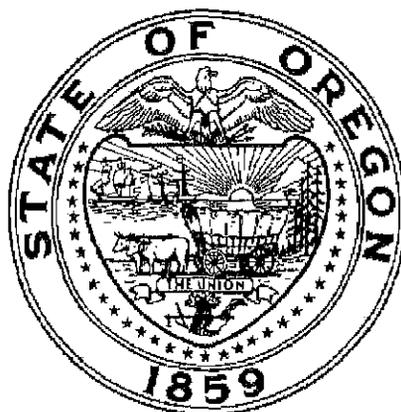


**STATE OF OREGON  
DEPARTMENT OF  
CONSUMER & BUSINESS SERVICES**

**INSURANCE DIVISION**



REPORT OF FINANCIAL EXAMINATION

OF

**PACIFICSOURCE HEALTH PLANS  
SPRINGFIELD, OREGON**

AS OF

DECEMBER 31, 2013

STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**PACIFICSOURCE HEALTH PLANS  
SPRINGFIELD, OREGON**

**NAIC COMPANY CODE 54976**

DECEMBER 31, 2013

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**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 HEALTH PLANS  
110 International Way  
Springfield, Oregon 97477**

**NAIC Company Code 54976**

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

## SCOPE OF EXAMINATION

We have performed our single-state, full-scope examination of PacificSource Health Plans. The examination was conducted in conjunction with the examination of a subsidiary life and health insurer, PacificSource Community Health Plans, Inc., and a separate report of examination will be prepared for that entity. The last examination of this health care service contractor 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 Plan by obtaining information about the Plan including corporate governance, identifying and assessing inherent risks within the Plan, 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 Plan were considered in accordance with the risk focused examination process.

## **COMPANY HISTORY**

Pacific Hospital Association was incorporated as a non-profit corporation in the State of Oregon on April 12, 1933, as "Pacific Hospital Society" under the provisions of ORS Chapter 65. On June 20, 1940, the Oregon Insurance Division issued a Certificate of Authority to operate as a hospital association. Pacific Hospital Association operated as a hospital association until April 1, 1968, at which time the Oregon Insurance Commissioner issued a Certificate of Authority authorizing it to operate as a health care service contractor pursuant to ORS Chapter 750. On October 18, 1994, the Association changed its business name to PacificSource Health Plans, and on that date the Oregon Insurance Division granted an amended Certificate of Authority to reflect the name change.

### **Capitalization**

On October 28, 2013, the Oregon Insurance Division approved the Company's Form A filing to create a new, non-insurer ultimate parent for the holding company group. The formation of the new parent is intended to maximize return on existing capital while also increasing access to sources of commercial financing for the member companies.

The Plan has no capital stock. The corporation has one member, PacificSource, an Oregon non-profit public benefit corporation. The Plan reported gross paid in and contributed surplus of \$(2,833,784), which is identical to the amount reported in the prior report of examination.

### **Dividends and Other Distributions**

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

Neither the Plan's Articles nor its Bylaws authorize any committee. However, the Plan'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 Restated Articles of Incorporation, effective September 9, 2009, was amended and restated on December 27, 2013, to name PacificSource as the sole member. The Articles of Incorporation conformed to the Oregon Insurance Code.

### Bylaws

Effective December 27, 2013, the Bylaws were amended and restated to make a number of substantive changes. Article II was amended to remove requirements for membership and eliminated the five classes of directors. Each director is now elected annually by the Sole Member. Article IV was amended to remove the office of chair-elect and remove the

requirement for a two-year term of the Chair. Article VI was amended to allow the Sole Member to remove any director, with or without cause. Article VII was amended to allow special meetings to be called by the Sole Member. Article VIII was amended to state the corporation shall have one member. Article IX was amended to allow the Sole Member to vote in person or by proxy. Article X was amended to eliminate the office of chair-elect. Article XIV was amended to state the Sole Member must approve certain corporate actions, including amending articles and bylaws, mergers or acquisition, or voluntary dissolution. The Plan's Bylaws conformed to Oregon statutes.

