

Statutory Financial Examination of  
**Tongass Timber Trust**

FE07-04

as of December 31, 2006

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

**FINAL REPORT:**  
**September 5, 2008**

STATE OF ALASKA  
DEPARTMENT OF COMMERCE, COMMUNITY, AND ECONOMIC DEVELOPMENT  
DIVISION OF INSURANCE  
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STATE OF ALASKA  
DEPARTMENT OF COMMERCE, COMMUNITY,  
AND ECONOMIC DEVELOPMENT  
DIVISION OF INSURANCE  
550 W. 7<sup>th</sup> Avenue, Suite 1560  
Anchorage, AK 99501

Order FE07-04 )  
In the Matter of Examination of )  
Tongass Timber Trust )

FINDINGS OF FACT

1. A report of examination of Tongass Timber Trust, domiciled in the State of Alaska, has been issued by the State of Alaska, Division of Insurance, to Umialik Insurance Company.
2. The Report of Examination of Tongass Timber Trust (FE07-04) has been transmitted to Mr. Owen Graham, Executive Director, Tongass Timber Trust (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 October 8, 2008.
3. The Director of the Division of Insurance has fully considered and reviewed the report 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 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).

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ORDER

IT IS ORDERED

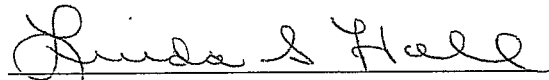
1. Pursuant to AS 21.06.150(b)(1), the Report of Examination of Tongass Timber Trust (FE07-04) is approved as filed.

2. Pursuant to AS 21.06.060, the Report of Examination shall be kept in the Office of the Director of the Division of Insurance and be open to public inspection.

3. The Examinee will implement all recommendations within a reasonable amount of time but no later than one year from the issue date of this examination report, unless otherwise recommended in the Report of Examination. Failure to implement compliance recommendations may result in action against the Examinee for violation of this order.

This order is effective Oct. 14, 2008.

Dated this 14<sup>th</sup> day of October, 2008 at Anchorage, Alaska.



Linda S. Hall, Director  
State of Alaska  
Division of Insurance

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August 29, 2008

Ms. Linda S. Hall, Director  
Division of Insurance  
Department of Commerce, Community,  
and Economic Development  
State of Alaska  
550 West 7<sup>th</sup> Avenue, Suite 1560  
Anchorage, AK 99501-3567

Dear Director Hall:

In accordance with Alaska Statute (AS) 21.06.120, an examination has been made as of December 31, 2006, of the affairs and financial condition of:

Tongass Timber Trust  
111 Stedman Street, Suite 200  
Ketchikan, AK 99901

Division insurance financial examiners conducted the fieldwork on this examination.

The examination covers the two-year period from January 1, 2005, through December 31, 2006, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

Statutory financial statements as of December 31, 2006, are included. This report includes a summary of the actuarial review of reserve adequacy as of December 31, 2006, conducted by Ms. Katie Campbell, FSA, MAAA, Actuary for the Division of Insurance, State of Alaska, as a part of this examination process.

## **SCOPE OF EXAMINATION**

This examination covered the two-year period from January 1, 2005, to December 31, 2006. Transactions subsequent to this period were reviewed where deemed appropriate. This is the first statutory financial examination of the Trust since receiving its license as a multiple employer welfare arrangement (MEWA) on June 16, 2005.

The examination was conducted in accordance with the rules and regulations of the Division of Insurance, State of Alaska.

The work papers of the Trust's independent certified public accountants, Milner, Howard, Mortensen, Palmer & Johnson, P.C. (Milner), were reviewed and relied on where it was determined to be appropriate. The appropriate Milner work papers have been incorporated into the examination work files.

This report is an exception-oriented report commenting only on areas where further explanation or reporting of findings is considered necessary. This examination included a review of the Trust's compliance with Alaska statutes.

## **DESCRIPTION OF COMPANY**

### **Company History**

Tongass Timber Trust (Tongass Timber, or the Trust), is an Alaska-domiciled multiple employer welfare arrangement (or MEWA) organized pursuant to Title 21, Chapter 85 of the Alaska Statutes (AS). Tongass Timber Trust was originally established as an employee health and welfare plan in 1964 by the Alaska Loggers Association, Inc., the precursor to the Alaska Forest Association, Inc., in order to provide group health, life insurance and accidental death and dismemberment benefits for workers employed by member firms. The Trust applied for and received a certificate of authority to operate as a multiple employer welfare arrangement on June 16, 2005.

