



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**OREGON FAIR PLAN ASSOCIATION
BEAVERTON, OREGON**

AS OF

DECEMBER 31, 2010

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SALUTATION

May 24, 2011

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

**OREGON FAIR PLAN ASSOCIATION
8705 SW Nimbus Avenue, Suite 360
Beaverton , Oregon 97008**

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

SCOPE OF EXAMINATION

Our financial examination of the Association as of December 31, 2010, covers the sixteen year period from the date of the previous examination conducted as of December 31, 1994. Material transactions or events occurring subsequent to the examination cut-off date were reviewed and noted during the examination.

We considered the provisions of ORS 731.300 and the NAIC procedures and guidelines during our examination. We conducted our examination in accordance with the NAIC Financial Condition Examiners Handbook. 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. Corrective actions taken by the Association in response to comments and recommendations in the December 31, 1994, report of examination were reviewed.

PLAN HISTORY

The Association was created on July 1, 1971, as mandated by Oregon Revised Statutes 735.045. The Association replaced the Oregon Property Insurance Placement Facility.

MANAGEMENT AND CONTROL

Board of Directors

The Board of Directors is comprised of nine directors. Five of the directors shall be nominated by member insurers, subject to the approval of the director of the Department of Consumer and Business Services, each of which will represent the following groups:

1. American Insurance Association
2. Alliance of American Insurers
3. National Association of Independent Insurers
4. Domestic Insurers
5. All other insurers, stock or non-stock

The remaining four directors are to be selected by the Governor, one of whom shall be an insurance producer holding an appointment as an Oregon producer of a member insurer. Of the other three directors appointed by the Governor, one shall be a resident of a county with population of over

400,000, and none shall have been an employee or agent of a member insurer. The term of a director is three years. A director may also have filled an unexpired term, subject to the limit of a maximum of four years total, per ORS 735.055.

The Association's Board of Directors as of December 31, 2010, was as follows:

<u>Name and Address</u>	<u>Affiliation</u>	<u>Term</u>
Jim Ignozitto Portland, OR	Farmers/Zurich Insurance American Insurance Association	7/1/2010 – 6/30/2013
Michael J. Cronan Portland, OR	Liberty Mutual/Liberty Northwest Alliance of American Insurers	7/1/2008 – 6/30/2011
Mary Pat Gustafson Portland, OR	Liberty Mutual/Liberty Northwest	Alternate Board Member
Sharon Moller Bothell, WA	Allstate Insurance Company Insurance member-at-large	7/1/2008 – 7/16/2011
Lisa Hargis McMinnville, OR	Oregon Mutual Insurance Domestic Insurers	7/16/2009 – 7/16/2011
Gary Hubbard Salem, OR	State Farm Insurance All other insurers – stock & non-stock	7/1/2009 – 6/30/2012
Gary Whiting Beaverton, OR	Public Member County -> 400,000 population	9/10/2008 – 9/9/2011
Tom Faurot Hillsboro, OR	Public Member Governor Appointment Insurance Agent	11/5/2010 – 11/14/2013
John Folawn Portland, OR	Public Member Governor Appointment	9/10/2008 – 9/9/2011

Officers

The Association's officers at December 31, 2010, were as follows:

<u>Name</u>	<u>Title</u>
Gary Hubbard	Chairman
Michael J. Cronan	Vice Chairman

Phillip L. Benson, Executive Director, has overseen the Association's daily operations since 2001.

Members

Each insurer transacting essential property insurance in the State of Oregon becomes and will remain a member of the Association as a condition of its authority to transact insurance in the State of Oregon.

CORPORATE RECORDS

The Association has neither Articles of Incorporation nor Bylaws, but instead operates pursuant to ORS 735.005 to 735.145, including a Plan of Operation established by ORS 735.085. The Plan of Operation is generally in conformance with Oregon statutes and was amended once during the examination period.

TERRITORY AND PLAN OF OPERATION

The Association was formed under Oregon statutes to provide essential property insurance for owners of insurable property for which coverage of these properties is not available through the normal insurance market. Essential property insurance as described by ORS 735.005, is insurance against direct loss to property as defined and limited in standard fire policies and extended coverage endorsements thereon, as approved by the director, and insurance against the perils of vandalism and malicious mischief. The function of the Association is to provide an equitable distribution of the risks insured through the Association among the member insurers.

The Association's Board of Directors is authorized to levy assessments as deemed necessary to pay claims and expenses of the Association. All assessments are made on pro rata basis in the proportion that the member's net written premium bears to the net direct written premium of all member insurers in the second previous year. The Association's maximum and minimum assessment per calendar year is 2% of the insurer's net written premiums and \$50 respectively. The Association may at the end of any calendar year, refund to member insurers, in the same proportion provided for assessments, the amount by which the Board of Directors finds that the funds of the Association exceed its current liabilities plus the liabilities estimated for the coming year (ORS 735.075(5)). The Plan of Operation states that the member insurers share in both the losses and gains of the Association. Current

liabilities at December 31, 2007, 2008 and 2009, and actual expenses in the succeeding year averaged \$1,009,000. Member's equity at December 31, 2010, was \$2,685,268. **I recommend the Board of Directors of the Association consider refunding members equity in an amount determined by the Board of Directors in compliance with ORS 735.075(5) and the Plan of Operation.**