### **MANAGEMENT AND CONTROL**

#### **Board of Directors**

The Bylaws, in Article II, state the governing board of the corporation shall be known as the Board of Directors, said directors being referred to as trustees. The number of directors shall consist of no fewer than five (5) members and no more than thirteen (13) members, and elected annually by the Sole Member. As of December 31, 2013, the Plan was governed by a twelve member Board of Directors as follows:

<b><u>Name and Address</u></b>	<b><u>Principal Affiliation</u></b>	<b><u>Representative</u></b>	<b><u>Member Since</u></b>
Hal M. Brown Eugene, Oregon	CEO Pacific Continental Bank	Public	2007
Patricia P. Buchanan* Eugene, Oregon	Physician River Road Medical Group	Medical	2006
Edwin E. Dahlberg Boise, Idaho	Former CEO St. Luke's Regional Medical Center	Public	2009
John C. DeWenter Springfield, Oregon	Attorney	Public	1989
Priscilla J. Gould Eugene, Oregon	Retired	Public	2008

<u>Name and Address</u>	<u>Principal Affiliation</u>	<u>Representative</u>	<u>Member Since</u>
Jeffrey A. Houck Eugene, Oregon	Physician Pathology Consultants, PC	Medical	2006
Vern L. Katz Eugene, Oregon	Physician	Medical	2010
Gretchen N. Pierce Eugene, Oregon	President Hult & Associates LLC	Public	2010
Divya Sharma Bend, Oregon	Physician	Medical	2012
David E. Schute Portland, Oregon	Physician GreenField Health	Medical	2010
Richard Wright Eugene, Oregon	President and CEO Market of Choice	Public	2011
Charles R. Zachem, III Eugene, Oregon	Physician	Medical	2007

\*Chairman

### 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 Operating Officer
Peter F. Davidson	Exec. VP and Chief Financial Officer
Erick T. Doolen	Sr. VP and Chief Information Officer
Kristin E. Kernutt	Secretary
Tom Ewing, MD	Exec VP and Chief Medical Officer

