



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**OREGON LIFE & HEALTH INSURANCE GUARANTY ASSOCIATION
SALEM, OREGON**

AS OF

DECEMBER 31, 2009

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SALUTATION

April 6, 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 the statutory provisions of ORS 734.850 and ORS 731.300,
we have examined the business affairs and financial condition of

OREGON LIFE & HEALTH INSURANCE GUARANTY ASSOCIATION
PO Box 4520
Salem, Oregon 97302

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, 2009, covers the fifteen 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.

HISTORY

The Association is a nonprofit legal entity created in 1975 by the Oregon Life and Health Insurance Guaranty Association Act. The Association was established to assist in the detection and prevention of insurance companies' insolvencies and to assure the payment of claims of policyholders under certain insurance policies of insolvent insurance companies. The intent of the Association is to pay valid claims of all life policies, health policies, and annuities written by impaired or insolvent insurance companies domiciled in Oregon as well as policies written by foreign insurance companies authorized to do business in Oregon.

The Association has the power to assess life and health insurance companies authorized to do business in Oregon ("member insurers") in order to provide the necessary funds to assure the performance of insurance contractual obligations and administration.

MANAGEMENT AND CONTROL

Membership

Under the provisions of ORS 734.800, all insurers transacting the business of life and health insurance in Oregon must remain members of the Association as a condition of their authority to transact business in Oregon.

Board of Directors

As authorized by ORS 734.805, the Board of Directors consists of seven members selected by the member insurers. Directors serving the Association at December 31, 2009, were as follows:

<u>Name and Address</u>	<u>Affiliation</u>	<u>Term</u>
Steve Murrell Tualatin, OR	Claims/Legislative Liaison State Farm Insurance Company	2013
Toni Ostrom Portland, OR	Vice President Operations Regence Life and Health Insurance Company	2009
Justin Delaney* Portland, OR	Assistant VP & General Counsel Standard Insurance Company	2011
Nancy Hill Newport Beach, CA	Assistant Vice President Compliance Pacific Life Insurance Company	2012
Deborah Sloan Meridian, ID	Senior VP & Actuary United Heritage Life Insurance Company	2012
Brian F. Kreger Mercer Island, WA	VP & General Counsel Farmers New World Life Insurance Company	2013
Todd Thaker, ESQ Sacramento, CA	Vice President Prudential Insurance Company of America	2010

*Chairman of the Board

Officers

Association officers serving at December 31, 2009, were:

<u>Name</u>	<u>Title</u>
Justin Delaney	Chairman
Nancy Hill	Secretary/Treasurer

Daily operations are performed by James B. Kleen, Administrator, of JBK and Associates, who performs the day-to-day activities of the Association. These activities are conducted out of his home and, as well, the books and records are maintained there.

CONFLICT OF INTEREST

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

CORPORATE RECORDS

In compliance with ORS 734.820, the Association has a Plan of Operation similar to a commercial organization's Articles of Incorporation and Bylaws. The provisions of ORS 734.820(3) set forth certain items that must be included in the plan of operation. ORS 734.820(3)(a) requires the plan to establish procedures for handling the assets of the association. The assets of the Association consist of cash and investments. No provision for handling these assets is included in the Plan of Operation.

I recommend the Plan of Operation be amended to include procedures for handling the assets of the Association.

ORS 734.850 requires the Association to submit, no later than May 1 each year, a financial report for the preceding calendar year and a report of its activities during the preceding calendar year.

The Association reported in its 2009 annual report that its Fund Balance by Insolvency reflects 41 individual accounts maintained by the Association in 2009. These individual accounts include 33 that relate to insurance company insolvencies.

Board Minutes

Minutes of the Board of Directors meetings were reviewed for the most recent five years. Board of Directors meetings were held periodically and a quorum achieved at all meetings. The examiner reviewed the minutes of the meetings of the Board of Directors from 2005 through 2010. Although

investment guidelines were discussed, the Board of Directors did not formally approve the Association's investments.

I recommend the Board of Directors approve the Association's investments in compliance with ORS 733.730.

FIDELITY BONDS AND OTHER INSURANCE

Insurance coverage was reviewed for adequacy of limits and retentions and the solvency of the insurers providing the coverages. The Association is insured up to \$250,000 per occurrence against losses from acts of dishonesty and fraud by its officers or acting administrator. The Association had no other insurance coverages in force as of the date of this examination. Pursuant to the provisions of ORS 734.870, there shall be no liability on the part of, and no cause of action of any nature shall arise against, any member insurer or its agents or employees, the Association or its agents or employees, members of the Board of Directors, or the director of the Department of Consumer and Business Services or the representatives of the director, for any action taken by them in the performance of their powers and duties under ORS 734.750 to 734.890.

TERRITORY AND PLAN OF OPERATION

The Association operates solely for the benefit of policyholders and claimants of insolvent insurers in Oregon. As mentioned previously, the Association has a written Plan of Operation as required by ORS 734.820.

The Association can assess member insurers based on the need to fund policyholder claims of liquidating insurers and administrative expenses. Class A assessments are made for the purpose of meeting administrative costs and other general expenses not related to a particular impaired or insolvent insurer. Class B assessments are made to fund policyholder claims of impaired or insolvent domestic insurers.

ACCOUNTS AND RECORDS

The audited financial statements of the Association are presented on a cash basis of accounting. A statement of cash receipts, cash disbursements, and change in cash balance is a summary of the cash activity of the Association. This is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The enclosed financial statements are presented on a modified cash basis showing the investments of the Association on a historic cost basis with related accrued interest.

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.

