



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**OREGON INSURANCE GUARANTY ASSOCIATION
BEAVERTON, OREGON**

AS OF

DECEMBER 31, 2010

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SALUTATION

August 10, 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 the

**OREGON INSURANCE GUARANTY ASSOCIATION
10700 SW Beaverton-Hillsdale Highway, Suite 426
Beaverton, Oregon 97005**

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 seventeen year period since the prior examination was conducted as of December 31, 1993. 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, 1993, report of examination were reviewed.

HISTORY

The Association is a 501(c)(6) organization exempt from income tax as provided under 501(1) of the Internal Revenue Code. The Association was formed September 9, 1971, under the provisions of ORS 734.510 through 734.710.

MANAGEMENT AND CONTROL

Membership

Under the provisions of ORS 734.540, all direct insurers in the State of Oregon, except life, health, title, surety, credit, mortgage guaranty, home protection, wet marine and transportation, are required to be members of the Association.

Board of Directors

As required by ORS 734.560, the Board of Directors is comprised of nine directors. Directors serve a three year term.

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

<u>Name and Address</u>	<u>Affiliation</u>	<u>Term</u>	<u>Representing</u>
Gary Hubbard DuPont, WA	Regional Manager State Farm Insurance Company	2011	All other insurers stock or non-stock
Steve Patterson McMinnville, OR	Vice President & General Counsel Oregon Mutual Insurance Company	2012	Domestic Mutual PCI
Diana Van Horn Beaverton, OR	Regional Vice President Unigard Insurance Group	2012	PCI Stock
Elizabeth A. Mocerri Bothell, WA	Laws & Regulations Allstate Insurance Company	2013	Stock
Brandon LaSalle Denver, CO	Government Affairs Council American Family Insurance	2013	PCI
Brian Miller Portland, OR	Government Affairs Representative Farmers Insurance Group	2012	Domestic Mutual PCI
Kevin W. Lucke Sublimity, OR	Vice President Claims Sublimity Insurance Company	2011	Domestic Stock
Melissa R. Crawford Portland, OR	Regional Assistant General Counsel Nationwide Insurance Company	2013	PCI Mutual
Margie Cooper Portland, OR	Regional Manager Liberty Mutual Group	2012	PCI Stock

Officers

Association officers serving at December 31, 2010, were:

<u>Name</u>	<u>Title</u>
Gary Hubbard	Chairman Executive Committee
Steve Patterson	Vice Chairman Executive Committee
Diana L. Van Horn	Treasurer Executive Committee

Daily operations are performed by David C. Johnson, CPCU, AIM, Administrator, and Karen Smith, Administrative Assistant.

CONFLICT OF INTEREST

The Association requires all key employees and directors to annually sign conflict of interest statements. During the examination period, all directors and key employees signed conflict of interest statements and no conflicts were disclosed.

CORPORATE RECORDS

The Association has neither Articles of Incorporation nor Bylaws, but instead operates pursuant to ORS 734.510 to 734.710, including a Plan of Operation established by ORS 734.590.

The Plan of Operation, as amended on May 31, 1994, conforms to Oregon statutes.

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 Administrator. 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 coverage. A fidelity bond covers the Association for losses up to \$1,000,000, after a \$10,000 retention. A directors and officers policy covered losses up to \$1,000,000 after a \$15,000 retention for non-employment discrimination or \$10,000 retention for all other losses. A business owner's package policy insures the Association against employee dishonesty up to \$40,000. Other insurance coverages in force at December 31, 2010, were:

Business owners

Workers' compensation

These coverages appear to be adequate.

TERRITORY AND PLAN OF OPERATION

The Association's purpose, according to ORS 734.520, is to provide for the payment of covered claims under certain insurance policies to avoid excessive delays in payment and to avoid financial loss to claimants or policyholders because of the insolvency of an insurer, to assist in the detection and prevention of insurer insolvencies, to provide an association to assess the cost of such protection among insurers and to assist in the liquidation of insurers. As of December 31, 2010, the Association had 514 claim files pending from 23 insolvent insurers.

GROWTH OF THE ASSOCIATION

The following exhibit illustrates the Association's growth during the examination period. Information was obtained from the Association's filed statements.

