

Statutory Financial Examination of
ALASKA VISION SERVICES, INC.

FE 16-01

as of September 30, 2015

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

NAIC Company Code: 47201
NAIC Group Code: 1189

FINAL REPORT
September 8, 2016



THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

Department of Commerce, Community,
and Economic Development

DIVISION OF INSURANCE

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September 8, 2016

Lori Wing-Heier, Director
Division of Insurance
Department of Commerce, Community,
and Economic Development
State of Alaska
550 West Seventh 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:

Alaska Vision Services, Inc.
530 7th Avenue
Fairbanks, AK 99701

(NAIC CoCode 47201; Group Code 1189)

SCOPE OF EXAMINATION

We have performed the full-scope, single-state examination of Alaska Vision Services, Inc. (AVS or the Company). The examination covered the period of January 1, 2013 through September 30, 2015. Transactions subsequent to the initial full-scope examination period were reviewed where deemed appropriate. The last examination of the Company covered the period of January 1, 2009 through December 31, 2011, with a roll-forward of the examination covering the period of December 31, 2011 through December 31, 2012.

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 are 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.

ORDER

IT IS ORDERED

1. Pursuant to AS 21.06.150(b)(1), the Report of Examination of Alaska Vision Services, Inc. (FE 16-01) 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 December 15, 2016.

Dated this 15th day of December in Anchorage, Alaska.



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

TABLE OF CONTENTS

Salutation	1
Scope of Examination.....	1
Summary of Examination Findings	2
Significant Findings	2
Description of Company.....	2
Company History.....	2
Corporate Records.....	3
Management and Control.....	3
Territory and Plan of Operation	4
Summary of Actuarial Review	4
Financial Statements (As of September 30, 2016)	4
Statement of Assets, Liabilities and Surplus	5
Statement of Revenue and Expenses.....	6
Reconciliation of Surplus - January 1, 2013 - September 30, 2015	7
Analysis of Changes in Financial Statements Resulting from Examination.....	8
Subsequent Events.....	8
Summary of Examination Findings and Recommendations	8
Finding 1 - Authorization of Investment Transactions and Written Plan.....	8
Finding 2 - Member Annual Meetings and Appointments of Directors.....	9
Finding 3 - Excess Holdings in Investments of a Single Person.....	9
Closing	10
Affidavit	11

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. Other items may be identified during the examination that, due to their nature (e.g. subjective conclusions, proprietary information, etc.), are not included within the examination report but are separately communicated to other regulators and/or the Company.

SUMMARY OF EXAMINATION FINDINGS

Significant Findings

The Company was found to be out of compliance with the following statutory requirements:

- Finding 1 – Authorization of Investment Transactions and Written Plan
- Finding 2 – Member Annual Meetings and Appointments of Directors
- Finding 3 – Excess Holdings in a Single Investment

DESCRIPTION OF COMPANY

Company History

AVS is an Alaska-domiciled medical service corporation organized pursuant to Title 21, Chapter 87 (Hospital and Medical Service Corporations) of the Alaska Statutes. AVS was organized as a not-for-profit corporation (pursuant to AS 10.20) on April 27, 1965 “exclusively for the promotion of social welfare within the meaning of Section 501(c)(4) of the Internal Revenue Service” per its Articles of Incorporation. AVS received a Certificate of Authority (D 1411) from the State of Alaska, Division of Insurance effective June 3, 1982 authorizing the Company to transact the business of a medical service corporation, (ophthalmology and optometry).

In 1988, AVS contracted with California Vision Service Plan of Sacramento, California (VSP) for plan administration, and VSP became the controlling member. VSP is a non-stock, not-for-profit corporation operating in the State of California that controls several vision service plans in the United States.

The IRS revoked the tax exempt status of VSP and other subsidiaries, including AVS, effective January 1, 2003. After losing a lawsuit with the U.S. District Court in Sacramento in 2005, VSP filed an appeal with the U.S. Court of Appeals for the Ninth Circuit, which ruled in January 2008 that VSP does not qualify for exemption under IRS 501(c)(4). VSP appealed to the U.S. Supreme Court, which denied a hearing of the case in 2010, effectively ending the appeal process and letting stand the IRS revocation of the group’s tax exempt status. During the appeal period and subsequent, AVS, licensed as a medical service corporation under AS 21.87, continued to operate as a not-for-profit corporation under the laws of the State of Alaska – Title 10, Chapter 20 (Nonprofit Corporations Act) of the Alaska Statutes – even while paying federal taxes.

