three US Bank CDs as a deposit held for the Idaho Department of Insurance, for the benefit of all policyholders. The deposit was verified from the records of the Oregon Insurance Division, as the Company is holding the deposit with the Oregon Insurance Division at the request of the Idaho Insurance Department. The deposit was properly listed in the 2013 annual statement on Schedule E – Part 3.

### **COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS**

There were two recommendations made in the 2010 report of examination, however, no adjustments were made to surplus as a result of the examination findings. In a follow-up report prepared January 28, 2014, the Oregon Insurance Division concluded the Company was in compliance with the recommendations.

### **SUBSEQUENT EVENTS**

During 2013, the Company's Board of Directors facilitated the reorganization of the PacificSource group of companies by creating a new not-for-profit holding company, PacificSource. Effective December 31, 2013, PacificSource became the sole member of PacificSource Health Plans. Further, both the Plan and its subsidiaries, including the Company, are now parties to respective Administrative Services Agreements with the holding company, PacificSource. Under the terms of the agreements, various services are performed by PacificSource for these companies in exchange for monthly compensation and all employees are now directly employed by PacificSource. On December 31, 2014, a new non-profit entity, PacificSource Community Health Plans, was formed and PCHP was merged into this entity.

## FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of PacificSource Community Health Plans, Inc. as of December 31, 2013:

Statement of Assets  
Statement of Liabilities, Capital and Surplus  
Statement of Revenue and Expenses  
Reconciliation of Surplus Since the Last Examination

**PACIFICSOURCE COMMUNITY HEALTH PLANS, INC.**  
**ASSETS**  
**As of December 31, 2013**

| <b>Assets</b>  | <b>Balance per<br/>Company</b> | <b>Examination<br/>Adjustments</b> | <b>Balance per<br/>Examination</b> | <b>Notes</b> |
|--|--------------------------------|------------------------------------|------------------------------------|--------------|
| Bonds  | \$16,493,508                   | \$ -                               | \$16,493,508                       | 1            |
| Common stocks  | 33,223,871                     | -                                  | 33,223,871                         | 1            |
| Cash, cash equivalents and short-term investments              | 10,678,220                     | -                                  | 10,678,220                         | 1            |
| Other invested assets  | 2,662,063                      | -                                  | 2,662,063                          | 2            |
| Receivable for securities                                      | 4                              | -                                  | 4                                  |              |
| Aggregate write-ins for invested assets                        | -                              | -                                  | -                                  |              |
| Subtotal, cash and invested assets                             | <u>\$63,057,666</u>            | <u>\$ -</u>                        | <u>\$63,057,666</u>                |              |
| Investment income due and accrued                              | 99,148                         | -                                  | 99,148                             |              |
| Premiums and considerations                                    |                                |                                    |                                    |              |
| Uncollected premiums, agents' balances in course of collection | 256,495                        | -                                  | 256,495                            |              |
| Accrued retrospective premiums                                 | 6,334,000                      | -                                  | 6,334,000                          |              |
| Amounts recoverable from reinsurers                            | 438,103                        | -                                  | 438,103                            |              |
| Amounts receivable relating to uninsured plans                 | 676,661                        | -                                  | 676,661                            |              |
| Current FIT recoverable  | 3,823,000                      | -                                  | 3,823,000                          |              |
| Net deferred tax asset   | 600,000                        | -                                  | 600,000                            |              |
| Receivable from parent, affiliates and subsidiaries            | 841,394                        | -                                  | 841,394                            |              |
| Health care receivable   | 721,618                        | -                                  | 721,618                            |              |
| Aggregate write-ins for other than invested assets             | <u>1,962,694</u>               | <u>-</u>                           | <u>1,962,694</u>                   | 3            |
| Total assets   | <u>\$78,810,779</u>            | <u>\$ -</u>                        | <u>\$78,810,779</u>                |              |

