MIKE KREIDLER
STATE INSURANCE COMMISSIONER

STATE OF WASHINGTON

Phone: (360) 725-7000

OFFICE OF
INSURANCE COMMISSIONER

In the Matter of	)	No. G06-62
	)	
The Financial Examination of	)	FINDINGS, CONCLUSIONS,
WASHINGTON LIFE AND DISABILITY	)	AND ORDER ADOPTING REPORT
INSURANCE GUARANTY ASSOCIATION	)	OF EXAMINATION

BACKGROUND

An examination of the financial condition of the **WASHINGTON LIFE AND DISABILLITY INSURANCE GUARANTY ASSOCIATION** (the Association) as of December 31, 2004, was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings, comments and recommendations was transmitted to the Association for its comments on September 28, 2006. The Association's response to the report is attached to this order only for the purpose of a more convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners' work papers, and the submissions by the Association.

Subject to the right of the Association to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 1 through 12 of the report.

Mailing Address: P.O. Box 40255 • Olympia, WA 98504-0255
Street Address: 5000 Capitol Blvd. • Tumwater, WA 98501

CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of the **WASHINGTON LIFE AND DISABILLITY INSURANCE GUARANTY ASSOCIATION** and to order the Association to take the actions described in the Instruction and Comments and Recommendations sections of the report. The Commissioner acknowledges that the Association may have implemented some of the Instruction and Comments and Recommendations prior to the date of this order. The Instruction and Comments and Recommendations in the report are appropriate responses to the matters found in the examination.

ORDER

The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

The Association is ordered as follows, these being the Instruction and Comments and Recommendations contained in the examination report on pages 1-4.

1. The Association is ordered to comply with RCW 48.32A.085 by issuing a certificate of contribution to the assessed companies, or by receiving OIC approval for substitution of the invoice and cancelled check in lieu of a certificate. Instruction 1, Examination Report, page 1.

2. The Association is ordered to consider placing all significant asset receipts and disbursements under outside control and accountability. Most of the Association's receipts are directed to a bank lock-box, which thereby establishes external control over gross receipts. However, it is ordered that the Association consider having all funds which are sent directly to the Executive Director's office placed under similar external control. An outside agency could be engaged to receive and process all incoming mail, depositing any funds in the bank lock-box account. In addition, all potential fund remitters should be advised that such remittances must go directly to the bank lock-box. All other significant transactions should require at least retroactive approval by the Board of Directors (BOD). Comments and Recommendations 1, Examination Report, page 2.

3. The Association is ordered to consider obtaining property insurance for the records and equipment needed to restart operations after a catastrophe and ensuring that recoverable records are maintained in the same event. Comments and Recommendations 2, Examination Report, page 2.

4. Pursuant to RCW 48.32A.085(1), the Association is ordered to consider that a due date be shown on assessment invoices. The due date should be at least 30 days after delivery of the invoice. Comments and Recommendations 3, Examination Report, page 3.

5. The Association is ordered to consider documenting the computations required by RCW 48.32A.085(5)(a)(i). Comments and Recommendations 4, Examination Report, page 3.

6. In order to ensure that the appropriate services are being provided at the correct price, it is ordered that the Association consider obtaining a copy of any contract with any TPA or consultant under which payments or reimbursements are made by the Association. Comments and Recommendations 5, Examination Report, page 3.

7. It is ordered that the Association consider adhering to the NAIC Financial Condition Examiners Handbook requirements and execute a satisfactory custodial agreement with the Bank of America. Comments and Recommendations 6, Examination Report, page 4.

8. In order to document that there are no conflicts of interest, the Association is ordered to consider obtaining annual conflict of interest certifications from Board members, employees, agents or representatives and retaining them for future reference. Comments and Recommendations 7, Examination Report, page 4.

9. In order to negotiate the best possible terms for investment services, the Association is ordered to consider obtaining fee schedules from banks and investment custodians and factoring that information into the selection of providers of banking and custodial services. Comments and Recommendations 8, Examination Report, page 4.

IT IS FURTHER ORDERED THAT, the Association file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how the Association has addressed each of the requirements of this order.

ENTERED at Olympia, Washington, this 27th day of November, 2006.

MIKE KREIDLER
Insurance Commissioner

Jim Odiorne

From: WLDIGA [wldiga@earthlink.net]
Sent: Monday, October 30, 2006 4:48 PM
To: Jim Odiorne
Cc: Susan Campbell; John Patton; Roger Harbin; C. Robert Ogden
Subject: WLDIGA Responses to Examination

Jim,

Attached are the Washington Life and Disability Insurance Guaranty Association's responses to the examination findings you shared with us. Thank you for your patience while we formulated these responses.

If you have any questions about any of the Association's thoughts on the findings in the examination report, please do not hesitate to contact me.