### **Management and Control**

Tongass Timber was formed using monies in trust from the Alaska Forest Association (AFA, or the Association), its sponsor.

The MEWA's trust documents provide that the trust fund shall be administered by a board of five Trustees, each considered an agent of the trust fund. Trustees are appointed by the Nominating Committee of the Alaska Forest Association and serve until resignation, death, or termination by the Nomination Committee.

During the period under examination, Tongass Timber Trust's Board of Trustees consisted of five individuals at year-end 2005 and only four at year-end 2006 as follows:

NAME	RESIDENCE	TITLE	AS OF
Keaton Gildersleeve	Oregon	Chairman	1993 – Present
Leo Gellings	Oregon	Trustee	1984 – Present
Jerry Larrabee	Arizona	Trustee	1977 – Present
Robert Byers	Alaska	Trustee	2004 – Present
John Rivers	Alaska	Trustee	2004 – 2006

The Trust's Executive Director, Mr. Owen Graham, though not a Trustee, attends all Board of Trustee meetings.

Tongass Timber Trust holds its annual meeting in October of the year concurrent with the Alaska Forest Association's annual meeting. The Board also has one other regularly-scheduled meeting in March and meets in special meetings throughout the year when necessary.

The Trust employs six individuals to oversee and maintain the operation of the Trust. The six positions consist of: Executive Director, Benefits Administrator, Executive Assistant, Eligibility and Premiums Manager, Claims Supervisor, and an office assistant. The Trust's executive director, Mr. Owen Graham, has served in this capacity since 2001.

### **Affiliated Companies**

Tongass Timber Trust was formed using monies in trust from the Alaska Forest Association. The Trust is affiliated with the Alaska Loggers Association Retirement Plan, a subsidiary of the Association which administers the Association's retirement and pension accounts.

### **Corporate Records**

The Trust maintains all business records at the Trust's home office in Ketchikan, Alaska. In accordance with state regulations, the Trust maintains adequate Minutes of the Board of Trustees at the Trust's home office.

### **Fidelity Bond and Other Insurance**

Through January 1, 2006, the Trust was covered by a \$500,000 fidelity bond issued by the CNA Insurance Companies through a local insurance broker. In 2006, the Trust entered into a fiduciary liability and defense costs coverage agreement underwritten by Federal Insurance Company, a member of the Chubb Group of Insurance Companies, with a maximum \$2 million of coverage in any one policy year on any one loss or in the aggregate in excess of a \$1,000 deductible.

### **Officers', Employees' and Agents' Welfare and Pension Plans**

Tongass Timber Trust, through Alaska Forest Association, Inc., maintains a voluntary 401(k) retirement plan for its employees. Under the provisions of the 401(k) plan, eligible participants may contribute up to 15% of their salaries subject to certain limitations. Alaska Forest Association, Inc., matches 3% of each participant's salary.

Through July 31, 2003, Tongass Timber Trust contributed to a defined benefit retirement plan for its employees. On August 1, 2003, the Plan trustees froze the defined benefit plan and replaced it with a defined contribution plan. On January 1, 2005, the trustees increased the contribution rate to the plan from \$1 to \$3 per hour for covered employees; of which \$2.50 of the contribution was allocated to the defined benefit plan in order to make up the plan's unfunded liability, with the remaining \$.50 credited to the individual accounts of covered participants in the defined contribution plan.

### **Territory and Plan of Operation**

The Trust provides health benefits (medical, hospital, surgical, major medical and dental), temporary benefits and death benefits to full-time employees of member companies of the Alaska Forest Association, and to their beneficiaries and covered dependents. Employees must work at least 100 hours per month for two-consecutive months to begin eligibility and 100 hours per month thereafter to maintain eligibility.



**Growth of the Company**

The following exhibit shows the results of Tongass Timber Trust's operations for the period 2004-2006. The figures are taken from the Company's annual financial statements filed for these years:

Year	Direct Premiums Written	Net Premiums Written	Assets	Liabilities	Reserves
2004	\$2,721,483	\$2,594,349	\$6,793,617	\$449,140	\$6,344,477
2005	\$2,479,426	\$2,322,198	\$6,912,812	\$512,214	\$6,400,598
2006	\$2,575,987	\$2,410,920	\$6,618,834	\$606,062	\$6,012,772

**Business Written by State**

Tongass Timber writes group health and life insurance benefits for workers employed by member firms and is only licensed within the state of Alaska.

