

Statutory Financial Examination of
ARECA INSURANCE EXCHANGE

FE 15-01

as of December 31, 2014

Issued by
STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY AND
ECONOMIC DEVELOPMENT
DIVISION OF INSURANCE

NAIC Company Code: 16926
NAIC Group Code: 0000

FINAL REPORT:
May 26, 2016

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY AND
ECONOMIC DEVELOPMENT
DIVISION OF INSURANCE
550 WEST 7TH AVENUE, SUITE 1560
ANCHORAGE, AK 99501-3567

Order FE 15-01)
In the Matter of Examination of)
ARECA Insurance Company)

FINDINGS OF FACT

1. A report of examination of ARECA Insurance Company, domiciled in the State of Alaska, has been issued by the State of Alaska, Division of Insurance, to ARECA Insurance Company.

2. The Report of Examination of ARECA Insurance Company (FE 15-01) has been transmitted to Meera Kohler, Chair of the Board of Trustees of ARECA Insurance Company (Examinee), and Examinee has been accorded at least 30 days opportunity to review and comment on this Report of Examination. A response from the examinee was received on June 14, 2016.

3. The Director of the Division of Insurance has fully considered and reviewed the report, the examinee response and any relevant portions of the examiner's work papers to the extent she considered necessary.

CONCLUSIONS OF LAW

1. The written Report of Examination referred to in Finding of Fact No. 1 was issued in accordance with Alaska Statute (AS) 21.06.150(b).

2. The actions set forth in Finding of Fact No. 2 were conducted in accordance with AS 21.06.150(b).

3. The Director of the Division of Insurance has reviewed the Report of Examination, the examinee response and any other relevant work papers as set forth in Finding of Fact No. 3 to the extent she considered necessary in accordance with AS 21.06.150(b).

ORDER

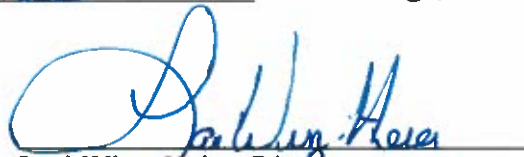
IT IS ORDERED

1. Pursuant to AS 21.06.150(b)(1), the Report of Examination of ARECA Insurance Company (FE 15-01) is approved as filed.

2. Pursuant to AS 21.06.060, the Report of Examination shall be posted on the Division of Insurance website and be available for public inspection.

This order is effective June 23rd 2016

Dated this 23rd day of June in Anchorage, Alaska.



Lori Wing-Heier, Director
State of Alaska
Division of Insurance

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THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

Department of Commerce, Community,
and Economic Development

DIVISION OF INSURANCE

550 West Seventh Avenue, Suite 1560
Anchorage, Alaska 99501-3567
Main: 907.269.7900
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May 26, 2016

Lori Wing-Heier, Director
Division of Insurance
Department of Commerce, Community
and Economic Development
State of Alaska
550 West 7th Avenue, Suite 1560
Anchorage, AK 99501-3567

Dear Director Wing-Heier:

In accordance with your instructions and authorizations, and in accordance with statutory requirements, an examination has been made of the financial condition and business affairs of:

ARECA Insurance Exchange ("the Exchange")
703 W Tudor Road
Anchorage, AK 99503

(NAIC CoCode 16926)

SCOPE OF EXAMINATION

We have performed our full-scope single-state examination of ARECA Insurance Exchange. The last examination covered the period of January 1, 2009 through December 31, 2011. This examination covers the three year period January 1, 2012 through December 31, 2014.

We conducted our examination in accordance with the NAIC *Financial Condition Examiners Handbook*. The Handbook requires that we plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the company and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes significant findings of fact, as required by AS 21.06.150 and general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (e.g. subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to other regulators and/or the company.

SUMMARY OF EXAMINATION FINDINGS

Significant Finding

The examiners found that all Board of Trustee members had not filed Conflict of Interest statements as required by company policy. This was a reoccurring finding from prior examinations. (Please see Current Finding.)

DESCRIPTION OF COMPANY

Company History

The Exchange is an Alaska-domiciled insurance company organized pursuant to Title 21, Chapter 75, of the Alaska Statutes. The Exchange is an unincorporated reciprocal exchange for assessable policies that was formed to provide workers' compensation, property, boiler and machinery, general, and automotive liability insurance to members of the Alaska Power Association (APA), formerly known as the Alaska Rural Electric Cooperative Association (the Association). ARECA Insurance Management, Inc. (AIM) is the wholly-owned attorney-in-fact for the Exchange. The Exchange received a Certificate of Authority, #D-1530, from the State of Alaska on December 30, 1983, authorizing them to transact the business of property, casualty, surety, boiler and machinery, marine and transportation, and health insurance. As of December 31, 2014, ARECA was licensed only in Alaska.