Michael N. O'Day, CPA Inactive, FLMI
Executive Director
Washington Life and Disability Insurance Guaranty Association

This E-Mail may contain confidential, privileged information intended only for the addressee. If you are not an addressee, or if you believe you were incorrectly designated an addressee, please do not read, copy or disseminate this message or any attachments. In that event, please permanently delete the message and call me immediately at (360) 426-6744. Thank you.

SCOPE OF EXAMINATION

This examination covers the period January 1, 2000 through December 31, 2004 and comprises a comprehensive review of the books and records of the Association. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination. The findings of the previous examination report were reviewed and any items that were not satisfactorily addressed by the Association are discussed later in the report.

Corporate records, external reference materials, and various aspects of the Association's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Association's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTION

The examiners reviewed the Association's audited financial statements as part of the statutory examination. This review was performed to determine if the Association's accounts and records were prepared and maintained in accordance with Title 48 RCW.

The following summarizes the instructions, comments and recommendations generated while performing this review.

1. Certificate of Contribution

In accordance with RCW 48.32A.085(8), ". . .the association shall issue to each insurer paying an assessment other than a class A assessment, a certificate of contribution..." The Association does not issue a certificate of contribution on the basis that the invoice and cancelled check constitute this certificate.

The Association is instructed to comply with RCW 48.32A.085 by issuing a certificate of contribution to the assessed companies, or by receiving OIC approval for substitution of the invoice and cancelled check in lieu of a certificate.

Association Response:

The Association will request approval from the OIC to substitute the invoice and cancelled check in lieu of a certificate of contribution. If approval is denied, the Association will begin issuing certificates of contribution with its next Class B assessment.

COMMENTS AND RECOMMENDATIONS

1. Internal Controls and Cash Receipts

The Executive Director (ED) handles all of the day-to-day administration of the Association as an independent contractor. WLDIGA does not have any other independent contractors or employees. The use of one person to perform all accounting functions does not provide for the important internal control of separation of duties and could result in an opportunity for transactions to be executed without appropriate oversight. For example, on many occasions, the ED receives large sums of cash which are directly remitted to the WLDIGA offices without going through its lock-box. Although the ED copies the checks and lists them on a summary sheet, no other person establishes control over the funds. Further, most payers do not require a receipt and there is no corresponding billing process against which the funds could be matched. This situation presents an obvious control deficiency which must be corrected. There may be other transactions where asset diversion is possible due to the lack of functional separation.

Since the operation uses one person to perform all accounting functions, for internal control purposes, it is essential to place all significant asset receipts and disbursements under outside control and accountability. Most receipts are directed to a bank lock-box, which thereby establishes external control over gross receipts. However, it is recommended that funds which are sent directly to the ED's office be placed under similar external control. For example, an outside agency could be engaged to receive and process all incoming mail, depositing any funds in the bank lock-box account. Non-monetary mail and any remittance advices can be sent directly to the ED. In addition, all potential fund remitters should be advised that such remittances must go directly to the bank lock-box. All other significant transactions should require at least retroactive approval by the Board of Directors (BOD).

Association Response:

The Association agrees that an exposure exists when cash payments are received directly by the Association. Accordingly, the Association has instructed all known remitters to send any funds due the Association to its bank operated lock-box. Since taking this action, no cash receipts have been received directly by the ED. The Association believes the cost of engaging an outside agency to receive and process all mail directed to the Association would provide little or no added protection and exceed the benefit of such a service.

The Association policy for cash disbursements requires two authorized signatures for any disbursement exceeding $5,000.00. This requires at least one member of the Executive Committee to be involved in any significant cash disbursement activity at the time it occurs. No evidence of non-compliance with this policy has ever been found. Further, the Board of Directors reviews and retroactively approves all of the cash disbursement activity of the Association at its annual meeting each year.

2. Property Insurance

The Association does not have any property insurance. In addition, the ED backs up all financial information on transportable storage media and keeps the backup files elsewhere on the Association's premises. In the event of a disaster, these records could be destroyed with no recoverable copies.

It. is recommended that property insurance be obtained for the records and equipment needed to restart operations after a catastrophe and ensure that recoverable records are maintained in the same event.

Association Response:

Although the Association does not have property insurance it does not believe this lack represents a significant risk. The Association does not own any of the equipment used in its day to day operations. The ED, in his capacity as an independent contractor providing services to the Association as specified by contract, is responsible for providing all equipment necessary to the operations of the Association. The ED does have property insurance that would cover the cost of replacing any equipment lost as the result of a disaster.

As noted, the ED does make regular backup copies of all computer data. While the ED does store copies of that data on the premises, copies are also stored in a fireproof container in a separate building located approximately 200 feet from the primary location. The ED also provides the Chairman of the Board of Directors of the Association with a complete duplicate copy of all computer data on a regular basis.

