

REPORT OF EXAMINATION
OF THE
KAISER PERMANENTE INSURANCE COMPANY
AS OF
DECEMBER 31, 2007

Participating State
and Zone:

California

Filed May 18, 2009

TABLE OF CONTENTS

	<u>Page</u>
SCOPE OF EXAMINATION.....	1
SUBSEQUENT EVENTS	2
MANAGEMENT AND CONTROL:	3
Administrative and Management Services Agreements	6
Joint Administration Agreements	6
Joint Marketing and Administration Agreements	7
Healthy Solutions Services Agreement.....	8
Medical Director Agreement.....	8
Settlement of Intercompany Transactions Agreement.....	8
Unaffiliated Service Agreements	9
TERRITORY AND PLAN OF OPERATION	9
REINSURANCE.....	10
ACCOUNTS AND RECORDS	10
FINANCIAL STATEMENTS:.....	11
Statement of Financial Condition as of December 31, 2007	12
Statement of Revenue and Expenses and Capital and Surplus Account for the Year Ended December 31, 2007	13
Reconciliation of Capital and Surplus from December 31, 2003 through December 31, 2007	14
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	15
Claims Unpaid and Unpaid Claims Adjustment Expenses	15
Amounts Due to Parent, Subsidiaries and Affiliates.....	15
SUMMARY OF COMMENTS AND RECOMMENDATIONS:.....	15
Current Report of Examination	15
Previous Report of Examination	16
ACKNOWLEDGEMENT	18

San Francisco, California
January 29, 2009

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Morris Chavez
Secretary, Zone IV-Western
Superintendent of Insurance
New Mexico Insurance Division
Santa Fe, New Mexico

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

KAISER PERMANENTE INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 300 Lakeside Drive, 13th Floor, Oakland, California 94612.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2003. This examination covers the period from January 1, 2004 through December 31, 2007, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination. The examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. This examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed

transactions, an evaluation of assets, and a determination of liabilities as of December 31, 2007, as deemed necessary under the circumstances.

In addition to items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas which require no further comment: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

SUBSEQUENT EVENTS

The Company began offering administrative services for the self-funded plan for Kaiser Foundation Health Plan, Inc. ("KFHP"), and its affiliates starting with employees located in Georgia on September 1, 2008; and commercial employers with employees based in California on January 1, 2009. The Company will serve as the administrator under an Administrative Services Only ("ASO") agreement. As the administrator, the Company will contract with the plan sponsor to provide all of the administrative services needed for self-funding. The claims services will be performed by an unrelated third-party administrator; and most of the remainder of the administrative services will be provided by KFHP in California, and by KFHP's HMO subsidiaries outside California. It is anticipated that this will create new business opportunities and enable the Company to remain competitive. The Company forecasts the revenues from this to be 10% of its total revenues in 2009.

The Company is party to a "Self-Funded Administrative Services Agreement" with an affiliate, Kaiser Foundation Health Plan of Georgia (KFHP-Georgia). Under the terms of the agreement, the Company is to administer the self-funded plans using the KFHP-Georgia's administrative services. The Company submitted the agreement to the California Department of Insurance (CDI) for prior approval in accordance with California Insurance Code (CIC) Section 1215.5(b)(4). The CDI granted a conditional exemption pursuant to CIC Section 1215.5(i) based on the Company being able to demonstrate to the examiners that the fees paid under the agreement are fair and reasonable. It was determined that the compensation under this agreement was fair and reasonable.

The Company is party to an Administrative Services Only (ASO) Services Agreement with its parent, KFHP with a revised effective date of September 1, 2008. Under the terms of the ASO Agreement, the Company will provide administrative services for KFHP's self-funded health benefits plans. This agreement was submitted to the CDI for prior approval in accordance with CIC Section 1215.5(b)(4) and is currently under review.