Corporate Records

The bylaws and minutes of the Board of Directors/Trustees of AIM and of the Exchange were reviewed during this examination. All board meeting notices appear to have been

given as required by the bylaws. All meetings had quorums. All actions of both AIM and the Exchange that required board approval were taken by resolution at a meeting or by resolution without a meeting as permitted by the bylaws.

The Exchange bylaws require that an annual and an organizational meeting be held each year in August or September. The annual meetings of the Exchange and of AIM were held as required by the bylaws for each year covered by this examination, and attendance included a quorum. All elections were held in accordance with bylaws and statute.

The Exchange amended their bylaws effective September 24, 2013 to allow for creation of an Executive Committee to act on behalf of the Board in certain circumstances, as well as other minor changes. The bylaws were also amended effective July 2, 2014 to exclude governmental entities from being issued assessable policies. The revised bylaws were approved by the Division and were determined to be in compliance with AS 21.69.290.

Management and Control

The Exchange is an unincorporated association of subscribers that insure the other subscribers in the Exchange. Membership in the Exchange is effective following the execution and approval of a Subscriber's Agreement between the Exchange and each member. Each subscriber has a contingent assessment liability, as provided in the subscribers' agreement, for payment of actual losses and expenses incurred while the subscriber's policy was in force. Subscribers may be required to make contributions to surplus of the Exchange from time to time as required by the Trustees in order to maintain adequate levels of surplus. Pursuant to the bylaws no one subscriber shall be assessed an aggregate liability in any one calendar year in excess of an amount equal to the direct premium for such a policy during the year.

The Exchange has a subscribers' advisory committee (Board of Trustees) that consists of one person selected by the governing body of each member. The Board of Trustees elects the Chairman of the Board of Trustees, and any other officers as the business of the Exchange may require. Following is a list of officers so elected/appointed for the Exchange as of December 31 of each year covered by this examination, as reported in the minutes of the Board of Trustees.

ARECA Insurance Exchange

NAME	TITLE	December 31,		
		2012	2013	2014
Meera Kohler	Chairman	X	X	X
Bill Nordmark	Vice Chairman	X		
Henry Strub	Vice Chairman		X	
Rick Schikora	Vice Chairman			X
Cliff Davidson	Treasurer	X		
Jodi Mitchell	Treasurer		X	X
Marilyn Leland	Secretary	X	X	
Crystal Enkvist	Secretary			X

Pursuant to a management agreement dated December 16, 1983, the affairs of the Exchange are handled by the attorney-in-fact, AIM, which is a wholly owned subsidiary of the Exchange. A Services Contract between the Exchange and the Alaska Rural Electric Cooperative Association dated August 9, 2011, requires that the attorney-in-fact receives reimbursement of proportionate employee costs from the Exchange. The Alaska Rural Electric Cooperative Association changed its name to the Alaska Power Association (APA) in 2004.

Pursuant to the bylaws of AIM, the attorney-in-fact shall have seven directors from the members of the governing bodies of the subscribers of the Exchange, and no subscriber shall provide more than one director. Any subscriber credited with more than 20% of capital and surplus of the Exchange shall be entitled to designate one director to the Board of Directors of the attorney-in-fact.

Territory and Plan of Operation

The Exchange is authorized to transact the following lines of business: property, casualty, surety, health, marine, and transportation policies. As of December 31, 2014, they were licensed only in Alaska. The Exchange's marketing strategy utilizes appointed agents to increase the number of its subscribers.

Based on the lines of business for which the Exchange is licensed, and pursuant to the requirements of AS 21.09.070, the Exchange is required to maintain minimum policyholders' surplus of \$4,125,000.

Reinsurance

The Exchange has reinsured its cumulative and individual risks through excess-of-loss per-occurrence and facultative reinsurance agreements through direct placements with various reinsurers.

As of December 31, 2014, the Exchange had a maximum retention per occurrence of \$500,000 on automobile liability and general liability; \$1,000,000 retention on workers'

compensation and property; and \$3,000,000 retention on railroad protective. Automobile liability and general liability were reinsured up to \$6,000,000 in losses; workers' compensation was reinsured up to \$11,000,000 in losses; and railroad protective was reinsured up to \$8,000,000 in losses. Excess-of-loss property reinsurance covers 100% of losses up to \$50,000,000 excess of \$1,000,000 of all physical perils excluding Boiler and Machinery, Earthquake and Flood, and 100% of losses up to \$50,000,000 excess of member deductibles with respect to Boiler and Machinery, Earthquake and Floods. The Exchange does not assume any reinsurance.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by The Exchange with the Alaska Division of Insurance and present the financial condition of the company for the period ending December 31, 2014.