Effective November 1, 2015, AVS and Vision Service Plan, Inc. merged with VSP Vision Care, Inc., which was as the surviving entity. See the “Subsequent Events” section below.

Corporate Records

AVS agreed to operate under a Consent Judgment and Order (Judgment) entered in the Superior Court for the State of Alaska, Third Judicial District, at Anchorage dated January 21, 1981. This Judgment includes orders as follows.

- (a) The amended bylaws of AVS shall provide that the Board of Directors would be composed of three members who are licensed optometrists and ophthalmologists, and four consumer representatives who are not licensed optometrists or ophthalmologists.
- (b) The Board of Directors shall have exclusive authority to determine the fees paid to providing doctors in consideration for vision services rendered to subscribing members.
- (c) In determining the fees paid to providing doctors, the board shall adopt a fee schedule based on usual and customary fees charged by optometrists and ophthalmologists in the community for similar vision services rendered to subscribing and non-subscribing members.
- (d) Fee information collected by the board is limited for use solely in determining usual and customary fees.
- (e) AVS is permanently enjoined and restrained from, in any manner, directly or indirectly engaging in any other contract, combination, agreement, understanding, or concert of action in restraint of trade or commerce.

The Articles of Incorporation and Bylaws were reviewed during this examination. Bylaws in effect during the examination years were the Amended Bylaws, effective April 8, 1999. There were no amendments to the Company's Articles of Incorporation during the period under examination. Annual Board of Director meetings and elections were held each year as required by the Articles and Bylaws.

Management and Control

VSP, a not-for-profit California corporation, is the sole voting and controlling member with one vote that can be exercised in person or by proxy. AVS has arranged for use of the VSP federally registered and common law service marks through an Administration and Marketing Agreement dated August 25, 1997. VSP also started providing administrative and managerial services to AVS through an Administration and Marketing Agreement dated February 10, 1998, amended September 30, 2003, and most recently amended effective January 1, 2008.

No significant management control changes have occurred since the previous examination. There have been no significant changes in executive management of AVS during the period covered by this examination.

AVS is party to an inter-company tax allocation agreement with VSP whereby the federal income tax return is filed on a consolidated basis. Additionally, VSP provides administrative and marketing services for AVS as detailed in an administration and marketing agreement. Allocation of cost is based on the percentage of written premiums among the entities within the VSP group.

Territory and Plan of Operation

AVS is an Alaska-domiciled medical service corporation. Its primary purpose is to provide prepaid vision services to individuals residing and working in the state of Alaska.

Under the Administration and Marketing Agreement described above, VSP provides all marketing services to AVS and markets AVS plans to non-subscriber beneficiary groups in Alaska. These marketing services include, but are not limited to, providing all sales and marketing personnel with needed support to maximize sales, providing marketing training to the sales personnel of AVS, and paying all normal operating expenses.

SUMMARY OF ACTUARIAL REVIEW

The actuarial opinion and memorandums supporting the opinions were prepared by the independent appointed actuary Frederick Kilbourne of The Kilbourne Company for each year in 2013 and 2014. Additionally, the independent auditors Deloitte & Touche, LLP (Deloitte) independently calculated the reserve balances and found them to be within a reasonable range. AVS held reserves that were conservative relative to the independent actuary and Deloitte estimates.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the Alaska Division of Insurance and present the financial condition of the Company for the period ending September 30, 2015.

FINANCIAL STATEMENTS
STATEMENT OF ASSETS, LIABILITIES, AND SURPLUS
 As of September 30, 2015

<u>Assets</u>		<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$ 5,352,126	\$	\$ 5,352,126
Cash & short-term investments	2,870,153		2,870,153
Investment income due & accrued	35,628		35,628
Uncollected premiums and agents's balances in course of collection	83,603	1,392	82,211
Amounts receivable relating to uninsured plans	1,066,774		1,066,774
Current federal income tax recoverable and interest thereon	31,324		31,324
Deferred tax asset	61,061		61,061
Total Assets	\$ 9,500,669	\$ 1,392	\$ 9,499,277