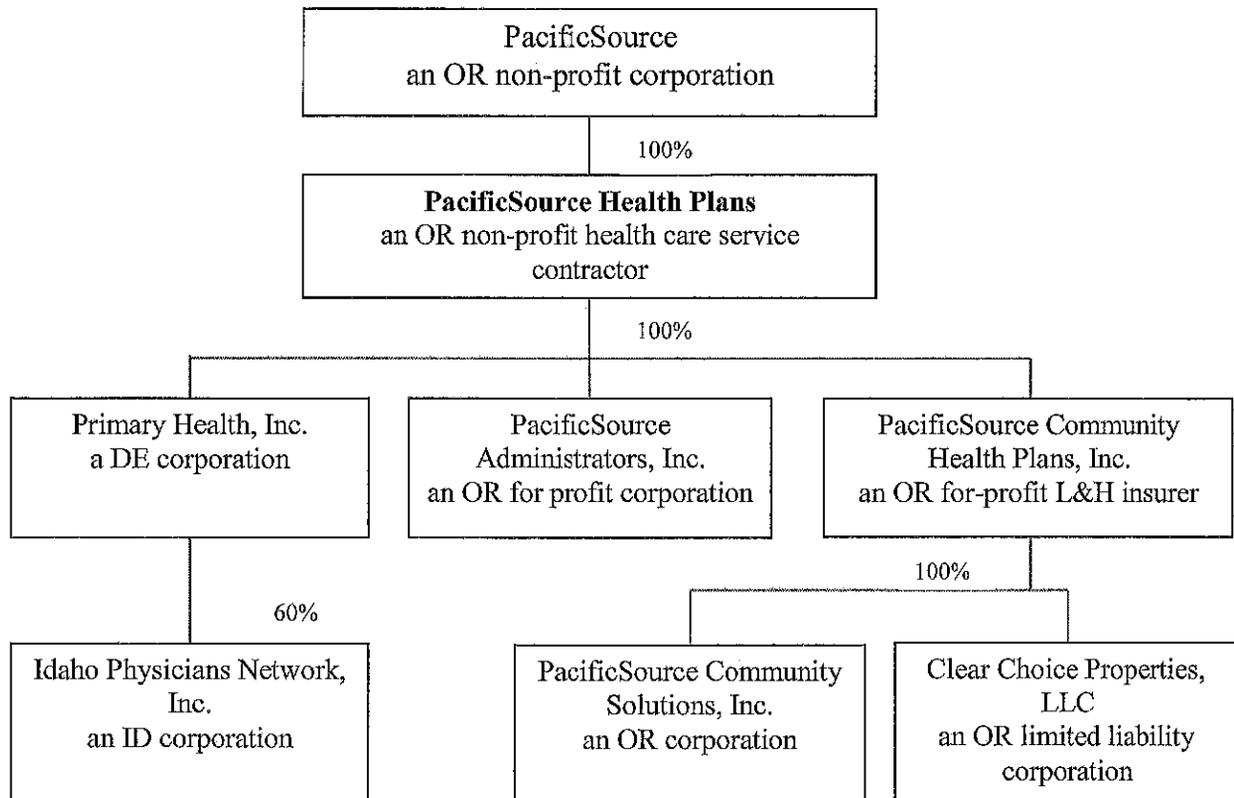
### Conflict Of Interest

The Plan'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 Plan'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 Plan:



As described in the history section above, the Plan formed a non-profit public benefit corporation named PacificSource to become the holding company of the Plan and its subsidiaries. In addition to the Plan, it controls 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.

PacificSource Community Health Plans, Inc. (PCHP) is an Oregon domiciled stock life and health insurance company formerly known as Clear One Health Plans, Inc. It writes what the company refers to as Government Plan business, consisting of Medicare Advantage and Medicaid plans.

In addition to the above wholly-owned subsidiaries, PacificSource is the ultimate controlling entity of the following:

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.

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. This company is 100% owned by PCHP.

## INTERCOMPANY AGREEMENTS

With the creation of the new insurance company holding system, agreements in place between the Plan 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 Plan and its subsidiaries:

### Administrative Services Agreement – PCHP

Effective May 22, 2010, and last amended on January 1, 2013, the Plan agreed to provide PacificSource Community Health Plans, Inc., 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 any other services required. PCHP agreed to compensate the Plan a monthly base fee, plus the actual cost of third-party services the Plan obtains for PCHP'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 – IPN

Effective August 1, 2009, and amended February 1, 2013, the Plan entered into an Administrative Services Agreement with Idaho Physicians Network, Inc. Under the terms of the agreement, the Plan agreed to serve as the exclusive provider of administrative, executive, contracting, consulting, management, marketing, information technology, and other support services to IPN, in exchange for 90% of the revenues collected by IPN. Payment under the agreement is due immediately upon receipt. The Plan assigned its interest in the Agreement to Primary Health, Inc., effective December 31, 2013.

### Administrative Service Agreement – PAI

Effective February 28, 2003, and last amended January 1, 2011, the Plan agreed to provide PacificSource Administrators, Inc., executive oversight, information systems advisory services, human resource services, accounting and financial management services and support, legal services, marketing services and support, administrative services, and other services required. PAI agreed to compensate the Plan a fixed monthly fee. This agreement was terminated by both parties effective December 31, 2013.

### Tax Allocation Agreement

Effective January 1, 2010, the Plan 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 the Plan 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 Plan has Certificates of Authority in the States of Idaho, Montana, Oregon and Washington. The primary service areas include Central and Southern Oregon, and there are regional offices in Portland, Bend, Medford, Boise, Idaho, Idaho Falls, Idaho, and Helena, Montana. The Plan is an administrative and contracting organization, whose primary functions are:

- Enrolling health plan members
- Maintaining membership records
- Collecting membership premiums and dues
- Collecting other revenues (including co-pays, deductibles, and fees)
- Contracting with providers of medical and dental health care services

The Plan depends on a subsidiary, PacificSource Administrators, Inc., as a broker and administrator for the group business accounts. The Plan's health care network includes approximately 46,300 participating providers throughout Idaho, Oregon, and SW Washington, and comprehensive network coverage in Montana through InterWest Health Network.

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

<u>Line of Business</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Indiv. hospital & medical	35,513	38,399	29,016	22,711	17,969
Group hospital & medical	137,587	159,953	147,941	132,169	128,522
Medicare supplement	50	69	65	72	81
Dental	15,145	15,400	15,761	18,310	29,992
Other	<u>18,680</u>	<u>10,666</u>	<u>10,894</u>	<u>9,971</u>	<u>6,930</u>
Total enrollment	<u>206,975</u>	<u>224,487</u>	<u>203,677</u>	<u>183,233</u>	<u>183,494</u>

In 2013, the Plan reported direct business in the following states:

<u>State</u>	<u>Direct Premiums Written</u>
Idaho	\$ 93,432,693
Montana	46,774,563
Oregon	589,198,191
Washington	<u>6,041</u>
Total	<u>\$729,411,488</u>