FINANCIAL STATEMENTS
STATEMENT OF ASSETS, LIABILITIES AND SURPLUS
 As of December 31, 2014

	As Reported 12/31/2014	Adjustments	As Adjusted 12/31/2014
<u>Net Admitted Assets</u>			
Bonds	\$ 19,181,835		\$ 19,181,835
Common stock	7,053,207		7,053,207
Properties occupied by the company	186,536		186,536
Properties held for the production of income	177,037		177,037
Cash, cash equivalents & short term investments	2,156,729		2,156,729
Investment income due and accrued	124,192		124,192
Premiums and agents' balances in course of collection	19,817		19,817
Amounts recoverable from reinsurers	50,537		50,537
Total Admitted Assets	\$ 28,949,890		\$ 28,949,890
<u>Liabilities, Surplus and Other Funds</u>			
<u>Liabilities</u>			
Losses	\$ 4,540,544		\$ 4,540,544
Loss adjustment expenses	832,133		832,133
Other expenses (excluding taxes, licenses and fees)	270,935		270,935
Taxes, licenses and fees	36,926		36,926
Unearned premiums	714,953		714,953
Advance premium	75,398		75,398
Payable to parent, subsidiaries and affiliates	24,526		24,526
Payable for securities	497,328		497,328
Aggregate write-ins for liabilities	84,454		84,454
Total Liabilities	\$ 7,077,197		\$ 7,077,197
<u>Surplus</u>			
Aggregate write-ins for other than special surplus funds	2,622,706		2,622,706
Gross paid-in and contributed surplus	19,937,922		19,937,922
Unassigned funds (surplus)	(687,934)		(687,934)
Surplus as regards policyholders	\$ 21,872,694		\$ 21,872,694
Total Liabilities and Surplus	\$ 28,949,890		\$ 28,949,890

FINANCIAL STATEMENTS
STATEMENT OF OPERATIONS
 As of December 31, 2014

	As Reported 12/31/2014	Adjustments	As Adjusted 12/31/2014
<u>Underwriting Income</u>			
<u>Revenue</u>			
Premiums earned	\$ 4,531,551		\$ 4,531,551
Total Revenue	\$ 4,531,551		\$ 4,531,551
<u>Deductions</u>			
Losses incurred	\$ 1,520,884		\$ 1,520,884
Loss adjustment expenses incurred	748,347		748,347
Other underwriting expenses	1,669,355		1,669,355
Total underwriting deductions	\$ 3,938,586		\$ 3,938,586
Net underwriting gain or loss	\$ 592,965		\$ 592,965
<u>Investment Income</u>			
Net investment income earned	\$ 361,811		\$ 361,811
Net realized capital gains or (losses)	1,725,702		1,725,702
Net investment gain or (loss)	\$ 2,087,513		\$ 2,087,513
<u>Other Income</u>			
Finance and service charges not included in premiums	\$ 5,043		\$ 5,043
Aggregate write-ins for miscellaneous income	3,014		3,014
Total other income	\$ 8,057		\$ 8,057
Net income before dividends to policyholders	\$ 2,688,535		\$ 2,688,535
Dividends to policyholders	0		0
Net income before federal income tax	\$ 2,688,535		\$ 2,688,535
Federal income tax incurred	65,828		65,828
Net income (loss)	\$ 2,622,707		\$ 2,622,707
<u>Capital and Surplus Account</u>			
Surplus, December 31, prior year	\$ 23,023,893		\$ 23,023,893
<u>Gains and (Losses) in Surplus</u>			
Net income (loss)	\$ 2,622,707		\$ 2,622,707
Change in net unrealized capital gains (losses)	(829,640)		(829,640)
Change in net deferred income tax	65,828		65,828
Change in nonadmitted assets	(10,094)		(10,094)
Surplus adjustments: Paid in	2,804,345		2,804,345
Aggregate write-ins for gains and losses in surplus	(5,804,345)		(5,804,345)
Change in surplus as regards policyholders	\$ (1,151,199)		\$ (1,151,199)
Surplus for the period ended December 31, 2013	\$ 21,872,694		\$ 21,872,694

FINANCIAL STATEMENTS
RECONCILIATION OF SURPLUS
As of December 31, 2011 through December 31, 2014