**PACIFICSOURCE COMMUNITY HEALTH PLANS, INC.**  
**LIABILITIES, CAPITAL AND SURPLUS**  
**As of December 31, 2013**

| Liabilities, Surplus and other Funds                  | Balance per<br>Company | Examination<br>Adjustments | Balance per<br>Examination | Notes |
|---|------------------------|----------------------------|----------------------------|-------|
| Claims unpaid   | \$30,258,657           | \$ -                       | \$30,258,657               | 4     |
| Accrued medical incentive pool and bonus              | 306,107                | -                          | 306,107                    | 4     |
| Unpaid claim adjustment expenses                      | 773,778                | -                          | 773,778                    | 4     |
| Aggregate health policy reserves                      | 1,118,139              | -                          | 1,118,139                  | 4     |
| Premiums received in advance                          | 225,822                | -                          | 225,822                    |       |
| General expenses due or accrued                       | 3,460,194              | -                          | 3,460,194                  |       |
| Amounts due to parent, subsidiaries and<br>affiliates | 880,404                | -                          | 880,404                    |       |
| Aggregate write-ins for liabilities                   | <u>317,873</u>         | -                          | <u>317,873</u>             |       |
| Total Liabilities                                     | <u>\$37,340,974</u>    | <u>\$ -</u>                | <u>\$37,340,974</u>        |       |
| Gross paid in and contributed surplus                 | \$10,272,763           | \$ -                       | \$10,272,763               |       |
| Unassigned funds (surplus)                            | <u>31,197,042</u>      | -                          | <u>31,197,042</u>          |       |
| Surplus as regards policyholders                      | <u>41,469,805</u>      | -                          | <u>41,469,805</u>          |       |
| Total Liabilities, Surplus and other Funds            | <u>\$78,810,779</u>    | <u>\$ -</u>                | <u>\$78,810,779</u>        |       |

**PACIFICSOURCE COMMUNITY HEALTH PLANS, INC.**  
**STATEMENT OF REVENUE AND EXPENSES**  
**For the Year Ended December 31, 2013**

| Revenue  | Balance per<br>Company | Examination<br>Adjustments | Balance per<br>Examination | Notes |
|--|------------------------|----------------------------|----------------------------|-------|
| Net premium income   | \$301,463,208          | \$ -                       | \$301,463,208              |       |
| Change in unearned premium reserve and<br>reserve for rate credits                             | (1,039,009)            | -                          | (1,039,009)                |       |
| Fee-for-service  | -                      | -                          | -                          |       |
| Risk revenue   | -                      | -                          | -                          |       |
| Aggregate write-ins for non-health care<br>related revenues -- gain on sale of fixed<br>assets | <u>(12,075)</u>        | <u>-</u>                   | <u>(12,075)</u>            |       |
| Total revenue  | 300,412,124            | -                          | 300,412,124                |       |
| Hospital and Medical   |                        |                            |                            |       |
| Hospital/medical benefits  | 209,764,261            | -                          | 209,764,261                |       |
| Other professional services  | 6,633,187              | -                          | 6,633,187                  |       |
| Outside referrals  | 16,612,928             | -                          | 16,612,928                 |       |
| Emergency room and out-of-area   | 2,559,307              | -                          | 2,559,307                  |       |
| Prescription drugs   | 46,261,313             | -                          | 46,261,313                 |       |
| Incentive pool, withhold adjustments and<br>bonus amounts                                      | <u>753,902</u>         | <u>-</u>                   | <u>753,902</u>             |       |
| Subtotal   | 282,584,898            | -                          | 282,584,898                |       |
| Less:  |                        |                            |                            |       |
| Net reinsurance recoveries   | <u>801,535</u>         | <u>-</u>                   | <u>801,535</u>             |       |
| Total medical and hospital   | 281,783,363            | -                          | 281,783,363                |       |
| Non-health claims  | -                      | -                          | -                          |       |
| Claim adjustment expenses  | 9,181,630              | -                          | 9,181,630                  |       |
| General administrative expenses  | 17,987,914             | -                          | 17,987,914                 |       |
| Increase in reserves for life and accident<br>and health contracts                             | <u>-</u>               | <u>-</u>                   | <u>-</u>                   |       |
| Total underwriting deductions  | <u>308,952,907</u>     | <u>-</u>                   | <u>308,952,907</u>         |       |
| Net underwriting gain or (loss)  | <u>(8,540,783)</u>     | <u>-</u>                   | <u>(8,540,783)</u>         |       |
| Net investment income earned   | 189,989                | -                          | 189,989                    |       |
| Net realized capital gains (losses)  | <u>707,223</u>         | <u>-</u>                   | <u>707,223</u>             |       |
| Net investment gains (losses)  | 897,212                | -                          | 897,212                    |       |
| Net gain or (loss) from agents' or premium<br>balances charged off                             | (22,727)               | -                          | (22,727)                   |       |
| Aggregate write-ins for other income or<br>expense   | (1,660,913)            | -                          | (1,660,913)                |       |
| Federal income taxes incurred  | <u>(2,723,969)</u>     | <u>-</u>                   | <u>(2,723,969)</u>         |       |
| Net investment income earned   | <u>\$ (6,603,242)</u>  | <u>\$ -</u>                | <u>\$ (6,603,242)</u>      |       |