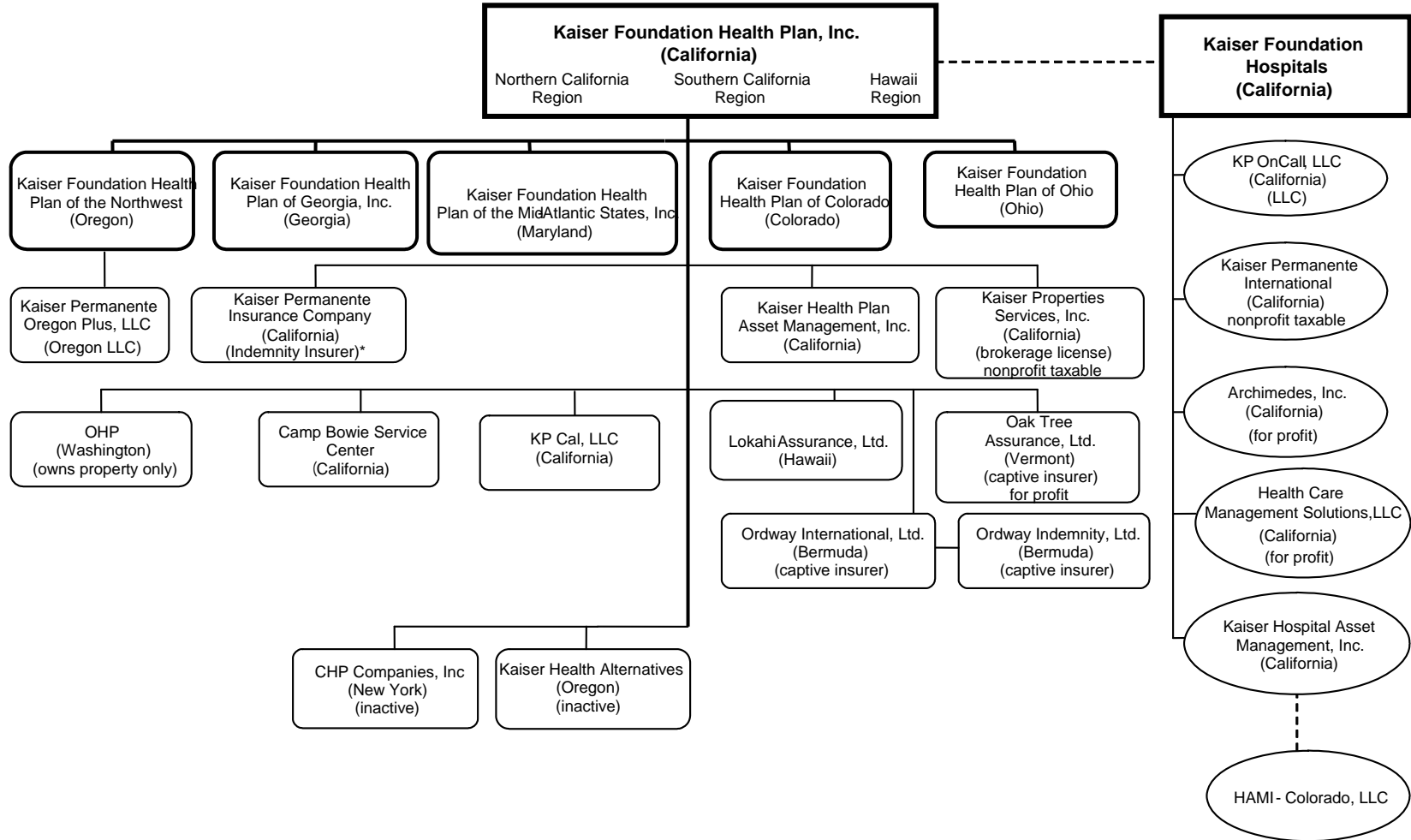
Beginning in 2009, the Company plans to provide an exclusive provider organization (EPO) group product. The EPO product is an individually underwritten group plan providing exclusive provider benefits and services utilizing the KFHP provider network. KFHP providers will bill the Company on a fee-for-service basis for medical and surgical services provided to the Company's EPO insureds. The Company estimated the revenues from this product will be 9% of its total revenues in 2009.