	Allocated to Policy Holders	SURPLUS		TOTAL
		Paid-In	Unassigned	
Balance at December 31, 2011	\$ 2,591,192	\$ 17,641,435	\$ (347,235)	\$ 19,885,392
Net income – 2012			3,065,034	3,065,034
Change in net unrealized capital gains or (losses)			193,976	193,976
Change in nonadmitted assets			19,683	19,683
Surplus allocated to policy holders	3,065,034		(3,065,034)	0
Allocation of prior year surplus	(2,591,192)	2,591,192		0
Payment of capital to policy holders		(438,495)		(438,495)
Balance at December 31, 2012	\$ 3,065,034	\$ 19,794,132	\$ (133,576)	\$ 22,725,590
Net income – 2013			2,804,345	2,804,345
Change in net unrealized capital gains or (losses)			200,551	200,551
Change in nonadmitted assets			18,997	18,997
Surplus allocated to policy holders	2,804,345		(2,804,345)	0
Allocation of prior year surplus	(3,065,034)	3,065,034		0
Payment of capital to policy holders		(2,725,590)		(2,725,590)
Balance at December 31, 2013	\$ 2,804,345	\$ 20,133,576	\$ 85,972	\$ 23,023,893
Net income – 2014			2,622,707	2,622,707
Change in net unrealized capital gains or (losses)			(829,640)	(829,640)
Change in net deferred income tax			65,828	65,828
Change in nonadmitted assets			(10,094)	(10,094)
Surplus allocated to policy holders	2,622,707		(2,622,707)	0
Allocation of prior year surplus	(2,804,345)	2,804,345		0
Payment of capital to policy holders		(3,000,000)		(3,000,000)
Balance at December 31, 2014	\$ 2,622,707	\$ 19,937,921	\$ (687,934)	\$ 21,872,694

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS
RESULTING FROM THE EXAMINATION

No adjustments to the financial statements filed as of December 31, 2014 were made as a result of the examination.

FINDING AND RECOMMENDATION

Finding – Conflict of Interest Statements

It is the policy of the Exchange to require board members and officers complete conflict of interest statements annually to ensure that all potential conflicts of interest were disclosed. In 2014 three Board of Trustees members did not complete conflict of interest statements. This is a repeat exception from the prior two examinations.

Recommendation: It is recommended that the Exchange require a completed conflict of interest statement, in addition to any other documentation required, from all officers and board members before they are allowed to serve on any boards or committees.

CLOSING

This examination was conducted in accordance with practices and procedures promulgated by the NAIC. This examination also includes a compliance review of applicable Alaska Statutes and Regulations.

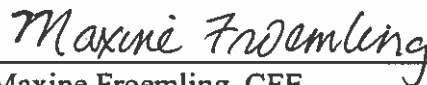
In addition to the undersigned, Wallace Thomas, Financial Examiner I from the Alaska Division of Insurance participated in the examination. Also participating in the examination were contract examiners from Risk and Regulatory Consulting, LLC as follows: Cathie Stewart, CPA, CFE, Darin Benck, CPA, CFE, Emma Bebee, Barry Ash, and Lisa Chanzit, FCAS, MAA.

We wish to express our appreciation for the courteous cooperation and assistance extended to us by the management and staff of ARECA Insurance Exchange during the course of this examination.

This report is respectfully submitted,



David Phifer, CFE
Examiner-in-Charge



Maxine Froemling, CFE
Chief Financial Examiner

AFFIDAVIT

Anchorage, Alaska)
June 1, 2016)
)
STATE OF ALASKA)
THIRD JUDICIAL DISTRICT)

I, the undersigned, being duly sworn, do verify that the report of examination as of December 31, 2014, of ARECA Insurance Exchange, an Alaska-domiciled company holding Certificate of Authority #D-1530, is true to the best of my knowledge and belief.

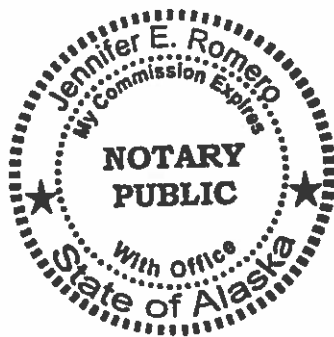
David Phifer

David Phifer, CFE
Examiner-in-Charge

Maxine Froemling

Maxine L. Froemling, CFE
Chief Financial Examiner

Subscribed and sworn to before me this 1st day of June, 2016.



Jennifer E. Romero
Notary Public for the State of Alaska

My commission expires: With Office