Custodial Agreement

The Association has a brokerage investment account agreement with Merrill Lynch. The provisions of OAR 836-027-0200 allow a domestic insurer to enter into a custodial or safekeeping arrangement with a custodian for the purpose of holding securities owned by the insurer as provided in OAR 836-027-0200(3) and (4). Such an arrangement must be made by written agreement between the domestic insurer and the custodian, must meet the requirements and standards of this rule and must provide that the securities be held by the custodian or its agent. A "Custodian" means a bank or trust company licensed by the United States or by any state thereof and regularly examined by its licensing authority pursuant to OAR 836-027-0200(2)(d).

Additionally, a custodial or safekeeping arrangement must account for and safeguard the securities of the domestic insurer, must facilitate examination of the insurer and the records of the insurer's custody account maintained by the custodian and must be in accordance with the following standards established in the Examiners Handbook, published by the National Association of Insurance Commissioners as identified in OAR 836-027-0200(4)(a) to (l).

Merrill Lynch does not satisfy the definition of a custodian nor does the agreement contained the required safeguards.

I recommend the Association hold its securities in a bank, trust company, or securities depository in accordance with the provisions of OAR 836-027-0200.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The Association complied with the recommendations made in the 1994 report of examination.

SUBSEQUENT EVENT

During the 2011 legislative session the Department of Consumer and Business Services worked with the Association and other interested parties and sponsored House Bill 2087. This bill would

- Establish three health insurance subaccounts for disability insurance, long term care insurance, and major medical and all other health insurance.
- Increase certain coverage limits to policyholders of insolvent insurers up to the following amounts:
 - Health insurance benefits other than disability insurance and long term care insurance - \$500,000
 - Disability insurance benefits - \$300,000
 - Long term care insurance benefits - \$300,000
- Aggregate limit for health insurance benefits other than disability insurance and long term care insurance with respect to any one individual - \$500,000.
- Increases the maximum assessment for administrative and legal costs and other general expenses per member insurer to \$300 in a calendar year.
- Declares an emergency and the bill will take effect on its passage.

The Governor signed House Bill 2087 on May 27, 2011. The effective date of the bill was May 27, 2011.

OREGON LIFE & HEALTH INSURANCE GUARANTY ASSOCIATION
BALANCE SHEET
AS OF DECEMBER 31, 2009

<u>Assets</u>	<u>Annual Statement</u>	<u>Examination Adjustments</u>	<u>Net Admitted Assets</u>
Cash	\$ 164,800		\$ 164,800
Investments	11,112,021		11,112,021
CMA money fund	107,517		107,517
Accrued interest	<u>10,533</u>		<u>10,533</u>
 Total Assets	 <u>\$11,394,871</u>	 <u>\$ 0</u>	 <u>\$11,394,871</u>
 <u>Liabilities & Equity</u>			
Retained earnings	<u>11,394,871</u>		<u>11,394,871</u>
Total Equity	<u>11,394,871</u>	<u>0</u>	<u>11,394,871</u>
Total Liabilities & Equity	<u>\$11,394,871</u>	<u>\$ 0</u>	<u>\$11,394,871</u>

OREGON LIFE & HEALTH INSURANCE GUARANTY ASSOCIATION
STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND CHANGE
IN CASH BALANCE

For the Year Ended December 31, 2009

Cash Receipts

Assessments – Class A	\$ 0
Expense reimbursements	20,950
Premiums	550
Interest and dividends	387,964
Proceeds from sales and maturities of investments	<u>11,061,228</u>
Total cash receipts	<u>11,470,692</u>

Cash Disbursements

Claims	1,707
Reinsurance and assumptions	637,871
Administrative	162,206
Legal and accounting	28,138
Purchase of investments	11,636,891
Purchase of investment interest	10,533
Other	<u>52,035</u>
Total cash disbursements	<u>12,529,381</u>
Excess (deficiency) of cash receipts over cash disbursements	(1,058,689)
Cash balance - Beginning of year	<u>1,331,006</u>
Cash balance – End of year	<u>\$ 272,317</u>

NOTES TO THE FINANCIAL STATEMENTS

Cash and Cash Equivalents

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

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.

Note 1 – Cash and Investments

Cash and investments account for 100% of total assets. Cash is held in a checking account and CMA Money Fund.

Investments were in securities issued by Federal Home Loan Bank, Fannie Mae, U.S. Treasury and miscellaneous other issuers. These are carried on the statement at cost. Cost is \$34,448 more than fair value, an immaterial difference. Maturity dates are from January 8, 2010 through December 17, 2012. Interest rates for the securities are from 0% to 7.8% with most being in the 3 to 6% range.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Page

- 6 I recommend the Plan of Operation be amended to include procedures for handling the assets of the Association.
- 7 I recommend the Board of Directors approve the Association's investments in compliance with ORS 733.730.
- 9 I recommend the Association hold its securities in a bank, trust company, or securities depository in accordance with the provisions of OAR 836-027-0200.

CONCLUSION

During the fifteen year period covered by this examination, the Association's surplus increased from \$3,686,452, as presented in the December 31, 1994, report of examination, to \$11,394,871, as shown in this report of examination. Comparative assets and liabilities are shown below:

	<u>2009</u>	December 31, <u>1994</u>	<u>Change</u>
Assets	\$11,394,871	\$13,846,452	(\$2,451,581)
Liabilities	<u>0</u>	<u>10,160,000</u>	<u>(10,160,000)</u>
Surplus	<u>\$11,394,871</u>	<u>\$ 3,686,452</u>	<u>\$7,708,419</u>

ACKNOWLEDGMENT

The cooperation and assistance extended by the Administrator and others on behalf of the Association during the examination process are gratefully acknowledged.

In addition to the undersigned, Ellen F. Quale, CPA, AFE, 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 Life and Health 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 Life and Health 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: _____