The Company is party to a Joint Marketing and Administrative Services Agreement with KFHP with a proposed effective date of December 1, 2008. Under the terms of this agreement, KFHP will provide administrative services, provider network administration and integrated care management services. This agreement was submitted to the CDI for prior approval in accordance with CIC Section 1215.5(b)(4) on October 31, 2008 and is currently under review.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Kaiser Foundation Health Plan, Inc. (KFHP) is the ultimate controlling entity. KFHP owns 50% of the voting stock of the Company. The remaining 50% of the Company's voting stock is owned by eight independent Permanente Medical Groups as follows: The Permanente Medical Group, Inc.; Southern California Permanente Medical Group; Hawaii Permanente Medical Group, Inc.; Colorado Permanente Medical Group, P.C.; The Southeast Permanente Medical Group, Inc.; Northwest Permanente, P.C.; Ohio Permanente Medical Group, Inc.; and Mid-Atlantic Permanente Medical Group, P.C. An organizational chart follows:

KAISER FOUNDATION HEALTH PLAN, INC. SUBSIDIARIES AND AFFILIATED CORPORATIONS



* Kaiser Foundation Health Plan, Inc., owns 50% of the voting stock of the Company. The remainder of the Company's stock is owned by eight Permanente Medical Groups

Management of the Company is vested in a six-member board of directors elected annually. As of December 31, 2007, the directors and principal officers were as follows:

Directors

<u>Name and Residence</u>	<u>Primary Business Affiliation</u>
Gerald C. Bajada Oakland, California	Vice President of Financial Services The Permanente Medical Group, Inc.
Francis J. Crosson M.D. Palo Alto, California	Executive Director The Permanente Federation, LLC
Mitchell J. Goodstein Oakland, California	President Kaiser Permanente Insurance Company
James E. Newsome Englewood, Colorado	Vice President of Finance Kaiser Permanente Health Plan of Colorado
Wade J. Overgaard Oakland, California	Senior Vice President of Sales and Account Manager Kaiser Foundation Health Plan, Inc.
Jeffrey S. Selevan M.D. Pasadena, California	Medical Director of Business Management Southern California Permanente Medical Group

Principal Officers

<u>Name</u>	<u>Title</u>
Mitchell J. Goodstein	President
Victoria B. Zatkin	Vice President and Secretary
Kelly J. Walsh**	Controller
George A. Spaeth***	Assistant Secretary and Senior Counsel
Arthur M. Southam M.D.	Senior Vice President
Thomas R. Meier	Vice President and Treasurer
Larry Y. Wilson****	Chief Financial Officer

**replaced by Daniel McDermott on October 20, 2008. Kelly Walsh assumed another position with the Company.

***retired on April 18, 2008

****retired and replaced by William E. Joram on November 19, 2008.

It was noted during a review of the Company's Insurance Holding Company System Annual Registration Statements filed during the exam period that the Company did not properly disclose all management agreements, service contracts and cost-sharing arrangements with affiliates in its Form B Annual Registration Statement as required under the California Insurance Code Section (CICS) 1215.4. It is recommended that the Company disclose all management agreements, services contracts and cost-sharing arrangements (including amendments) with affiliates in its Annual Registration Statement in accordance with the CICS 1215.4

Administrative and Management Services Agreement

The Company and its parent, Kaiser Foundation Health Plan, Inc. (KFHP), entered into an Administrative and Management Services Agreement on November 30, 1994. Under the terms of the agreement, KFHP provides various services to the Company including actuarial, accounting, marketing, investment, administrative, financial, legal, data processing, computer programming, human resources and other management services. The Company pays KFHP for the actual cost of these services. The total cost to the Company in 2007 was \$751,081. In February 2000, the California Department of Insurance (CDI) granted a partial exemption for certain types of amendments to this agreement, as well as the Joint Administration Agreements discussed below. In February 2004, the CDI revised this exemption to require prior approval filing pursuant to CICS 1215.5(b)(4) for amendments involving a financial impact on the Company.

Joint Administration Agreements

The Company and KFHP entered into a Joint Administration Agreement on February 3, 1995 to pair KFHP's prepaid health care programs with the Company's indemnity products for purposes of joint marketing and administration. The two companies' health benefit programs are combined to create various health care products. The captioned agreements are between the Company and KFHP's affiliated health plans in Northern California, Southern California,

Colorado, Georgia, Hawaii, Kansas, Mid-Atlantic States (Maryland, Virginia, and District of Columbia), and Ohio. Under the terms of these agreements, the affiliated health plans agree to provide the following services to the Company including marketing, advertising, enrollment, underwriting, pricing, utilization management, billings, collections, and claims adjudication in some circumstances. The total cost to the Company in 2007 was \$4,907,552.