### GROWTH OF THE COMPANY

Growth of the Plan over the past five years is reflected in the following schedule. Amounts were derived from Plan'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	173,618,057	66,542,205	107,075,852	4,290,283
2010*	196,430,513	82,322,912	114,107,602	8,134,728
2011	203,462,605	77,744,555	125,718,050	10,919,667
2012	209,216,149	99,439,325	109,776,825	(25,935,955)
2013*	230,087,481	78,793,742	151,293,739	14,706,783

\*Per examination

## LOSS EXPERIENCE

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

<u>Year</u>	<u>(1) Total Revenues</u>	<u>(2) Total Hospital and Medical</u>	<u>(2)/(1) Medical Loss Ratio</u>	<u>(3) CAE and General Expenses</u>	<u>(2)+(3)/(1) Combined Loss Ratio</u>
2009	520,645,087	439,202,187	84.4%	76,898,205	99.1%
2010 *	582,966,063	493,099,186	84.6%	84,978,743	99.2%
2011	644,237,184	545,553,079	84.7%	89,376,112	98.6%
2012	722,232,759	650,530,509	90.1%	104,765,890	104.6%
2013 *	724,143,059	626,659,696	86.5%	97,927,342	100.1%

\*Per examination

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

## REINSURANCE

### Assumed

None.

### Ceded

At December 31, 2010, the Plan was covered by an HMO Excess Risk Reinsurance agreement with RGA Reinsurance Company (NAIC #93572, authorized in Oregon since May 25, 1982). Under the policy, the reinsurer reimbursed the Plan for unlimited losses per member for each individual risk, after retention of \$650,000. 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 with RGA Re 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 \$151,293,739 at December 31, 2013, it appears the Company does not maintain risk on any one subject in excess of 10% of its surplus to policyholders, in compliance with ORS 731.504.

### **ACCOUNTS AND RECORDS**

In general, the Plan's records and source documentation supported the amounts presented in the Plan's 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**

As of the examination date, the Company maintained a \$250,000 surety bond on file at the Oregon Insurance Division, which meets the requirements of ORS 750.045(2). In addition, the Plan reported \$1,089,000 in a US Bank CD 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. An additional deposit of \$251,833 in cash at Mountain West Bank, on deposit with the Montana Commissioner of Securities and Insurance, was confirmed directly with the bank. Both deposits were properly listed in the 2013 annual statement on Schedule E – Part 3.

## **COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS**

There was one recommendation 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 Plan was in compliance with the recommendation.

## **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 the Plan. Further, both the Plan and its subsidiaries 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.

## **FINANCIAL STATEMENTS**

The following examination financial statements show the financial condition of PacificSource Health Plans 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 HEALTH PLANS**  
**ASSETS**  
**As of December 31, 2013**

Assets	Balance per Company	Examination Adjustments	Balance per Examination	Notes
Bonds	\$ 98,946,314	\$ -	\$ 98,946,314	1
Preferred stocks	394,670	-	394,670	
Common stocks	68,171,285	-	68,171,285	1
Cash, cash equivalents and short-term investments	39,220,260	-	39,220,260	1
Other invested assets	1,248,124	-	1,248,124	2
Receivable for securities	1,248	-	1,248	
Aggregate write-ins for invested assets	-	-	-	
Subtotal, cash and invested assets	<u>\$207,981,901</u>	<u>\$ -</u>	<u>\$207,981,901</u>	
Investment income due and accrued	648,123	-	648,123	
Premiums and considerations				
Uncollected premiums, agents' balances in course of collection	6,510,654	-	6,510,654	
Amounts recoverable from reinsurers	4,592,584	-	4,592,584	
Amounts receivable relating to uninsured plans	2,266,631	-	2,266,631	
Current FIT recoverable	3,773,000	-	3,773,000	
Receivable from parent, affiliates and subsidiaries	1,965,834	-	1,965,834	
Health care receivable	1,939,085	-	1,939,085	
Aggregate write-ins for other than invested assets	409,669	-	409,669	
Total Assets	<u>\$230,087,481</u>	<u>\$ -</u>	<u>\$230,087,481</u>	