CONFLICT OF INTEREST

The Association does not have a conflict of interest policy requiring directors, officers and key employees to disclose potential conflicts of interest. The NAIC Financial Condition Examiners Handbook requires an insurer have a formal written conflict of interest policy. ORS 733.210(2) states that the director may apply and require insurers to use and comply with standards, practices and procedures established by the National Association of Insurance Commissioners in its manuals or other publications, including actuarial, accounting and other opinion and reports requirements. **I recommend the Association adopt a conflict of interest policy requiring employees to report any potential conflict of interest to the Board, or a Board member, and that employees annually give written acknowledgement of the policy. This would comply with the NAIC Financial Condition Examiners Handbook and ORS 733.210(2).**

BOARD OF DIRECTOR MINUTES

Board minutes for the examination period were reviewed. Meetings were held in accordance with the Association's Plan of Operation. Overall, the minutes supported the transactions of the Association and the actions taken by its Board of Directors and manager. A quorum was met at all meetings.

FIDELITY BONDS AND OTHER INSURANCE

The Association has adequate insurance coverages in all significant areas of risk. The examination of these coverages involved adequacy of limits and retentions, and solvency of the insurers providing the coverages. The Association has the first \$250,000 of Crime coverage under its Business Owners primary policy. There is a separate Crime policy for limits of \$1,000,000 excess of the first \$250,000. There is a third policy with limits of \$2,000,000 excess of \$1,000,000. Fidelity bond coverage was found to exceed the minimum coverage recommended by the NAIC. In addition, the

Company is covered against Directors' and Officers' liability up to \$1,000,000 after \$5,000 retention. Other insurance coverages in force at December 31, 2010, included Business Owners and Workers' Compensation.

RETIREMENT PLAN

All employees meeting the minimum eligibility requirements are participants in the Association's Simplified Employees Pension (SEP) retirement plan. The employees are fully vested when they become eligible to participate in the plan. The SEP is funded by a discretionary contribution determined by the Board of Directors. Contributions to the SEP were 15% of eligible employee compensation: \$33,165 and \$32,680 for the years ended December 31, 2010 and 2009, respectively.

GROWTH OF THE ASSOCIATION

The following exhibit illustrates the Association's growth during the examination period. Statistics were derived from the Associations' financial statements filed with the Insurance Division.

<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Members Equity</u>	<u>Net Income</u>
1994*	\$1,332,055	\$ 957,946	\$ 374,109	\$ 80,677
1995	1,420,461	344,017	420,882	103,131
1996	1,281,983	1,061,011	220,972	(106,926)
1997	1,508,892	961,236	547,653	213,029
1998	1,620,604	1,087,459	533,145	182,192
1999	1,366,381	971,578	394,803	48,971
2000	1,401,263	887,199	514,064	164,434
2001	1,448,446	803,595	644,851	235,192
2002	1,617,963	1,035,314	582,649	(62,202)
2003	1,986,624	1,271,749	714,875	132,226
2004	2,427,485	1,200,878	1,226,607	511,732
2005	2,901,953	1,023,788	1,878,165	651,558
2006	2,777,184	1,244,737	1,532,447	(345,718)
2007	2,911,443	1,043,030	1,868,413	138,038
2008	2,847,697	844,745	2,002,952	134,539
2009	3,272,415	737,173	2,535,242	532,290
2010*	\$3,286,737	\$ 601,469	\$2,685,268	\$127,433

*Per examination

LOSS EXPERIENCE

Annual underwriting results for the Association since 1994 are shown in the following table. Amounts were compiled from the Association's financial statements filed with the Insurance Division.

<u>Year</u>	<u>Premium</u>	<u>Loss & Loss Adjustment Expense</u>	<u>Loss Ratio</u>
1994*	\$1,177,170	\$601,069	51.1%
1995	1,227,535	647,170	52.7%
1996	1,245,959	852,562	68.4%
1997	1,285,620	555,458	43.2%
1998	1,426,000	648,690	45.5%
1999	1,201,133	744,849	57.2%
2000	1,199,970	549,003	45.8%
2001	1,215,289	387,470	31.9%
2002	1,332,567	716,984	53.8%
2003	1,776,108	754,548	42.5%
2004	1,713,966	383,252	22.4%
2005	1,768,128	356,114	20.1%
2006	1,253,166	716,931	57.2%
2007	1,364,995	575,268	42.1%
2008	1,344,103	487,704	36.3%
2009	1,204,869	153,153	12.7%
2010*	\$1,069,109	\$368,274	34.4%

*Per examination

REINSURANCE

The Association is authorized to cede risks written which exceed the risk retention threshold set by management. The current retention limits are \$300,000 on dwellings and \$500,000 on commercial property. Reinsured risks are ceded with a facultative contract.

ACCOUNTS AND RECORDS

The Association's records and source documentation supported the amounts presented in its certified statements filed with the Insurance Division and were maintained in a manner by which the financial condition was readily verifiable as required by ORS 733.170.