It was noted in the prior examination report that the compensation clause in these agreements did not reflect the amounts paid to the affiliates for the services rendered and, as such, it may not comply with California Insurance Code Section 1215.5(a).

It was recommended the Company amend the agreements in order to specify the basis on which the affiliates are to be reimbursed. The Company has yet to amend the agreements to specify the basis on which the affiliates are reimbursed. It is recommended that the Company amend its Joint Administration Agreements with its parent and affiliates (all Regions) in order to specify the basis on which the affiliates are to be reimbursed and file with CDI for approval in accordance with CICS 1215.5(b)(4). In addition, it was recommended that the Company maintain adequate records to support the charges paid to affiliates are fair and reasonable in compliance with CICS 1215.5(a). During the examination, the Company was able to provide records to support that amounts paid to affiliates are fair and reasonable.

Joint Marketing and Administration Agreements

In 2003 and 2004, the Company had filed with the CDI two separate Joint Marketing and Administration Agreements with Kaiser Foundation Health Plan of Georgia, Inc. (KFHP-Georgia) and Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc. (KFHP-MAS), respectively. These agreements are to replace the Joint Administration Agreement with KFHP-Georgia and KFHP-MAS discussed above. The CDI had financial objections regarding these agreements, since they do not include the required language or a demonstration that the method of compensation is based on actual cost or is fair and reasonable. It is recommended that the Company amend its Joint Marketing and Administration Agreements with its affiliates in order

to specify the basis on which the affiliates are to be reimbursed and re-file with the CDI for approval in accordance with CICS 1215.5(b)(4).

Healthy Solutions Services Agreement

The Company is party to a Healthy Solutions Services Agreement with Health Care Management Solutions, LLC (HCMS), effective April 1, 2007. Under the terms of the agreement, HCMS will provide the tools and other capabilities to identify, reach and engage individuals and health care providers in health coaching, medical and health decision support content, and other medical and health decision support services. This agreement was filed with the CDI on April 20, 2007 in accordance with CIC Section 1215.5(b)(4) and is still under review.

Medical Director Agreement

The Company is party to a Medical Director Agreement with The Permanente Federation, LLC (TPF), effective July 1, 2008. Under the terms of the agreement, TPF will provide the Company with physician medical director services. The medical director will direct, oversee, and coordinate medical quality; appeals and grievances; and utilization management related strategies, goals and key activities for the Company. The effective date of this agreement was July 1, 2008. This Agreement was approved by the CDI on December 26, 2008.

Settlement of Intercompany Transactions Agreement

The Company has entered into a Settlement of Intercompany Transactions Agreement with various affiliates, effective December 31, 2007. Under the terms of the agreement, each party is required to use its best efforts to settle all of its receivables within thirty days, but no later than ninety days. It is recommended that the Company continue to work with CDI Legal Division to determine whether this agreement is subject to the filing and prior approval requirement of CIC Section 1215.5.

Unaffiliated Service Agreements

The Company is party to a service agreement with Delta Dental Plan of California (Delta). Under the terms of the agreement, Delta processes and pays all of the Company's dental claims using its own funds and is later reimbursed by the Company.

The Company has a Master Services Agreement with Perot Systems Healthcare Services, LLC (Perot). Under the terms of the agreement, Perot provides medical claims processing services for the Company in California, Hawaii, Georgia, and Mid-Atlantic States (Virginia, Maryland, and Washington D.C.).

The Company is party to a service agreement with Meritain Health, Inc. (Meritain), wherein, Meritain agrees to provide medical claims processing services for the Company in Ohio.

The Company also has an agreement with MedImpact Healthcare System Inc. (MedImpact) in which MedImpact agrees to process and pay all prescription drug claims for the Company.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2007, the Company was licensed to write health insurance in the states of California, Colorado, Georgia, Hawaii, Kansas, Maryland, Missouri, Ohio, Oregon, South Carolina, Virginia, Washington, and the District of Columbia. Direct premiums written in 2007 totaled \$206,428,585, of which California accounted for 44.21%, Colorado 15.48%, and Ohio 14.42% with the remainder in District of Columbia, Georgia, Hawaii, Maryland, and Virginia. Of the \$206,428,585 in direct premiums written, \$53,724,164 or 26.03% represented dental indemnity business.