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

Liabilities, Surplus and other Funds	Balance per Company	Examination Adjustments	Balance per Examination	Notes
Claims unpaid	\$ 62,298,969	\$ -	\$ 62,298,969	3
Accrued medical incentive pool and bonus	185,878	-	185,878	3
Unpaid claim adjustment expenses	1,721,588	-	1,721,588	3
Aggregate health policy reserves	3,865,380	-	3,865,380	3
Premiums received in advance	3,525,885	-	3,525,885	
General expenses due or accrued	4,195,818	-	4,195,818	
Net deferred tax liability	1,500,000	-	1,500,000	
Ceded reinsurance premiums payable	433,990	-	433,990	
Amounts withheld or retained for account of others	1,048,458	-	1,048,458	
Amounts due to parent, subsidiaries and affiliates	7,970	-	7,970	
Aggregate write-ins for liabilities	<u>9,806</u>	-	<u>9,806</u>	
<b>Total Liabilities</b>	<b><u>\$ 78,793,742</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 78,793,742</u></b>	
Gross paid in and contributed surplus	\$ (2,833,784)	\$ -	\$ (2,833,784)	
Unassigned funds (surplus)	<u>154,127,523</u>	-	<u>154,127,523</u>	
Surplus as regards policyholders	<u>151,293,739</u>	-	<u>151,293,739</u>	
<b>Total Liabilities, Surplus and other Funds</b>	<b><u>\$230,087,481</u></b>	<b><u>\$ -</u></b>	<b><u>\$230,087,481</u></b>	

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

Revenue	Balance per Company	Examination Adjustments	Balance per Examination	Notes
Net premium income	\$723,301,146	\$ -	\$ 723,301,146	
Change in unearned premium reserve and reserve for rate credits	(1,076,115)	-	(1,076,115)	
Fee-for-service	-	-	-	
Risk revenue	-	-	-	
Aggregate write-ins for non-health care related revenues – gain on sale of fixed assets	<u>1,918,029</u>	<u>-</u>	<u>1,918,029</u>	
Total revenue	724,143,060	-	724,143,060	
Hospital and Medical				
Hospital/medical benefits	355,768,076	-	355,768,076	
Other professional services	42,426,188	-	42,426,188	
Outside referrals	24,779,579	-	24,779,579	
Emergency room and out-of-area	139,876,224	-	139,876,224	
Prescription drugs	76,347,157	-	76,347,157	
Incentive pool, withhold adjustments and bonus amounts	<u>195,377</u>	<u>-</u>	<u>195,377</u>	
Subtotal	639,392,601	-	639,392,601	
Less:				
Net reinsurance recoveries	<u>12,732,905</u>	<u>-</u>	<u>12,732,905</u>	
Total medical and hospital	626,659,696	-	626,659,696	
Non-health claims	-	-	-	
Claim adjustment expenses	24,989,867	-	24,989,867	
General administrative expenses	72,937,475	-	72,937,475	
Increase in reserves for life and accident and health contracts	<u>-</u>	<u>-</u>	<u>-</u>	
Total underwriting deductions	<u>724,587,038</u>	<u>-</u>	<u>724,587,038</u>	
Net underwriting gain or (loss)	<u>(443,978)</u>	<u>-</u>	<u>(443,978)</u>	
Net investment income earned	4,319,482	-	4,319,482	
Net realized capital gains (losses)	<u>14,041,412</u>	<u>-</u>	<u>14,041,412</u>	
Net investment gains (losses)	18,360,894	-	18,360,894	
Net gain or (loss) from agents' or premium balances charged off	(15,537)	-	(15,537)	
Aggregate write-ins for other income or expense	(3,014,880)	-	(3,014,880)	
Federal income taxes incurred	<u>179,716</u>	<u>-</u>	<u>179,716</u>	
Net investment income earned	<u>\$ 14,706,783</u>	<u>\$ -</u>	<u>\$ 14,706,783</u>	

**PACIFICSOURCE HEALTH PLANS**  
**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>\$109,776,826</u>	<u>\$125,718,049</u>	<u>\$114,107,602</u>
Net income	14,706,783	(25,935,955)	10,919,667
Change in net unrealized capital gains or (losses)	6,051,589	2,391,232	(5,972,826)
Change in net deferred income tax	(18,835,000)	2,900,000	(37,000)
Change in non-admitted assets	34,741,617	3,985,450	14,982,994
Change in provision for reinsurance	-	-	-
Change in surplus notes	-	-	-
Cumulative effects of changes in accounting principles	(2,645,133)	-	-
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>7,497,057</u>	<u>718,050</u>	<u>(8,282,388)</u>
Change in surplus as regards policyholders for the year	<u>41,516,913</u>	<u>(15,941,223)</u>	<u>11,610,447</u>
Surplus as regards policyholders, December 31, current year	<u>\$151,293,739</u>	<u>\$109,776,826</u>	<u>\$125,718,049</u>