**Loss Experience**

The following exhibit shows the Company's loss experience for the years covered by the examination period:

Year	Contributions Earned	Losses Incurred	Loss Incurred Ratio	Expenses Incurred	Expense Ratio
2004	\$2,595,691	\$1,477,536	56.9%	\$582,006	22.4%
2005	\$2,322,096	\$1,901,192	81.9%	\$522,374	22.5%
2006	\$2,410,433	\$2,719,651	112.8%	\$829,256	34.4%

**Reinsurance**

As a MEWA, the Trust provides for pass-through of life insurance premiums to a group life policy underwritten by Mutual of Omaha. Additionally, the Trust maintains a stop-loss policy underwritten by QBE Insurance Corporation covering \$1 million per covered person excess of \$200,000, the Trust's maximum retention per covered individual.

The Trust does not cede any business and maintains no credit for ceded reserves.

### Accounts and Records

The Trust utilizes a small business mainframe computer server-edition running a DOS-based software program from Eldorado Health Benefits Management Solutions (Eldorado) that maintains policy information, claim information and processing, eligibility of individuals based on hours worked each month, billing by group, and payments received. The Trust's executive assistant, utilizing PeachTree software and Quatro-Pro/Excel spreadsheets, maintains the financial account information, check registers, and bank reconciliations on a stand-alone computer. These records are backed up nightly on zip-disks.

In addition, the Benefits Administrator records and maintains a separate Excel spreadsheet of employer debits and credits on a monthly basis that is backed up daily on to the network server and on the server's daily backup tapes. She produces hard-copy files of the monthly reports from each employer which are retained for review. She also maintains a major income and expense spreadsheet that is distributed monthly to the Trustees and consultants to inform them of the current financial position of the Trust. This is also backed up daily on the network server and backup tapes. Current backup tapes are protected in a fire-proof safe and replaced daily.

### SUMMARY OF ACTUARIAL REVIEW

Ms. Katie Campbell, FSA, MAAA, Actuary with the Division of Insurance, State of Alaska, reviewed the adequacy of Tongass Timber Trust's December 31, 2006, loss and loss expense reserves. In performing the analysis, reliance was placed on the loss and loss expense data provided by the Trust's consulting actuaries, and on the data contained in their 2006 Annual Statement. The actuarial analysis performed as part of this financial examination resulted in the following conclusion:

It is my opinion that the reserve assumptions and methodology are reasonable and the resulting unpaid claim reserve is in compliance with AS 21.85. The actuary appropriately added additional margin to the unpaid claim reserve to reflect that the Trust is small and experience volatile and not fully credible. Historical claim data show that the unpaid claim reserves have been sufficient in the past 5 years.

However, it was further noted that:

In the future the actuarial work should include justification for the unpaid claim adjustment expense reserve. Based on the historical claim and expense data in the 2006 financial statement the claim adjustment expense reserve estimate is low. However, Tongass Timber Trust certainly had sufficient/excess surplus to cover any additional claim adjustment expenses.

**COMPLIANCE WITH RECOMMENDATIONS IN  
PRIOR REPORT OF EXAMINATION**

As the first statutory financial examination of Tongass Timber Trust, there are no prior reports with recommendations.

**FINANCIAL STATEMENTS**

The following financial statements represent the financial position of Tongass Timber Trust as of December 31, 2006:

**FINANCIAL STATEMENTS  
STATEMENT OF ASSETS, LIABILITIES, AND RESERVES  
As of December 31, 2006**

	<u>As Reported</u>	<u>Adjustment</u>	<u>Finding Number</u>	<u>As Adjusted</u>
<u>Assets</u>				
Bonds	\$ 1,367,881			\$ 1,367,881
Common stocks	2,739,958			2,739,958
Cash on hand and on deposit	210,095			210,095
Short-term investments	285,544			285,544
Write-ins for invested assets	1,866,385			1,866,385
Subtotals, cash and invested assets	<u>\$ 6,469,863</u>			<u>\$ 6,469,863</u>
Uncollected contributions	\$ 24,150			\$ 24,150
Interest and other investment income due and accrued	17,356			17,356
Furniture and equipment	5,394			5,394
Write-ins for other than invested assets	102,071			102,071
Total Assets	<u>\$ 6,618,834</u>			<u>\$ 6,618,834</u>
<u>Liabilities and Reserves</u>				
Claims and claims adjustment expenses unpaid	\$ 557,000			\$ 557,000
Unearned contributions	1,119			1,119
Other expenses due or accrued	47,943			47,943
Total liabilities	<u>\$ 606,062</u>			<u>\$ 606,062</u>
Earned surplus	6,012,772			6,012,772
Total reserves	<u>\$ 6,012,772</u>			<u>\$ 6,012,772</u>
Total liabilities and reserves	<u>\$ 6,618,834</u>			<u>\$ 6,618,834</u>