The Company jointly markets its indemnity health and dental products alongside Kaiser Foundation Health Plan, Inc.'s (KFHP) prepaid health care plans. It uses the same sales force employed by KFHP. The Company offers point-of-service, preferred provider organization option, out-of-area health, and dental coverages. The point-of-service product is a single benefit product with two elements: health care services through prepaid group coverage to be provided by KFHP and indemnity health care coverage through a policy issued by the Company. The preferred provider organization option offers the members within an employer group a choice of either one of the following: health care services through prepaid group practice coverage to be provided by KFHP, or indemnity health care coverage through an insurance policy issued by the Company. The Company's out-of-area products consist of indemnity health care coverage that provides coverage to subscribers who do not live in a KFHP's service area, but live in the United States.

REINSURANCE

The Company did not assume or cede any reinsurance during the period under examination.

ACCOUNTS AND RECORDS

The examination experienced difficulties in obtaining supporting documentation for certain balance sheet accounts. The Company could not readily provide the details and in some cases when details were provided, it was not sufficient. It is recommended that the Company maintain documentation to support all financial statement accounts.

FINANCIAL STATEMENTS

The financial statements prepared for this report include the following:

Statement of Financial Condition as of December 31, 2007

Summary of Operations and Capital and Surplus Account for the Year Ended
December 31, 2007

Reconciliation of Capital and Surplus from December 31, 2003 through
December 31, 2007

Statement of Financial Condition
as of December 31, 2007

<u>Assets</u>	<u>Ledger and Non-ledger Assets</u>	<u>Non- Admitted Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 96,454,201	\$	\$ 96,454,201	
Cash and short-term investments	18,101,432		18,101,432	
Investment income due and accrued	611,085		611,085	
Uncollected premiums and agents' balances in the course of collection	14,143,471		14,143,471	
Electronic data processing equipment and software	<u>1,209,844</u>	<u>1,209,844</u>	<u></u>	
Total assets	<u>\$ 130,520,033</u>	<u>\$ 1,209,844</u>	<u>\$ 129,310,189</u>	
 <u>Liabilities, Capital; and Surplus</u>				
Claims unpaid			\$ 33,652,070	(1)
Unpaid claims adjustment expenses			4,809,495	(1)
General expenses due or accrued			6,690,165	
Current federal and foreign income taxes payable			1,034,118	
Net deferred tax liability			163,305	
Amounts due to parent, subsidiaries and affiliates			16,298,254	(2)
Payable for securities			7,619,353	
Aggregate write-ins for other liabilities			<u>49,351</u>	
Total liabilities			70,316,111	
Common stocks		\$ 48,000		
Preferred capital stock		4,000,000		
Gross paid-in and contributed surplus		16,000,000		
Unassigned funds		<u>38,946,078</u>		
Total capital and surplus			<u>58,994,078</u>	
Total liabilities, capital and surplus			<u>\$ 129,310,189</u>	

Statement of Revenue and Expenses and Capital and Surplus Account
for the Year Ended December 31, 2007

Statement of Revenue and Expenses

Net premium income	\$ <u>206,428,585</u>
Total revenues	<u>206,428,585</u>
Hospital and medical benefits	99,353,410
Other professional services	31,513,409
Emergency room and out-of-area	2,034,276
Prescription drugs	23,604,973
Claims adjustment expenses	19,303,358
General administrative expenses	<u>13,296,106</u>
Total underwriting deductions	<u>189,105,532</u>
Net underwriting gain	<u>17,323,053</u>
Net investment income earned	5,220,926
Net realized capital gains	<u>177,476</u>
Net investment gain	<u>5,398,402</u>
Net income after capital gains tax and before all other federal income taxes	<u>22,721,455</u>
Federal income taxes incurred	<u>7,488,018</u>
Net income	<u>\$ 15,233,437</u>

Capital and Surplus Account

Capital and surplus, December 31, 2006	\$ 45,456,583
Net income	\$ 15,233,437
Change in net deferred income tax	(486,093)
Change in nonadmitted assets	<u>(1,209,849)</u>
Net change in capital and surplus	<u>13,537,495</u>
Capital and surplus, December 31, 2007	<u>\$ 58,994,078</u>