3. Invoice Due Date

Pursuant to RCW 48.32A.085(1), assessment invoices should be sent out at least 30 days prior to the due date. However, dates are not shown on the invoice.

To demonstrate compliance with RCW 48.32A.085(1), it is recommended that a due date be shown on the invoice. The due date should be at least 30 days after delivery of the invoice.

Association Response:

The Association added due date information to the assessment invoices it sent out in 2005. The due date shown on these invoices complied with RCW 48.32A.085 (1).

4. Assessment Limitation

Pursuant to RCW 48.32A.085(5)(a)(i), the total assessments authorized by the Association may not exceed 2% of a member's average domestic annual premiums during the three calendar years prior to an insurer's impairment or insolvency. The ED reviews each assessment to make sure that the average premium does not exceed the 2% limitation, but normal business practice presumes written corroboration of important computations.

In order to document compliance with RCW 48.32A.085(5)(a)(i), it is recommended that the computations required by that section be documented in writing.

Association Response:

The Association agrees that documenting the review of the calculation of assessments to assure that they do not exceed the 2% statutory limit is important. The Association will prepare and retain appropriate written documentation when making assessments in the future.

5. Contracts

The Association uses several third parties to perform various services. Written contracts for some of the arrangements were available, but the contracts for one third party administrator (TPA) and a consulting firm could not be located. WLDIGA stated that these agreements were contracted between the TPA/Consultant and the insolvent company's receiver or the National Association of Life and Health Insurance Guaranty Associations (NOLHGA).

In order to ensure that the appropriate services are being provided at the correct price, it is recommended that the Association obtain a copy of the contract with any TPAs or consultants.

Association Response:

The Association agrees that it is important to be able to confirm that services are being performed in accordance with the terms of the applicable contract. In the future, the Association will endeavor to obtain copies of all contracts to which it is a participating party.

6. Refund Documentation

RCW 48.32A. 125(2) requires that the OIC be notified if assessments are refunded, but there is no written documentation to prove that these notifications to the OIC took place.

In order to document compliance with RCW 48.32A.125(2), the OIC should be notified of any assessment refunds by email or some other method of assured delivery.

Association Response:

The Association has notified an individual at the OIC by email with detailed files attached including all assessment and refund activity every year for the last few years. The ED can provide copies of those emails and attachments if necessary.

7. Custodial Agreement

The Association utilizes The Bank of America as the custodian for a part of its securities. After a review of the agreement, the following departures from the NAIC Financial Condition Examiners Handbook (FCEH) were noted:

1. The agreement does not state that registered custodial securities shall be registered in the name of the company or its nominee, the custodian or its nominee, or a clearing corporation or its nominee.

2. The agreement does not have a provision that the assets of the account are withdrawable upon demand.

3. Confirmation of all transfers is not explicitly required.

4. There is no written requirement that if the custodian gains entry into a clearing corporation through an agent, there must be a written agreement making the agent equally subject to custodian's liability for loss of the securities.

5. Bank of America is not responsible for securing insurance to cover the loss of the custodial property.

It is recommended that the Association adhere to the FCEH requirements and execute a satisfactory custodial agreement with the Bank of America.

Association Response:

The Association will discuss this recommendation with the Bank of America and its legal counsel and determine whether it is possible to get a contract containing the recommended wording.

8. Conflict of Interest

WLDIGA has a conflict of interest resolution, a statement of policy, and a certification that should be signed by the BOD members, employees, agents and representatives of WLDIGA. The ED was unable to find any certifications.

In order to document that there are no conflicts of interest, it is recommended that WLDIGA obtain annual certifications from Board members, employees, agents or representatives and retain them for future reference.

Association Response:

The Association agrees it is important to document that there are no conflicts of interest. In accordance with the Association's existing policies in this regard the ED obtained signed Conflicts of Interest – Certification forms from the Board of Directors and others at the last annual meeting. This procedure will be performed annually in the future.

9. Bank Fees

The ED does not track investment fees paid to banks and the investment custodian. He believes that the Association is paying a reasonable amount but does not categorize the exact dollar amount paid.

In order to negotiate the best possible terms for investment services, the OIC recommends that the ED should obtain fee schedules and select providers accordingly.

Association Response:

The Association manages its own investment portfolio. While it uses Bank of America Securities LLC to execute its investment transactions, the Association makes its own decisions on its investments pursuant to an investment policy adopted by the Board of Directors. There are no explicit fees associated with the purchase and sale of the type of investments made by the Association. Based on its knowledge of market yields for the types of securities it purchases, the Association believes it is obtaining the best yields possible on its investments given existing market conditions. The Association has explored other methods of managing its investment portfolio and has concluded that its current approach is working satisfactorily.