Funds Subject to Escheat

It was noted in the 1994 examination that the Association does not remit unclaimed funds from checks outstanding over one year to the Oregon Division of State Lands (the Division). As a result, a recommendation was made that the Association establish a liability for checks outstanding over one year, and remit unclaimed funds to the Division in accordance with ORS 98.352. Subsequent to the effective date of this examination and prior to the completion of examination fieldwork, the Association established a procedure to contact payees owed checks that had gone uncashed for over one year. Checks that remain outstanding, after making a “good faith” effort to contact the payees, will be reported to the Division.

I recommend the Association comply with the provisions of OAR 141-45-041(5) and file an unclaimed property report listing the unclaimed checks with the Division.

Approval of Salaries

In the most recent five year period under examination, the Board of Directors minutes contained only one entry where salaries were discussed. In this entry there was no indication that the board formally approved the managing director's salary.

I recommend the Board of Directors formally approve each year the managing director's salary prior to the time of the change pursuant to ORS 732.320(3).

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The Association has complied with two of the recommendations made in the 1994 report of examination. A third recommendation regarding the escheatment of unclaimed property has not been complied with, but the Association has begun implementing the process to comply.

OREGON FAIR PLAN ASSOCIATION
BALANCE SHEET
AS OF DECEMBER 31, 2010

<u>Assets</u>	<u>Annual Statement</u>	<u>Examination Adjustments</u>	<u>Net Admitted Assets</u>
Cash and cash equivalents	\$2,940,618	\$ 0	\$2,940,618
Investment	<u>346,119</u>		<u>346,119</u>
Total Assets	<u>\$3,286,737</u>	<u>\$ 0</u>	<u>\$3,286,737</u>
 <u>Liabilities</u>			
Unpaid claims	28,000		28,000
Unpaid claim adjustments	4,000		4,000
Unearned premium	540,540		540,540
Agents commissions payable	27,845		27,845
Accounts payable	<u>1,084</u>	<u>0</u>	<u>1,084</u>
Total Liabilities	<u>601,469</u>	<u>0</u>	<u>601,469</u>
Members Equity	<u>2,685,268</u>		<u>2,685,268</u>
Total Liabilities & Members Equity	<u>\$3,286,737</u>	<u>\$ 0</u>	<u>\$3,286,737</u>

OREGON FAIR PLAN ASSOCIATION
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN MEMBERS EQUITY
For the Year Ended December 31, 2010

Revenue and Expenses

Premiums earned	\$1,069,109
Losses Incurred	338,702
Loss Adjustment Expenses Incurred	29,572
Underwriting expenses	<u>606,754</u>
Underwriting gain/(loss)	<u>94,081</u>
Interest Income	29,852
Other Income	<u>3,500</u>
Net Income	<u>\$127,433</u>

Members Equity

Beginning members equity	\$2,535,244
Net change in unrealized capital gains/(losses)	22,591
Net income	<u>127,433</u>
Ending members equity	<u>\$2,685,268</u>

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

The Association considers all short-term investments purchased with an original maturity of three months or less and certificates of deposit to be cash equivalents.

Checking account	\$ 685,988
Certificates of Deposit	2,254,274
Undeposited Checks	206
Petty Cash	<u>150</u>
Total	<u>\$2,940,617</u>

Investments

Investments are reflected on the statement of admitted assets, liabilities and members' equity – statutory basis at fair value with changes in unrealized gains and losses resulting from changes in fair value reflected in the statement of revenues, expenses and changes in members' equity – statutory basis. Interest and dividend income is reported as earned.

Income Taxes

The Association is exempt from Federal and State income taxes under Internal Revenue Code Section 501(c)(6). Management believes all activities of the Association qualify for tax exempt status. Therefore, no provision has been made in the accompanying financial statements for income taxes.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Page

- 7 I recommend the Association refund members equity in an amount determined by the board of directors which reflects the requirements of the Oregon statutes and the Plan of Operation.
- 7 I recommend the Association adopt a formal (written) conflict of interest policy which requires employees to report any potential conflict of interest to the board, or a board member, and that employees give written acknowledgement of the policy annually.
- 10 I recommend the Association comply with the provisions of OAR 141-45-041(5) and file an unclaimed property report listing the unclaimed checks with the Division.
- 10 I recommend the Board of Directors formally approve each year the managing director's salary prior to the time of the change pursuant to ORS 732.320(3).

CONCLUSION

During the period covered by this examination, the Association's surplus increased from \$374,109, as shown in the 1994 examination report, to \$2,685,268, as shown in this report of examination. The comparative assets and liabilities are shown below:

	<u>2010</u>	December 31,	<u>1994</u>	<u>Change</u>
Assets	\$3,286,737		\$1,332,055	\$1,954,682
Liabilities	<u>601,469</u>		<u>957,946</u>	<u>(356,477)</u>
Surplus	<u>\$2,685,268</u>		<u>\$ 374,109</u>	<u>\$2,311,159</u>

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, Raymond Anderson, CFE, insurance examiner for 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 Oregon Fair Plan Association.
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 Oregon Fair Plan Association, 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: _____