

Statutory Financial Examination of
ALASKA TIMBER INSURANCE EXCHANGE

FE 14-01

as of December 31, 2013

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

NAIC Company Code: 38687
NAIC Group Code: 000

FINAL REPORT:
January 30, 2015



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
Fax: 907.269.7910

**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 14-01)
In the Matter of Examination of)
Alaska Timber Insurance Exchange)

FINDINGS OF FACT

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

2. The Report of Examination of Alaska Timber Insurance Exchange (FE 14-01) has been transmitted to Michael Hinchon, President of Alaska Timber Insurance Exchange (Examinee), and Examinee has been accorded at least 30 days opportunity to review and comment in this Report of Examination. A response from the examinee was received on May 26, 2015.

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 he 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 Alaska Timber Insurance Exchange (FE 14-01) 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.

This order is effective June 10th 2015

Dated this 10th day of June 2015 in Anchorage, Alaska.



Lori Wing-Heier
State of Alaska
Division of Insurance

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THE STATE
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DIVISION OF INSURANCE

550 West Seventh Avenue, Suite 1560
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Main: 907.269.7900
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May 21, 2015

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:

Alaska Timber Insurance Exchange ("the Exchange")
2417 Tongass Avenue, Suite 214
Ketchikan, AK 99901

(NAIC CoCode 38687)

SCOPE OF EXAMINATION

We have performed our single-state examination of Alaska Timber Insurance Exchange (ATIE). The last examination covered the period of January 1, 2008 through December 31, 2010. This examination covers the three year period January 1, 2011 through December 31, 2013.

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 Findings

The Exchange does not have a written contingency plan for its uninterrupted and continued operation in the case of a catastrophe. The lack of a written contingency plan was a finding from prior examinations that has not been addressed. (Prior Exam Finding 1)

DESCRIPTION OF COMPANY

Company History

The Alaska Timber Insurance Exchange is organized as a reciprocal insurance exchange pursuant to Title 21, Chapter 75, of the Alaska Statutes. On March 28, 1980 it received a Certificate of Authority from the State of Alaska, as an unincorporated association authorized to offer property and casualty insurance (excluding vehicle) pursuant to AS 21.12.060 and AS 21.12.070. It issues non-assessable workers compensation policies to its subscribers. On September 3, 1998, the Exchange Board of Governors broadened reciprocal membership from just timber-related companies to companies outside the timber industry.

Corporate Records

The bylaws and minutes of the Board of Governors and of the Alaska Timber Exchange Management Corporation (ATEMC) were reviewed during this examination. All board meeting notices appear to have been given as required by the bylaws and all meetings had quorums. All actions of both ATEMC 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 meeting and an organizational meeting be held in the fourth quarter of each year. The annual meetings of the Exchange and of ATEMC 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. No changes to the Exchange bylaws were made during the exam period.

Management and Control

Subscribers own the Exchange. ATEMC serves as the attorney-in-fact for the Exchange and is wholly owned by the Exchange. ATEMC manages the daily operations of the reciprocal under a Management Agreement. ATEMC receives no compensation for its services other than reimbursement of reasonable expenses. The Exchange has no other subsidiaries or affiliates.

Alaska Statute and the Subscriber's Agreement limit the control of any single subscriber regarding matters critical to the Exchange. The Subscriber's Agreement limits each subscriber to one vote on the questions of terminating the attorney-in-fact; merging with another reciprocal insurer; converting to a stock or mutual insurer; or calling a special meeting of the Board. Subscribers have proportional voting on other matters based on the amount of surplus contributed to the Exchange. Proportional voting rights are determined on April 30 of each year.

The Restated Rules of the Exchange and minutes of the Board of Governors' meetings were reviewed during this examination. Subscribers elect board members at the annual member's meeting pursuant to the Restated Rules of the Exchange and statute. Three board members are elected to three-year terms annually. All actions requiring board approval were taken by resolution at a meeting or by resolution without a meeting as provided by the Restated Rules. The Audit Committee and Investment Committee are the only committees designated by the Board.

The following members of the Board of Governors were serving as of December 31, 2013:

| Name | City, State | Affiliation |
|-----------------------|-------------------------|--|
| Martin Pihl, Chairman | Ketchikan, Alaska | None (Formerly Ketchikan Pulp Company) |
| John Beedle | Juneau, Alaska | Northern Sales Company, Inc. |
| Brian Brown | Ketchikan, Alaska | Evergreen Timber, LP |
| James Byron | Ketchikan, Alaska | Byron Brothers Cutting |
| Leo Gellings | Bend, Oregon | Phoenix Logging Company |
| Ann Gilberto | Juneau, Alaska | North Pacific Erectors, Inc. |
| Keaton Gildersleeve | Gaston, Oregon | None (Formerly Gildersleeve, Inc.) |
| Linda Lewis | Ketchikan, Alaska | Phoenix Logging Company |
| Tom McFarland | Leavenworth, Washington | None (Formerly Alaska Pulp Company) |

Territory and Plan of Operation

The Exchange specializes in workers' compensation policies and is licensed solely in the State of Alaska. It issues policies only in the state of Alaska. The Exchange's marketing strategy utilizes appointed agents to increase the number of its subscribers.