The Plan reported \$(2,645,133) as a reduction in surplus due to the cumulative effects of changes in accounting principles. In actuality, the change is due to reclassifying the prior year-end liability of the Defined Benefit Pensions from the Plan to the holding company at December 31, 2013.

## NOTES TO FINANCIAL STATEMENTS

### Note 1 – Invested Assets

At year-end 2013, the Plan's long-term bond investments were in US obligations, US federal agency bonds, municipal obligations, and corporate issues. The Plan did have a moderate exposure to mortgaged-backed and asset-backed securities. Most of MBS/ABS issues were investment rated at year-end 2013, with a carrying book value of \$36.7 million comprised 37.1% of the total long-term bond portfolio, and 17.7% of all invested assets.

Short-term deposits consisted of one money market fund held in the custodial account at Wells Fargo Bank.

Common stocks included the equity in three wholly-owned subsidiaries, totaling \$54.7 million, of which \$41.6 million was concentrated in a subsidiary insurer's capital and surplus account. The remaining balance represents the book value of 21 separate mutual funds.

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

<u>Year</u>	<u>A</u>	<u>B</u>	<u>C</u>	<u>Ratio</u>	<u>Ratio</u>	<u>Ratio</u>
	<u>Bonds</u>	<u>Common Stocks</u>	<u>Cash and Short-term</u>	<u>A/ Total Assets</u>	<u>B/ Total Assets</u>	<u>C/ Total Assets</u>
2009	54,527,818	44,071,022	26,261,722	31.4%	25.4%	15.1%
2010*	60,721,972	80,741,447	22,152,664	30.9%	41.1%	11.3%
2011	88,492,622	79,933,599	623,372	43.5%	39.3%	0.3%
2012	94,199,415	84,270,710	(8,932,431)	45.0%	40.3%	(4.3)%
2013*	98,946,314	68,171,285	39,220,260	43.0%	29.6%	17.0%

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 Plan was in compliance with ORS 733.580.

Effective February 10, 2010, the Plan 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 Plan reported other long-term assets consisting of a hedge fund, Phoenix Fixed Income Fund LP. 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 Plan reported investment of \$4,616,454 in this fund, and the Plan was in compliance with the statute.

### Note 3 – Actuarial Reserves

A review of the unpaid claims and claim adjustment expense reserves for the Plan 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, Vice President of Actuarial Science, Underwriting and Analytics 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	\$58,884,677	\$62,298,969
Accrued Medical Incentive Pool and Bonus Payments	185,878	185,878
Unpaid Claims Adjustment Expenses (CAE)	1,766,540	1,721,588
Aggregate Health Policy Reserves	3,865,380	3,865,380
Premium Deficiency Reserves	-	-
Total Actuarial Liabilities	<u>\$64,702,475</u>	<u>\$68,071,815</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 \$3,369,340, resulting in a redundancy of 5.2%. 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 Plan has increased from \$114,107,602, as presented in the December 31, 2010, report of examination, to \$151,293,739, 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	\$230,087,481		\$196,430,513	\$33,656,968
Liabilities	<u>78,793,742</u>		<u>82,322,912</u>	<u>(3,529,170)</u>
Surplus	<u>\$151,293,739</u>		<u>\$114,107,601</u>	<u>\$37,186,138</u>

**ACKNOWLEDGMENT**

The cooperation and assistance extended by the officers and employees of the Plan 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,

  
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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            )

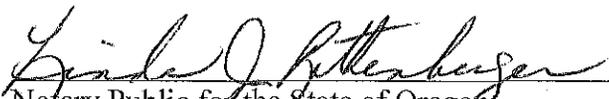
Greg A. Lathrop, CFE, PIR, being duly sworn, states as follows:

1. I have authority to represent the state of Oregon in the examination of PacificSource Health Plans, 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 Health Plans 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 21 day of May, 2015.

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

My Commission Expires: 3/22/2017