<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Unrestricted Net Assets</u>	<u>Restricted Net Assets</u>	<u>Total Net Assets</u>
1993*	2,238,785	3,548	2,235,237		2,235,237
1994	6,407,242	8,348	6,398,894		6,398,894
1995	4,374,348	393	4,373,955		4,373,955
1996	6,130,794	446	6,130,348		6,130,348
1997	6,315,560	5,865	6,309,695		6,309,695
1998	10,101,784	2,589,302	7,512,482		7,512,482
1999	8,258,060	1,296	8,256,764		8,256,764
2000	7,882,068	1,112	7,880,956		7,880,956
2001	23,316,781	148,107	23,168,674		23,168,674
2002	31,249,571	9,982	31,239,589		31,239,589
2003	36,897,431	422,312	36,475,119		36,475,119
2004	38,881,635	1,356	38,880,279		38,880,279
2005	37,629,882	3,025	37,626,857		37,626,857
2006	40,821,757	1,437	39,873,772	946,548	40,820,320
2007	49,460,384	5,618	44,547,524	4,907,242	49,454,766
2008	55,442,011	1,681	50,309,892	5,130,438	55,440,330
2009	58,701,374	525	53,354,735	5,346,114	58,700,849
2010*	62,457,344	1,560	57,009,637	5,446,147	62,455,784

*Per examination

LOSS EXPERIENCE

The following exhibit illustrates the Association's revenue and expenses related to unrestricted net assets. Information was obtained from the Association's filed statements.

Year	Revenue				Expenses Paid	Excess Revenue Over Expenses
	Security Deposits	Assessments	Other Revenue**	Total		
1993*	945,537	1,497,899	900,488	3,343,924	4,563,908	(1,219,984)
1994	530,239		5,483,391	6,013,630	1,849,973	4,163,657
1995	749,862		2,310,673	3,060,535	5,085,474	(2,024,939)
1996	546,384		2,666,249	3,212,633	1,456,240	1,756,393
1997	690,375		1,972,119	2,662,494	2,483,147	179,347
1998	320,000		2,494,144	2,814,144	1,611,357	1,202,787
1999	324,368		1,846,385	2,170,753	1,426,471	744,282
2000	418,000		1,271,531	1,689,531	2,065,339	(375,808)
2001	1,020,000	17,925,921	1,762,611	20,708,532	5,420,814	15,287,718
2002	11,977,655	10,957,279	1,685,840	24,620,774	16,549,859	8,070,915
2003	3,463,358	10,990,911	11,031,253	25,485,522	20,249,992	5,235,530
2004	8,271,568		7,638,130	15,909,698	13,504,538	2,405,160
2005	4,515,000		7,378,479	11,893,479	13,146,901	(1,253,422)
2006	2,903,726		7,291,449	10,195,175	7,948,260	2,246,915
2007	2,670,038		9,359,084	12,029,122	7,355,370	4,673,752
2008	4,967,644		5,510,280	10,477,924	4,715,556	5,762,368
2009	3,650,000		3,868,097	7,518,097	4,506,793	3,011,304
2010*	6,065,000		4,160,354	10,225,354	6,570,451	3,654,903

* Per examination

**Other revenue consists of Early Access funds, recoveries, and investment earnings.

ACCOUNTS AND RECORDS

Basis of Accounting

In accordance with ORS 734.660, the Association is required to report its financial condition to the director no later than March 30 of each year. The Association prepares its financial statements on the modified cash basis of accounting which is a basis of accounting different from generally accepted accounting principles in the United States of America. Consequently, certain revenues are recognized when received rather than when earned and certain expenses are recognized when cash is disbursed rather than when the obligation is incurred. Accordingly, the following modification of cash basis accounting has been made: interest receivable on investments as of

December 31, 2010, is included as an asset and administrative expenses payable as of December 31, 2010, are included as a liability. If revenue was recognized when earned and expenses were recognized when incurred, the fund balance would be reduced significantly. **I recommend the Association record in its financial statements an unpaid claims liability pursuant to ORS 733.030.**

Assessments and Recoveries

Assessments of member insurers of the Association are accrued at the time of assessment and are based on the proportion that the net direct written premium for specified coverages of each member insurer for the preceding calendar year bears to the total net direct written premiums for that coverage of all member insurers doing business in the State of Oregon for the preceding calendar year. The assessments are made at the discretion of the Board of Directors whenever funds are needed to pay claims, claims adjustment expenses and unearned premiums.

Assessments are limited to 2% of the net direct written premium of the member insurer for the preceding calendar year. There have been no assessments made since 2003.

Security Deposits

Security deposits remitted to the Association by the State of Oregon Insurance Division were properly accounted for.