Growth of the Company

The following schedule shows the year-end balance sheet for the years ending December 31, 2011 through December 31, 2013. The figures are reported in the annual statements of the Exchange for the years 2011 through 2013:

| Year | Admitted Assets | Liabilities | Surplus | Dividends to Policyholders |
|------|-----------------|--------------|-------------|----------------------------|
| 2013 | \$19,386,521 | \$10,247,240 | \$9,139,281 | \$2,100,000 |
| 2012 | 18,983,884 | 10,151,273 | 8,832,611 | 1,000,000 |
| 2011 | 19,086,927 | 10,909,461 | 8,177,467 | 400,000 |

Loss Experience

The following schedule shows the premiums earned and loss experience from the years ended December 31, 2011 through December 31, 2013. The figures are reported in the annual statements of the Exchange for the years 2011 through 2013:

| Year | Losses | | | Loss Expenses | |
|------|-----------------|-------------|---------------------|---------------|---------------------|
| | Earned Premiums | Incurred | % of Earned Premium | Incurred | % of Earned Premium |
| 2013 | \$4,760,346 | \$1,493,575 | 31.4% | \$466,204 | 9.8% |
| 2012 | 3,903,565 | 1,174,766 | 30.1% | 609,707 | 15.6% |
| 2011 | 4,065,117 | 2,016,058 | 49.6% | 464,745 | 11.4% |

Reinsurance

The Exchange's workers' compensation retention is \$500,000 each occurrence. Reinsurance coverage at December 31, 2013 is outlined below:

- First Excess of Loss Layer \$1,500,000 Excess of \$500,000
- Second Excess of Loss Layer \$8,000,000 Excess of \$2,000,000
- Third Excess of Loss Layer \$10,000,000 Excess of \$10,00,000

The reinsurance program has a maximum \$10,000,000 coverage on any one life.

Accounts and Records

Accounts and records are maintained electronically using various software programs for adjusting claims, data management and reporting, accounting and security. In August 2010 the Company converted to a new claims system that was run parallel to the existing software until the conversion was completed in the first quarter of 2011.

A written contingency plan is paramount to the continued operations of an insurance company in order to maintain operations during an unexpected interruption of normal business activities. The Exchange has not developed a written contingency plan (see Current Finding 1.) This is a repeat finding from prior exams (see Prior Finding 1.)

Statutory Deposits

Alaska statute AS 21.09.090 requires, in part, that insurers maintain a deposit in trust through the Director for the benefit of all its policyholders of no less than \$300,000. ATIE maintains the required statutory deposit at First Bank in Ketchikan, Alaska.

SUMMARY OF ACTUARIAL REVIEW

As of December 31, 2013, ATIE carried \$8,826,191 in net loss and expense reserves and \$16,595,000 in gross loss and expense reserves. For the actuarial review, ATIE provided medical, indemnity and loss adjustment expense data by accident year. Using this information, along with information obtained through interviews of company staff, the Division actuary reviewed the reserves held by ATIE as well as the Milliman, Inc. actuarial report in support of the 2013 Statement of Actuarial Opinion. Based on these reviews, ATIE's overall reserve position is determined to be within a reasonable range of reserve estimates and is accepted as stated.

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 December 31, 2013. The accompanying comments on financial statements should be considered an integral part of the financial statements.