<u>Liabilities</u>	<u>Covered</u>	<u>Uncovered</u>	<u>Total Liabilities</u>
Claims unpaid	\$ 100,834	\$	\$ 100,834
Unpaid claims adjustment expenses	1,007		1,007
Premiums received in advance	37,732		37,732
General expenses due or accrued	113,654		113,654
Remittances and items not allocated	8,740		8,740
Amounts due to parent, subsidiaries and affiliates	75,304		75,304
Liability for amounts held under uninsured plans	5,946		5,946
Taxes, licenses and fees payable	11,592		11,592
Escheatable checks	13,612		13,612
Total Liabilities	\$ 368,421	\$ 0	\$ 368,421

<u>Surplus</u>	
Health insurer assessment	\$ 32,977
Aggregate write-ins for other than surplus funds	50,000
Unassigned funds (surplus)	9,047,879
Surplus as regards policyholders	<u>\$ 9,130,856</u>
Total Liabilities and Surplus	\$ 9,499,277

FINANCIAL STATEMENTS
STATEMENT OF REVENUE AND EXPENSES
 As of September 30, 2015

	Uncovered	Total
Net premium income	\$ XXX	\$ 1,873,706
Fee-for-service		152,470
Total revenues	\$ XXX	\$ 2,026,176
Hospital/ medical benefits	\$	\$ 0
Other professional services		1,316,013
Subtotal	\$ 0	\$ 1,316,013
Less: Net reinsurance recoveries		0
Total hospital and medical	\$ 0	\$ 1,316,013
Claims adjustment expenses		15,278
General administrative expenses		176,006
Total underwriting deductions	\$ 0	\$ 1,507,297
Net underwriting gain or (loss)	\$ XXX	\$ 518,879
Net investment income earned		43,526
Net realized capital gains (losses)		0
Net investment gains or (losses)	\$ 0	\$ 43,526
Net gain or (loss) from agents' or premium balances charged off		0
Net income or (loss) before federal income taxes	XXX	\$ 562,405
Federal and foreign income taxes incurred	XXX	222,170
Net Income (Loss)	\$ XXX	\$ 340,235

FINANCIAL STATEMENTS
RECONCILIATION OF SURPLUS
 December 31, 2012 - September 30, 2015

	Statutory Reserve	SURPLUS		TOTAL
		Paid In	Unassigned	
Balance at December 31, 2012	\$ 50,000	\$ 0	\$ 7,725,165	\$ 7,775,165
Net income - 2013			479,868	479,868
Change in net deferred income tax			8,448	8,448
Change in nonadmitted assets			(367)	(367)
Balance at December 31, 2013	\$ 50,000	\$ 0	\$ 8,213,114	\$ 8,263,114
Net income - 2014			511,431	511,431
Change in net deferred income tax			6,051	6,051
Change in nonadmitted assets			(282)	(282)
Balance at December 31, 2014	\$ 50,000	\$ 0	\$ 8,623,736	\$ 8,780,314
Net income - 2015			340,235	340,235
Change in net deferred income tax			10,341	10,341
Change in nonadmitted assets			(34)	(34)
Balance at September 30, 2015	\$ 50,000	\$ 0	\$ 9,080,856	\$ 9,130,856

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS RESULTING FROM THE EXAMINATION

No adjustments to the financial statements filed as of September 30, 2015 were made as a result of the examination.

SUBSEQUENT EVENTS

Effective November 1, 2015, AVS merged with an affiliate, VSP Vision Care, Inc., a Virginia domiciled non-profit health insurer and the surviving corporation. VSP Vision Care, Inc. was approved for a Certificate of Authority in Alaska as a part of the merger plan. The merger was approved by the Director, on October 30, 2015, following a public hearing. Following the merger and transfer of business, it was agreed that AVS would file zero-balance statutory year-end and quarterly financial statements until the completion and filing of the examination report for this statutory financial examination. Following the acceptance of this examination report, AVS would be able to surrender their Certificate of Authority.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

Finding 1 – Authorization of Investment Transactions and Written Plan

The board of directors or a committee of the board of directors charged with the responsibility to direct its investments (Finance Committee for AVS) is required to take actions pursuant to AAC 21.211 (b) and (c) as follows:

- (b) (b) An investment acquired, held, and invested in under 3 AAC 21.201 -- 3 AAC 21.399 must be acquired and held under the supervision and direction of the board of directors of the insurer. The board of directors shall evidence by formal resolution, at least annually, that it has determined that each investment has been made in accordance with delegations, standards, limitations, and investment objectives prescribed by the board of directors or a committee of the board of directors charged with the responsibility to direct its investments.
- (c) (c) On at least a quarterly basis, and more often if considered appropriate, an insurer's board of directors or committee of the board of directors shall
 - (1) receive and review a summary report on the insurer's investment portfolio, the insurer's investment activities, and the insurer's investment practices engaged in under delegated authority, to determine whether the portfolio, activities, and practices are consistent with the written plan; and
 - (2) review and revise, as appropriate, the written plan.