Unclaimed Property

The Association has procedures to account for unclaimed funds and files periodic reports with the Oregon Division of State Lands as required by ORS 98.352.

Workers' Compensation Claims

A servicing facility processes workers' compensation claims for the Association. Workers' compensation claim files are maintained at the servicing facility which also sends out disbursements to claimants.

Custodial Agreement

The Association has a brokerage investment account agreement with Piper Jaffray (Piper). ORS 734.660 states the Oregon Insurance Guaranty Association is subject to regulation by the director of the Department of Consumer and Business Services in the same manner as an insurer. ORS 731.302 states, in conducting the examination, each examiner shall consider the guidelines and procedures in the examiner handbook, or its successor publication, adopted by the NAIC. The director may prescribe the examiner handbook or its successor publication and employ other guidelines and procedures that the director determines to be appropriate. The Oregon Insurance Division adopted OAR 836-027-0200, which requires an insurer to hold its securities at a bank or trust. Piper does not satisfy the definition of “custodian” provided in OAR 836-027-0200(2)(d).

I recommend the Association hold its securities in a bank, trust company, or securities depository as defined in OAR 836-027-0200 and ORS 706.008.

A review of the brokerage agreement showed it lacked the controls and safeguards required under OAR 836-027-0200(4).

I recommend the custodial agreement include the safeguards and controls required in OAR 836-027-0200(4)(a) through (l).

Refund from Association

Pursuant to ORS 734.575 any sums acquired by refund from the Oregon Insurance Guaranty Association that have previously been written off by contributing insurers and offset against corporate excise taxes or fire insurance gross premiums taxes, and are not then needed for purposes of ORS 734.510 to 734.710, shall be paid by the association to the director of the Department of Consumer and Business Services and deposited with the State Treasurer for credit to the General Fund of this state.

I recommend the Association pay to the Director of the Department of Consumer and Business Services any sums acquired by refunds from the Association that have been previously written

off by contributing insurers and offset against taxes that are not needed for the statutory purposes of the Association pursuant to ORS 734.575.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The Association complied with the recommendations made in the 1993 report of examination.

OREGON INSURANCE GUARANTY 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 (Note 1)	\$ 3,644,830	\$ 0	\$ 3,644,830
Interest receivable	470,131		470,131
Prepaid expenses	3,669		3,669
Equipment (net of depreciation)	25,047		25,047
Deposits	2,655		2,655
Restricted cash (Note 2)	159,387		159,387
Restricted investments (Note 2)	5,286,759		5,286,759
Long term investments	<u>52,864,866</u>	<u>0</u>	<u>52,864,866</u>
Total Assets	<u>\$62,457,344</u>	<u>\$ 0</u>	<u>\$62,457,344</u>
<u>Liabilities & Net Assets</u>			
Accounts payable	\$ 1,560		\$ 1,560
Total Liabilities	<u>1,560</u>		<u>1,560</u>
Net Assets			
Unrestricted net assets	57,009,637		57,009,637
Restricted net assets (Note 2)	<u>5,446,147</u>	<u>0</u>	<u>5,446,147</u>
Total Net Assets	<u>62,455,784</u>	<u>0</u>	<u>62,455,784</u>
Total Liabilities & Net Assets	<u>\$62,457,344</u>	<u>\$ 0</u>	<u>\$62,457,344</u>

OREGON INSURANCE GUARANTY ASSOCIATION
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
For the Year Ended December 31, 2010

UNRESTRICTED NET ASSETS

Revenues

Security deposits	\$ 6,065,000
Recoveries from receivers	414,425
Reimbursements	1,738,612
Interest income	1,653,839
Dividend income	2,781
Unrealized gain	<u>350,697</u>
Total Revenues	<u>10,225,354</u>

Insolvency Expenses

Claims paid	3,571,550
Claims adjustment expenses	210,581
Return of a recovery from receiver	1,919,676
Unearned premiums paid	25
Realized loss	<u>424,381</u>
Total Insolvency Expenses	6,126,213

General and Administrative 444,238

Total Expenses 6,570,451

Increase (decrease) in unrestricted net assets 3,654,903

RESTRICTED NET ASSETS (Note 2)

Revenues

Funds received from insurers	13,504
Interest income	163,367
Unrealized gain	<u>0</u>
Total Revenues	<u>176,871</u>