FINANCIAL STATEMENTS
STATEMENT OF ASSETS, LIABILITIES AND SURPLUS
As of December 31, 2013

| | <u>As Reported</u> <u>12/31/2013</u> | <u>Adjustments</u> | <u>As Adjusted</u> <u>12/31/2013</u> |
|--|---|--------------------|---|
| <u>Assets</u> | | | |
| Bonds | \$ 14,256,529 | | \$ 14,256,529 |
| Common stock | 1,000 | | 1,000 |
| Cash, cash equivalents & short term investments | 3,526,298 | | 3,526,298 |
| Investment income due and accrued | 93,770 | | 93,770 |
| Premiums and agents' balances in course of collection | 21,836 | | 21,836 |
| Deferred premium and agents' balances | 494,031 | | 494,031 |
| Amounts recoverable from reinsurers | 116,620 | | 116,620 |
| Current income tax recoverable | 21,464 | | 21,464 |
| Net deferred tax assets | 153,369 | | 153,369 |
| Guaranty funds receivable or on deposit | 453,089 | | 453,089 |
| Electronic data processing equipment and software | 2,969 | | 2,969 |
| Aggregate write-ins for other-than-invested assets | 245,546 | | 245,546 |
| Total Admitted Assets | \$ 19,386,521 | | \$ 19,386,521 |
| <u>Liabilities, Surplus and Other Funds</u> | | | |
| <u>Liabilities</u> | | | |
| Losses | \$ 7,242,278 | | \$ 7,242,278 |
| Loss adjustment expenses | 1,583,913 | | 1,583,913 |
| Commission payable and contingent commissions | 30,357 | | 30,357 |
| Other expenses (excluding taxes, licenses and fees) | 569,443 | | 569,443 |
| Taxes, licenses and fees | 49,280 | | 49,280 |
| Policyholders dividends declared | 500,000 | | 500,000 |
| Ceded reinsurance premiums payable | 271,969 | | 271,969 |
| Total Liabilities | \$ 10,247,240 | | \$ 10,247,240 |
| <u>Surplus</u> | | | |
| Aggregate write-ins for other than special surplus funds | 1,766,966 | | 1,766,966 |
| Gross paid-in and contributed surplus | 2,244,438 | | 2,244,438 |
| Unassigned funds (surplus) | 5,127,877 | | 5,127,877 |
| Surplus as regards policyholders | \$ 9,139,281 | | \$ 9,139,281 |
| Total Liabilities and Surplus | \$ 19,386,521 | | \$ 19,386,521 |

FINANCIAL STATEMENTS
STATEMENT OF UNDERWRITING AND INVESTMENT
As of December 31, 2013

| | As Reported 12/31/2013 | Adjustments | As Adjusted 12/31/2013 |
|--|---------------------------|-------------|---------------------------|
| <u>Underwriting Income</u> | | | |
| <u>Revenue</u> | | | |
| Premiums earned | \$ 4,760,346 | | \$ 4,760,346 |
| Total Revenue | \$ 4,760,346 | | \$ 4,760,346 |
| <u>Deductions</u> | | | |
| Losses incurred | \$ 1,493,575 | | \$ 1,493,575 |
| Loss adjustment expenses incurred | 466,204 | | 466,204 |
| Other underwriting expenses | 900,195 | | 900,195 |
| Total underwriting deductions | \$ 2,859,974 | | \$ 2,859,974 |
| Net underwriting gain or loss | \$ 1,900,372 | | \$ 1,900,372 |
| <u>Investment Income</u> | | | |
| Net investment income earned | \$ 324,450 | | \$ 324,450 |
| Net realized capital gains or (losses) | 1,540 | | 1,540 |
| Net investment gain or (loss) | \$ 325,990 | | \$ 325,990 |
| <u>Other Income</u> | | | |
| Net gain (loss) from agents' or premium balances charged off | \$ 194 | | \$ 194 |
| Aggregate write-ins for miscellaneous income | 25,886 | | 25,886 |
| Total other income | \$ 26,080 | | \$ 26,080 |
| Net income before dividends to policyholders | \$ 2,252,442 | | \$ 2,252,442 |
| Dividends to policyholders | 2,100,000 | | 2,100,000 |
| Net income before federal income tax | \$ 152,442 | | \$ 152,442 |
| Federal income tax incurred | (22,020) | | (22,020) |
| Net income (loss) | \$ 174,462 | | \$ 174,462 |
| <u>Capital and Surplus Account</u> | | | |
| Surplus, December 31, prior year | \$ 8,832,611 | | \$ 8,832,611 |
| <u>Gains and (Losses) in Surplus</u> | | | |
| Net income (loss) | \$ 174,462 | | \$ 174,462 |
| Change in net unrealized capital gains (losses) | (4) | | (4) |
| Change in net deferred income tax | (85,728) | | (85,728) |
| Change in nonadmitted assets | 53,719 | | 53,719 |
| Surplus adjustments: Paid in | (155,347) | | (155,347) |
| Aggregate write-ins for gains and losses in surplus | 319,567 | | 319,567 |
| Change in surplus as regards policyholders | \$ 306,669 | | \$ 306,669 |
| Surplus for the period ended December 31, 2013 | \$ 9,139,281 | | \$ 9,139,281 |