Tongass Timber Trust  
as of December 31, 2006  
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**FINANCIAL STATEMENTS**  
**STATEMENT OF OPERATIONS**  
As of December 31, 2006

	<u>As Reported</u>	<u>Adjustments</u>	<u>Finding Number</u>	<u>As Adjusted</u>
<u>Underwriting Income</u>				
Contributions earned	\$ 2,410,433			\$ 2,410,433
<u>Deductions</u>				
Claims and claims adjustment expenses incurred	2,719,651			2,719,651
Administrative and soliciting expenses incurred	829,256			829,256
Total underwriting deductions	<u>\$ 3,548,907</u>			<u>\$ 3,548,907</u>
NET UNDERWRITING GAIN (LOSS)	<u>(\$ 1,138,474)</u>			<u>(\$ 1,138,474)</u>
<u>Investment Income</u>				
Net investment income earned	\$ 196,132			\$ 196,132
Net realized capital gains (losses)	63,610			63,610
NET INVESTMENT GAIN (LOSS)	<u>\$ 259,742</u>			<u>\$ 259,742</u>
NET GAIN (LOSS)	<u>(\$ 878,732)</u>			<u>(\$ 878,732)</u>
<u>Reconciliation of Reserves</u>				
Total reserves, December 31 prior year	<u>\$ 6,400,598</u>			<u>\$ 6,400,598</u>
<u>Gains and (Losses) in Reserves</u>				
Net gain (loss)	(\$ 878,732)			(\$ 878,732)
Net unrealized capital gains or (losses)	490,906			490,906
Change in reserves for the year	<u>(\$ 387,826)</u>			<u>(\$ 387,826)</u>
Total reserves, December 31 current year	<u>\$ 6,012,772</u>			<u>\$ 6,012,772</u>

Tongass Timber Trust  
as of December 31, 2006  
FE 07-04

**FINANCIAL STATEMENTS**  
**STATEMENT OF CAPITAL AND RESERVE ACCOUNT**  
As of December 31, 2006

	<b>RESERVES</b>		<b>TOTAL</b>
	<u>Paid-In</u>	<u>Earned Surplus</u>	
Balance at December 31, 2003	-0-	\$5,479,540	\$5,479,540
Net gain (loss) – 2004		802,348	802,348
Net unrealized capital gains (losses)		62,589	62,589
Balance at December 31, 2004	-0-	\$6,344,447	\$6,344,447
Net gain (loss) – 2005		136,488	136,488
Net unrealized capital gains (losses)		(80,367)	(80,367)
Balance at December 31, 2005	-0-	\$6,400,598	\$6,400,598
Net gain (loss) – 2006		(878,732)	(878,732)
Net unrealized capital gains (losses)		490,906	490,906
Balance at December 31, 2006	<u>-0-</u>	<u>\$6,012,772</u>	<u>\$6,012,772</u>

**ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS**  
**RESULTING FROM EXAMINATION**

There were no recommended adjustments to the Trust's financial statements as a result of this examination.

**FINDINGS AND RECOMMENDATIONS**

**Finding 1 – Use of Independent Auditor**

The Trust utilizes its independent auditor to verify and, on occasion, reconcile its accounting functions on an ongoing basis as a last-stop reviewer. Specifically, monthly premium receipts review, monthly claim payments review, and in some instances, verification of bank reconciliations are done by the independent auditor jeopardizing the auditor's independence when opining on the Trust's annual audited statement.

Recommendation: It is recommended that the Trust develop and implement an internal process of checks-and-balances to verify amounts reported on a monthly basis rather than rely on the independent auditor to reveal undiscovered errors or discrepancies.

**Finding 2 – Loss Reserves Not Adjusted Throughout the Year**

The Trust carries forward prior year-end loss reserves established by their consulting actuary throughout the subsequent year. No adjustments are made based on claims filed or claims paid. As a result, neither the Trust nor the division has an accurate understanding of the real unpaid claim liability during the year.

Recommendation: It is recommended that the Trust make a reasonable estimation of unpaid claims no less than quarterly throughout the year to be reported in quarterly statutory financial statement filings to the division.

**Finding 3 – Attendance of Governing Board of Trustees**

The Trust's Board of Trustees was found to be in non-compliance with their own trust agreement which provides that the Trust be administered by a board of five Trustees. In their 2006 annual statement filing, the Trust only reported a board of four Trustees.