Expenses

Realized loss	41,595
Unrealized loss	<u>35,244</u>
Total Expenses	<u>76,839</u>

Increase (decrease) in restricted net assets 100,032

Total increase (decrease) net assets 3,754,935

Net assets, beginning of the year 58,700,849

Net assets, end of the year \$62,455,784

OREGON INSURANCE GUARANTY ASSOCIATION
STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2010

Net Cash Flows from Operating Activities

Increase (decrease) in net assets	\$ 3,754,935
Noncash expenses, revenues, losses and gains included in income	
--depreciation and amortization	6,243
--(gain) loss on sale of fixed assets	1,324
--realized (gain) loss on investments	465,976
--unrealized (gain) loss on investments	(315,453)
(Increase) decrease in:	
--interest receivable	(135,850)
--prepaid expenses	(863)
Increase (decrease) in:	
--accounts payable	<u>1,035</u>
Net Cash provided by (used in) Operating Activities	<u>3,777,347</u>

Cash Flows from Investing Activities

Purchase of fixed assets	(3,774)
Purchase of investments	(30,109,775)
Proceeds from sale of investments	<u>27,789,044</u>
Net Cash provided by (used in) Investing Activities	<u>(2,324,505)</u>

Net Increase (Decrease) in Cash and Cash Equivalents 1,452,842

Cash and Cash Equivalents at the beginning of year	<u>2,351,375</u>
Cash and Cash Equivalents at the end of year	3,804,217
Less - Cash Restricted as to use	<u>(159,387)</u>

Unrestricted Cash and Cash Equivalents at end of year \$ 3,644,830

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Cash & Investments

Cash and Investments account for 99.9 % of total assets.

Investments primarily consisted of amply secured obligations of the United States or a corporation rated by the NAIC as Class 1 and certificate of deposits.

Note 2 - Restricted Cash, Investments, and Net Assets

Prior to 2003, member insurers could offset assessments made by the Association against corporate excise tax or fire marshal tax liability pursuant to ORS 734.579. Beginning in the year following payment of an assessment, a member insurer could take a 20% credit in each of the next 5 years against either its fire marshal tax or corporate excise tax.

In 2003 the legislature amended ORS 743.579. Member insurers could no longer take a tax credit to offset assessments. Instead they could either expense the assessment or recoup the assessment from their policyholders.

For the assessments in 2001, member insurers were allowed to take the first 20% of their assessment as a tax credit against either their fire marshal tax or the corporate excise tax in 2002. In 2003 insurers began recouping from policyholders the remaining 80% of their 2001 assessments along with 100% of their 2002 and 2003 assessments.

For those member insurers that recouped more from policyholders than the assessments they originally paid, OAR 836-031-0855(10) provides that the insurer must dispose of the excess. One of the manners in which an insurer may dispose of the excess recoupment is to transfer the excess to the Association. Such funds shall be held by the Association to pay covered claims arising under subsequent insurer insolvencies.

The Balance Sheet included in this report includes Restricted Cash and Restricted Investments totaling \$159,387 and \$5,286,759, respectively, and Restricted Net Assets totaling \$5,446,147 that represent this excess recoupment from policyholders that have been paid to the Association. Likewise the Statement of Revenues, Expenses, and Changes in Net Assets reflect activity related to restricted cash, investments, and net assets.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

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

Page

- 9 I recommend the Association record in its financial statements an unpaid claims liability pursuant to ORS 733.030.
- 10 I recommend the Association hold its securities in a bank, trust company, or securities depository as defined in OAR 836-027-0200 and ORS 706.008.
- 10 I recommend the custodial agreement include the safeguards and controls required in OAR 836-027-0200 (4)(a) through (l).
- 11 I recommend the Association pay to the Director of the Department of Consumer and Business Services any sums acquired by refunds from the Association that have been previously written off by contributing insurers and offset against taxes that are not needed for the statutory purposes of the Association pursuant to ORS 734.575.

CONCLUSION

During the seventeen year period covered by this examination, the Association's net assets increased from \$2,235,237 as presented in the December 31, 1993, financial statements, to \$62,455,784, as shown in this report of examination. Comparative assets, liabilities and net assets are shown below:

	<u>2010</u>	December 31,	<u>1993</u>	<u>Change</u>
Assets	\$62,457,344		\$2,238,785	\$60,218,559
Liabilities	<u>1,560</u>		<u>3,548</u>	<u>(1,988)</u>
Net Assets	<u>\$62,455,784</u>		<u>\$2,235,237</u>	<u>\$60,220,547</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, Mark Giffin CFE, insurance examiner with the 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 Insurance Guaranty 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 Insurance Guaranty 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: _____