FINANCIAL STATEMENTS
STATEMENT OF CAPITAL AND SURPLUS ACCOUNT
As of December 31, 2013

| | Special and Other Than Special Surplus Funds | <u>SURPLUS</u> | | TOTAL |
|--|---|----------------------------|----------------------------|----------------------------|
| | | <u>Paid-In</u> | <u>Unassigned</u> | |
| Balance at December 31, 2010 | \$ 1,590,267 | \$ 2,481,495 | \$ 3,384,867 | \$ 7,456,629 |
| Surplus Contributed, Net | | (133,151) | | (133,151) |
| Reserve for Policy Deposit | 26,554 | | 39,352 | 65,906 |
| Net income – 2011 | | | 844,859 | 844,859 |
| Change in net deferred income tax | | | (290,060) | (290,060) |
| Change in nonadmitted assets | | | 233,284 | 233,284 |
| Balance at December 31, 2011 | <u>\$ 1,616,821</u> | <u>\$ 2,348,344</u> | <u>\$ 4,212,302</u> | <u>\$ 8,177,467</u> |
| Surplus Contributed, Net | | 51,441 | | 51,441 |
| Reserve for Policy Deposit | (169,421) | | 71,545 | (97,876) |
| Net income – 2012 | | | 690,170 | 690,170 |
| Change in net unrealized capital gains or (losses) | | | (51) | (51) |
| Change in net deferred income tax | | | (210,936) | (210,936) |
| Change in nonadmitted assets | | | 222,396 | 222,396 |
| Balance at December 31, 2012 | <u>\$ 1,447,400</u> | <u>\$ 2,399,785</u> | <u>\$ 4,985,426</u> | <u>\$ 8,832,611</u> |
| Surplus Contributed, Net | | (155,347) | | (155,347) |
| Reserve for Policy Deposit | 319,566 | | 2 | 319,568 |
| Net income – 2013 | | | 174,462 | 174,462 |
| Change in net unrealized capital gains or (losses) | | | (4) | (4) |
| Change in net deferred income tax | | | (85,728) | (85,728) |
| Change in nonadmitted assets | | | 53,719 | 53,719 |
| Balance at December 31, 2013 | <u><u>\$ 1,766,966</u></u> | <u><u>\$ 2,244,438</u></u> | <u><u>\$ 5,127,877</u></u> | <u><u>\$ 9,139,281</u></u> |

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

No adjustments to the financial statements filed as of December 31, 2013 were made to surplus as a result of the examination.

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

The following recommendation from the prior report of examination was found to be unresolved during the current examination:

Prior Finding 1 - Lack of Written Contingency Plan

The Exchange has not developed a written contingency plan. The Exchange's general manager, statutory accountant and claims manager all commute to the Exchange from various locations outside Alaska and work onsite at ATIE's offices in Ketchikan less than 50% of the time. Other work is conducted via remote connections and by telephone. Therefore, it is especially critical that everyone understand their responsibilities in the event of an unexpected interruption to normal business activities. Officers and staff should be provided with a board approved contingency plan that will assure data, systems and operations can be successfully recovered and continuity established. This is a repeat finding from past examinations.

Recommendation: It is recommended that a written contingency plan be developed and communicated to all personnel. The plan should be approved by the Board of Governors.

The following recommendation from the prior report of examination was resolved during the current examination:

Prior Finding 2 – Inadequate Bond

ATIE's Fidelity Bond coverage is now compliant with Alaska Statute 21.75.100.

FINDINGS AND RECOMMENDATIONS

Finding 1 - Lack of Written Contingency Plan

The Exchange has not developed a written contingency plan. The Exchange's general manager, statutory accountant and claims manager all commute to the Exchange from various locations outside Alaska and work onsite at ATIE's offices in Ketchikan less than 50% of the time. Other work is conducted via remote connections and by telephone. Therefore, it is especially critical that everyone understand their responsibilities in the event of an unexpected interruption to normal business activities. Officers and staff should be provided with a board approved contingency plan that will assure data, systems and operations can be successfully recovered and continuity established. This is a repeat finding from past examinations.

Recommendation: It is recommended that a written contingency plan be developed and formally approved by the Board of Governors during or prior to its 2015 Annual Meeting. The approved plans should then be submitted to the Division of Insurance for review. Once approved by the Division, the contingency plans should be communicated to all Exchange personnel and IT consultants.

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.

An affidavit of the Examiner-in-Charge, Darin Benck, CPA, 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*. Based on my review, to the best of my knowledge, the examination was performed in a manner consistent with those standards and procedures and properly reflects the financial condition of Alaska Timber Insurance Exchange as of December 31, 2013.

Also participating in the examination from the Alaska Division of Insurance were Insurance Financial Examiner II David Phifer, AFE, and Actuary Sarah McNair-Grove, FCAS, MCAA.

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

This report is respectfully submitted,

Maxine Froemling

Maxine Froemling, CFE
Chief Financial Examiner

AFFIDAVIT

Anchorage, Alaska)
May 11, 2015)
)
STATE OF ALASKA)
THIRD JUDICIAL DISTRICT)

I, the undersigned, being duly sworn, do verify that the report of examination as of December 31, 2013, of Alaska Timber Insurance Exchange, an Alaska-domiciled company holding Certificate of Authority #D-1271, 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 11th day of May, 2015.



Jennifer E. Romero
Notary Public for the State of Alaska

My commission expires: With Office