**PACIFICSOURCE COMMUNITY HEALTH PLANS, INC.**  
**RECONCILIATION OF SURPLUS SINCE THE LAST EXAMINATION**  
**For the Year Ended December 31,**

|  | 2013                | 2012                | 2011                |
|--|---------------------|---------------------|---------------------|
| Surplus as regards policyholders, December 31, previous year | <u>\$44,008,920</u> | <u>\$45,340,048</u> | <u>\$46,278,299</u> |
| Net income   | (6,603,242)         | (4,113,176)         | (1,453,212)         |
| Change in net unrealized capital gains or (losses)           | 4,081,896           | 2,970,713           | (4,039,502)         |
| Change in net deferred income tax                            | (340,000)           | (266,000)           | 695,372             |
| Change in nonadmitted assets                                 | 322,231             | 77,335              | 3,652,675           |
| Change in provision for reinsurance                          | -                   | -                   | -                   |
| Change in surplus notes                                      | -                   | -                   | -                   |
| Cumulative effects of changes in accounting principles       | -                   | -                   | -                   |
| Capital changes:   |                     |                     |                     |
| Paid in  | -                   | -                   | -                   |
| Transferred from surplus (Stock Dividend)                    | -                   | -                   | -                   |
| Transferred to surplus                                       | -                   | -                   | -                   |
| Surplus adjustments:   |                     |                     |                     |
| Paid in  | -                   | -                   | -                   |
| Transferred to capital (Stock Dividend)                      | -                   | -                   | -                   |
| Transferred from capital                                     | -                   | -                   | -                   |
| Dividends to parent (cash)                                   | -                   | -                   | -                   |
| Change in treasury stock                                     | -                   | -                   | -                   |
| Aggregate write-ins for gains and losses in surplus          | -                   | -                   | <u>206,416</u>      |
| Change in surplus as regards policyholders for the year      | <u>(2,539,115)</u>  | <u>(1,331,128)</u>  | <u>(938,251)</u>    |
| Surplus as regards policyholders, December 31, current year  | <u>\$41,469,805</u> | <u>\$44,008,920</u> | <u>\$45,340,048</u> |

## NOTES TO FINANCIAL STATEMENTS

### Note 1 – Invested Assets

At year-end 2013, the Company's long-term bond investments were in US obligations, US federal agency bonds, municipal obligations, and corporate issues. The Company did have a small exposure to mortgaged-backed and asset-backed securities. All of the MBS/ABS issues were investment rated at year-end 2013, with a carrying book value of \$5.4 million comprised 32.8% of the total long-term bond portfolio, and 8.5% of all invested assets.

Common stocks were comprised entirely of the equity in a wholly-owned subsidiary, PacificSource Community Solutions, an Oregon based Coordinated Care Organization regulated by the Oregon Health Authority.

A comparison of the major investments over the past five years is as follows:

| <u>Year</u> | <u>A</u><br><u>Bonds</u> | <u>B</u><br><u>Common</u><br><u>Stocks</u> | <u>C</u><br><u>Cash and</u><br><u>Short-term</u> | <u>Ratio</u><br><u>A/</u><br><u>Total Assets</u> | <u>Ratio</u><br><u>B/</u><br><u>Total Assets</u> | <u>Ratio</u><br><u>C/</u><br><u>Total Assets</u> |
|-------------|--------------------------|--|--|--|--|--|
| 2009        | 24,036,156               | 34,418,475                                 | 9,180,101  | 29.1%  | 41.6%  | 11.1%  |
| 2010*       | 16,997,783               | 35,824,407                                 | 572,825  | 20.6%  | 43.5%  | 0.7%   |
| 2011        | 20,216,199               | 32,084,036                                 | 5,858,117  | 29.0%  | 46.1%  | 8.4%   |
| 2012        | 13,695,905               | 32,276,694                                 | 72,939   | 19.4%  | 45.8%  | 0.1%   |
| 2013*       | 16,493,508               | 33,223,871                                 | 10,678,220                                       | 20.9%  | 42.2%  | 13.5%  |

The Finance Committee approved the investment transactions in each of the years under review, and the actions of the committee were approved by the Board of Directors, pursuant to ORS 733.740. As of December 31, 2013, sufficient invested assets were invested in amply secured obligations of the United States, the State of Oregon, or in FDIC insured cash deposits, and the Company was in compliance with ORS 733.580.

Effective February 10, 2010, the Company entered into a custodial agreement with Wells Fargo Bank N.A. The agreement contained all of the relevant protections described in OAR 836-027-0200(4)(a) through (l).

### Note 2 – Other Invested Assets

The Company reported other long-term assets consisting of investments in two subsidiary LLCs. Investments of these types are not expressly prohibited by ORS 732.325 or ORS 733.780, but they do fall under the "prudent investor" standard of ORS 733.670. As such, the Insurance Code limits them to the lesser of seven and one-half percent of the insurer's assets or the excess of the insurer's assets over all liabilities and required capitalization. At December 31, 2013, the Company reported investment of \$6,741,974 in subsidiary LLCs, and the Company was in compliance with the statute.