Reconciliation of Capital and Surplus
from December 31, 2003 through December 31, 2007

Capital and surplus, December 31, 2003, per Examination			\$ 34,025,616
	<u>Gain in</u>	<u>Loss in</u>	
	<u>Surplus</u>	<u>Surplus</u>	
Net income	\$ 26,644,731	\$	
Change in net deferred income tax		392,660	
Change in nonadmitted assets		1,209,849	
Change in asset valuation reserve	<u> </u>	<u>73,760</u>	
Total gains and losses in surplus	<u>\$ 26,644,731</u>	<u>\$ 1,676,269</u>	
Net increase in surplus			<u>24,968,462</u>
Capital and surplus, December 31, 2007, per Examination			<u>\$ 58,994,078</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Claims Unpaid and Unpaid Claims Adjustment Expenses

A Life Actuary from the California Department of Insurance reviewed the claims unpaid and unpaid claims adjustment expense reserves as of December 31, 2007 and concluded that the reserves were reasonably stated.

(2) Amounts Due to Parent, Subsidiaries and Affiliates

The Company is not in compliance with Statements of Statutory Accounting Principles (SSAP) No. 25, paragraph 6, which requires timely settlements of amounts owed between affiliates with a specified due date. Instead of settling intercompany balances, the Company withholds monies from its parent, Kaiser Foundation Health Plan, Inc. (KFHP), comparable to the amount of the monthly premium receivable from KFHP. It is recommended that the intercompany balances be settled timely with a specified due date in accordance with SSAP No. 25, paragraph 6.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control (Page 6): It is recommended that the Company disclose all management agreements, services contracts and cost-sharing arrangements and amendments with affiliates in its Form B Annual Registration Statement in accordance with the California Insurance Code Section (CICS) 1215.4.

Management and Control - Joint Administration Agreements (Page 6): It is recommended the Company amend its Joint Administration Agreements with its parent and affiliates to specify the basis on which the affiliates are to be reimbursed. The amended agreements should be filed with the California Department of Insurance (CDI) for approval in accordance with CICS 1215.5(b)(4).

Management and Control - Joint Marketing and Administration Agreements (Page 6): It is recommended that the Company amend its Joint Marketing and Administration Agreements with its affiliates in order to specify the basis on which the affiliates are to be reimbursed and re-file with the CDI for approval in accordance with CICS 1215.5(b)(4).

Management and Control – Settlement of Intercompany Transactions Agreement (Page 8): It is recommended that the Company continue to work with CDI Legal Division to determine whether this agreement is subject to the filing and prior approval requirement of CIC Section 1215.5.

Accounts and Records (Page 10): It is recommended that the Company maintain sufficient documentation to support all financial statement accounts.

Comments on Financial Statement Items - Amounts Due to Parent, Subsidiaries and Affiliates (Page 14): It is recommended that the intercompany balances be settled timely and with a specified due date in accordance with Statements of Statutory Accounting Principles 25.

Previous Report of Examination

Management and Control - Joint Administration Agreements (Page 5): It was recommended the Company amend these agreements to specify the basis on which the affiliates are reimbursed and maintain adequate records to support that amounts paid to affiliates are fair and reasonable pursuant to California Insurance Code Section (CICS) 1215.5(a). During the examination, the Company was able to provide records to support that amounts paid to affiliates are fair and reasonable. The Company has yet to amend the agreements to specify the basis on which the affiliates are reimbursed.

Accounts and Records-Information Systems Controls (Page 8): It was recommended that the Company provide adequate responses to the National Association of Insurance Commissioners' Information Systems Controls Questionnaire (ISQ), request its service providers to use the ISQ

as a guide for the SAS 70 audits, and follow-up with its service providers with regard to deficiencies noted in the SAS 70 audit reports. The Company has complied.

Comments on Financial Statement Items – Bonds (Page 13): It was recommended the Company maintain its securities in compliance with CICS 1104.9(c) and (d) at all times. The Company is now in compliance.

Comments on Financial Statement Items - Escheat Liabilities (Page 13): It was recommended that the Company establish proper procedures to clear the old outstanding checks and to establish proper escheat liabilities. The Company is now in compliance.