In 2005, while there were five Trustees listed in statutory filings with the Division, only four or fewer appeared actively involved in decision-making throughout the year and the Board's chairman had not been reported in attendance at any meeting for more than 18 months, spanning a period between April, 2004, and December, 2005. During these meetings, it appears the Executive Director, a non-board member, conducted the order of business. Only three Trustees were in attendance at the 2005 annual meeting. Through 2006, of the three Board of Trustee's meetings held, there were three Trustees in attendance at the Spring meeting and only two in attendance in the other two meetings, including the Annual membership meeting and the Annual meeting of the Board.

Recommendation: It is recommended that the Trust maintain an effective governing board of five Trustees, as stipulated in its trust agreement, who are in regular attendance at all meetings.

#### Finding 4 – Self-Funding Business Outside Allowed Lines

As a multiple employer welfare arrangement, the Trust is restricted under AS 21.85.030(a)(4) to providing only allowable benefits defined under AS 21.85.500(1) as medical care. Pursuant to a review of the Trust's policies, claims disbursements, and reserves, it was noted the Trust is underwriting and self-funding disability benefits. Disability benefits are not defined as medical care under Alaska statutes.

Recommendation: It is recommended that the Trust: 1) eliminate disability income as a covered benefit, 2) request for and received approval of the director of the Division of Insurance to offer this benefit, or 3) purchase 100% coverage specific to the risk offered by the Trust from an authorized insurer.

#### Finding 5 – Abandoned Property Subject to Escheatment

A review of the outstanding check register indicated 78 checks more than 3 years old that should be defined as abandoned property and subject to custody of the state. The amount calculated for escheatment totals \$8,646.26 and was considered immaterial for examination purposes.

Recommendation: It is recommended that the Trust recognizes property considered abandoned as defined by AS 34.45.110, and develop procedures pursuant to AS 34.45.120 and .280 that would escheat these monies to the custody of the state when applicable.

Finding 6 – Investment Reporting Not Provided in Substance Nor Format Required by Director

A review of the annual statement filings noted the Trust did not provide all the investment information required by the director nor was it provided in the format requested. Investment information was provided as an attachment in a format similar to that provided in its annual audited filing which differs in the information presented and in the format required by the state in a financial statement filing. The Trust is required to submit its financial information in the form provided by the director, including the content of the information, pursuant to AS 21.85.080(a).

Recommendation: It is recommended that the Trust report all required investment information within the form and format provided by the director.



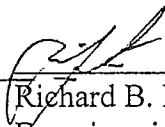
Tongass Timber Trust  
as of December 31, 2006  
FE 07-04

**CLOSING**

This examination was conducted by Mr. Richard Foster, CFE, along with Ms. Katie Campbell, FSA, MAAA, of the Alaska Division of Insurance, in accordance with practices and procedures promulgated by the Division.

We wish to express our appreciation for the courteous cooperation and assistance extended to us by the officers and employees of Tongass Timber Trust during the course of this examination.

This report is respectfully submitted.



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Richard B. Foster, CFE  
Examiner-in-Charge



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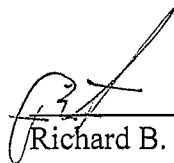
Gloria G. Glover, CFE  
Chief Financial Examiner

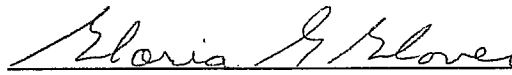
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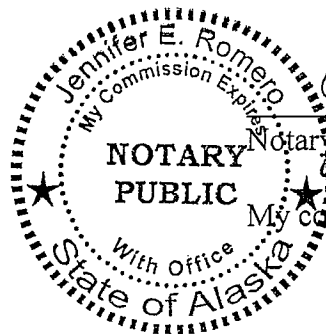
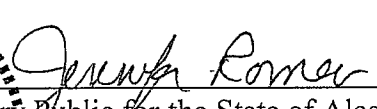
Anchorage, Alaska )  
June 20, 2008 )  
STATE OF ALASKA )  
THIRD JUDICIAL DISTRICT )

We, the undersigned, being duly sworn, do verify that the report of examination as of December 31, 2006, of Tongass Timber Trust, as an ongoing Alaska domiciled insurer holding Certificate of Authority D-10557, is true to the best of our knowledge and belief.

  
\_\_\_\_\_  
Richard B. Foster, CFE  
Insurance Financial Examiner II

  
\_\_\_\_\_  
Gloria G. Glover, CFE  
Chief Financial Examiner

Subscribed and sworn to before me this 5<sup>th</sup> day of September, 2008.

  
  
\_\_\_\_\_  
Notary Public for the State of Alaska  
My commission expires: With office