**Note 3 – Goodwill**

In conjunction with the acquisition completed on March 17, 2010, PacificSource purchased the common capital stock of the Company. Included in the purchase price was \$5,346,621 recognized as Goodwill, of which the Company retained \$3,073,258 as a write-in asset. This goodwill will be amortized using a straight-line method until May 21, 2020. During 2013, the Company amortized \$307,326 pursuant to the provisions of SSAP No. 68, paragraph 7, for a total remaining balance at year-end of \$1,962,694. There was no impairment recognized by the Company during the period under examination.

**Note 4 – Actuarial Reserves**

A review of the unpaid claims and claim adjustment expense reserves for the Company was performed by David Ball, FSA, MAAA, life and health actuary for the Oregon Insurance Division. As part of his review, he examined the supporting statements used by the actuary in preparation of the Statement of Actuarial Opinion as of December 31, 2013, prepared by Victor R. Pagua, FSA, MAAA, Chief Actuary for the Company.

Mr. Ball reviewed the reconciliation of the data used in the Company's financial statement to the data in the actuarial work papers and found them to be consistent. He relied on work performed by the examiners who reviewed the underlying data used to create the annual statement filing, as well as prepared his own independent calculations. He determined the following:

|   | <u>My Estimate</u>  | <u>Annual Statement</u> |
|---|---------------------|-------------------------|
| Claims Unpaid                                     | \$30,052,701        | \$30,258,657            |
| Accrued Medical Incentive Pool and Bonus Payments | 306,107             | 306,107                 |
| Unpaid Claims Adjustment Expenses (CAE)           | 901,581             | 773,778                 |
| Aggregate Health Policy Reserves                  | 1,118,139           | 1,118,139               |
| Accrued retrospective premiums CMS                | 6,334,000           | 6,334,000               |
| Premium Deficiency Reserves                       | -                   | -                       |
| Total Actuarial Liabilities                       | <u>\$38,712,528</u> | <u>\$38,790,681</u>     |

The appointed actuary opined that the reserves for unpaid claims and CAE carried by the Company as of December 31, 2013, were reasonable. Mr. Ball's total estimate was less than the appointed actuary's estimate by \$78,153, resulting in a redundancy of 0.2%. He concurred that the reserves of the Company were reasonably stated as of December 31, 2013.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

The examiner made no changes to surplus as a result of this examination, and had no recommendations. The examiner has presented the Company with a management letter containing matters not considered material for purposes of this examination.

## CONCLUSION

During the three year period covered by this examination, the surplus of the Company has decreased from \$46,278,299, as presented in the December 31, 2010, report of examination, to \$41,469,805, as shown in this report. The comparative assets and liabilities are:

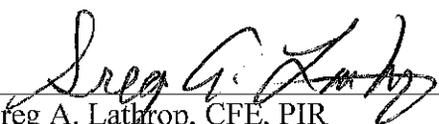
|             | <u>2013</u>         | <u>December 31,</u> | <u>2010</u>         | <u>Change</u>        |
|-------------|---------------------|---------------------|---------------------|----------------------|
| Assets      | \$78,810,779        |                     | \$82,444,314        | \$(3,633,535)        |
| Liabilities | <u>37,340,974</u>   |                     | <u>36,166,015</u>   | <u>1,174,959</u>     |
| Surplus     | <u>\$41,469,805</u> |                     | <u>\$46,278,299</u> | <u>\$(4,808,494)</u> |

## ACKNOWLEDGMENT

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

In addition to the undersigned, Mark Giffin, CFE, Keilei Yambaw, and Michael P. Phillips, CFE, CPA, AES, insurance examiners, and David Ball, FSA, MAAA, Life & Health Actuary for the State of Oregon, Department of Consumer and Business Services, Insurance Division, all participated in this examination.

Respectfully submitted,

  
\_\_\_\_\_  
Greg A. Lathrop, CFE, PIR  
Supervising Financial Examiner  
Department of Consumer and Business Services  
State of Oregon

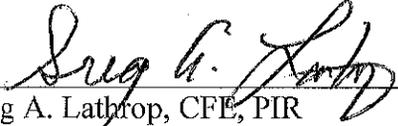
**AFFIDAVIT**

STATE OF OREGON            )  
  )    ss  
County of Marion            )

Greg A. Lathrop, CFE, PIR, being duly sworn, states as follows:

1. I have authority to represent the state of Oregon in the examination of PacificSource Community Health Plans, Inc., Springfield, Oregon.
2. The Insurance Division of the Department of Consumer and Business Services of the state of Oregon 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. The examination of PacificSource Community Health Plans, Inc., was performed in a manner consistent with the standards and procedures required by the Oregon Insurance Code.

The affiant says nothing further.

  
\_\_\_\_\_  
Greg A. Lathrop, CFE, PIR  
Supervising Financial Examiner  
Department of Consumer and Business Services  
State of Oregon

Subscribed and sworn to me this 24 day of May, 2015.

  
\_\_\_\_\_  
Notary Public for the State of Oregon

My Commission Expires: 3/22/2017