A review of the annual board minutes of AVS indicate "... that the investment transactions of AVS that have occurred since the last meeting are hereby approved." There is no indication of a formal resolution. This is a repeated finding from the two prior examinations. Additionally, a review of the Finance Committee minutes does not appear to reflect that there has been a review of investment transactions to determine if they are consistent with the written investment plan.

Recommendation: Based on the merger of AVS with VSP Vision Care, Inc. (a non-Alaska affiliate) effective November 1, 2015, compliance with Alaska statute is no longer applicable.

Finding 2 – Member Annual Meetings and Appointments of Directors

The Member meetings held were in violation of Alaska Statute 21.69.310(c), which states that Member meetings are to be held within the first six (6) months of the calendar year. The annual Member meetings held in 2013 and 2014 were held on December 23rd and December 16th, respectively. The annual Member meeting for 2015 was held on September 8th. The Company failed to comply with this statute for all years under examination.

Recommendation: Based on the merger of AVS with VSP Vision Care, Inc. (a non-Alaska affiliate) effective November 1, 2015, compliance with Alaska statute is no longer applicable.

Finding 3 – Excess Holdings in Investments of a Single Person

At September 30, 2015, the Company was not in compliance with 3 AAC 21.231(a) "General single issuer diversification, medium-grade investments and lower-grade investments, and Canadian investments for a life and health insurer" that states the following:

- (a) Except as otherwise provided in 3 AAC 21.201 - 3 AAC 21.399, a life and health insurer may not acquire, hold, or invest in, directly or indirectly through an investment subsidiary, an investment under 3 AAC 21.201 - 3 AAC 21.399 if, as a result of and after giving effect to the investment, the life and health insurer would hold more than three percent of its admitted assets in investments of all kinds issued, assumed, accepted, insured, or guaranteed by a single person.

The Company held \$501,066 in Toyota Motor Credit Corp bonds at September 30, 2015 which was approximately 5.3% of the Company's admitted assets.

Recommendation: Based on the merger of AVS with VSP Vision Care, Inc. (a non-Alaska affiliate) effective November 1, 2015, compliance with Alaska statute is no longer applicable.

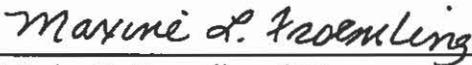
CLOSING

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.

An affidavit of the Examiner-in-Charge, Cathie Stewart, CFE, with Risk and Regulatory Consulting, LLC, is on file with the Alaska Division of Insurance and attests that the examination was performed in a manner consistent with the standards and procedures required by the Alaska Division of Insurance and the NAIC *Financial Condition Examiners Handbook*. In addition to the undersigned, the following examiners participated in the examination: Richard B. Foster, Insurance Financial Examiner II, CFE, Division of Insurance; and, Contract Examiners including: Darin D. Benck, CFE, and Emma A. Bebee, CPA, of Risk and Regulatory Consulting, LLC.

We wish to express our appreciation for the courteous cooperation and assistance extended to us by the management and staff of Alaska Vision Services, Inc. during the course of this examination.

This report is respectfully submitted,



Maxine L. Froemling, CFE
Chief Financial Examiner

AFFIDAVIT

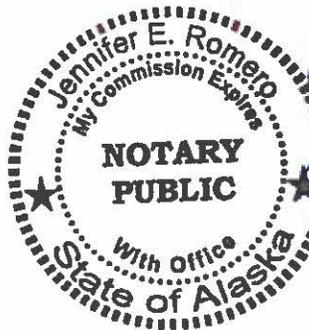
Anchorage, Alaska
December 2, 2016

STATE OF ALASKA
THIRD JUDICIAL DISTRICT

I, the undersigned, being duly sworn, do verify that the report of examination dated September 8, 2016, of Alaska Vision Services, Inc., an Alaska domiciled company holding Certificate of Authority D-1411, is true to the best of my knowledge and belief.

Maxine Froemling
Maxine L. Froemling, CFE
Chief Financial Examiner

Subscribed and sworn to before me this 2nd day of December, 2016.



Jennifer E. Romero
Notary Public for the State of Alaska
My commission expires: With Office