REPORT OF EXAMINATION
OF THE

KAISER PERMANENTE INSURANCE COMPANY

AS OF
DECEMBER 31, 2010

Filed: May 7, 2012

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San Francisco, California
March 5, 2012

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear 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

We have performed our multi-state examination of the Company. The previous examination of the Company was made as of December 31, 2007. This examination covers the period from January 1, 2008 through December 31, 2010. This examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners' Handbook and California statutes and regulations. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

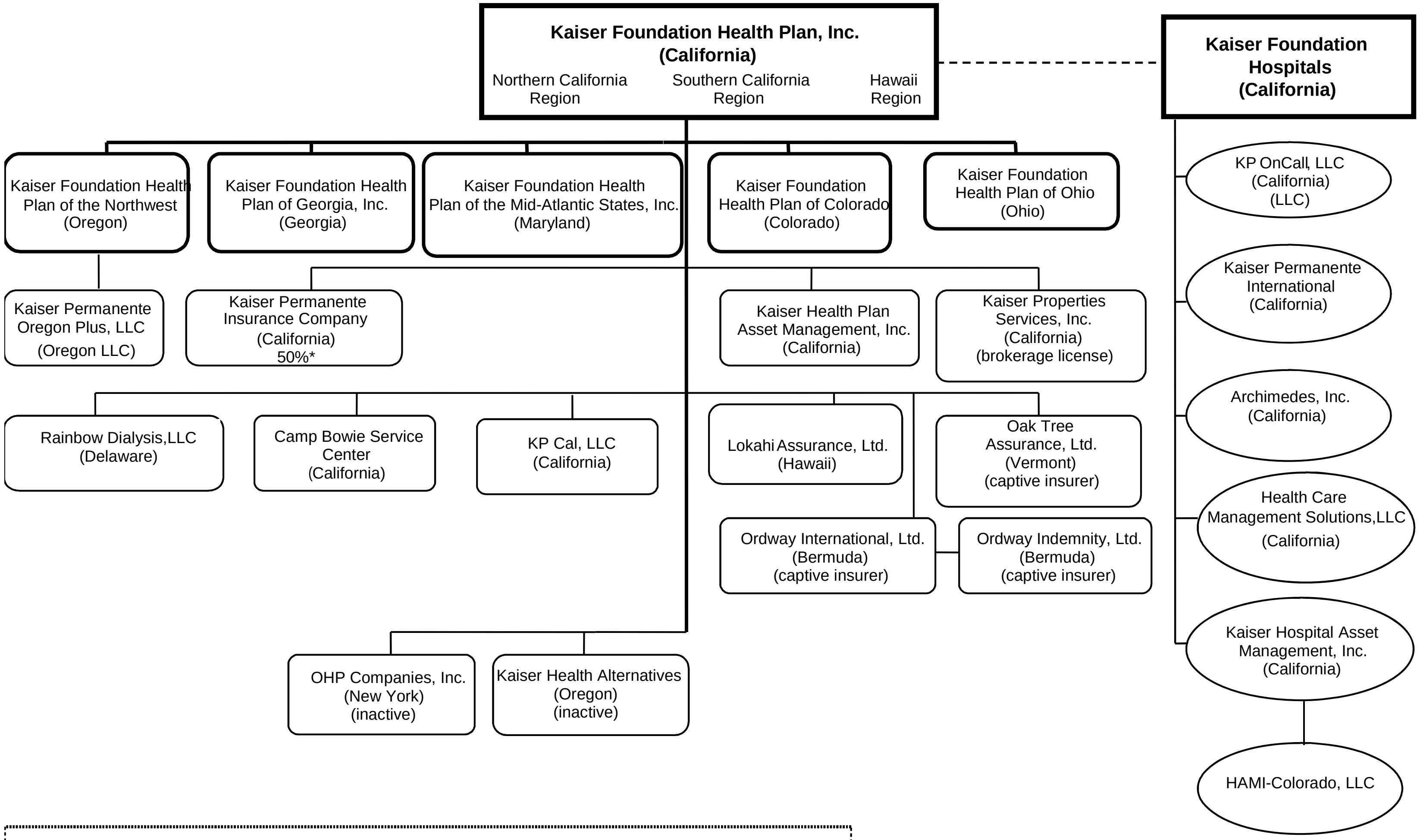
The examination was a coordinated examination and was conducted concurrently with the following insurance entities in the holding company group: Kaiser Foundation Health Plan of the Northwest; Kaiser Foundation Health Plan of Georgia, Inc.; and Kaiser Foundation Health Plan of Colorado; and included participation from the following states, respectively: Oregon, Georgia, and Colorado.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; corporate records; fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; loss experience; statutory deposits; and sales and advertising.

## 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 abridged organizational chart follows:

## KAISER FOUNDATION HEALTH PLAN, INC.
## SUBSIDIARIES AND AFFILIATED CORPORATIONS




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

- - - - Indicates operational interdependence as the governing body and management are essentially the same.

Management of the Company is vested in a six-member board of directors elected annually. As of December 31, 2010, the directors and principal officers were as follows:

Directors

| Name and Residence | Primary Business Affiliation |
|---|---|
| Gerald C. Bajada<br>Oakland, California | Vice President of Financial Services<br>The Permanente Medical Group, Inc. |
| Mitchell J. Goodstein<br>Oakland, California | President and Chairman of the Board<br>Kaiser Permanente Insurance Company |
| Janet A. Liang<br>Kailua, Hawaii | President<br>Kaiser Foundation Health Plan, Inc.<br>Hawaii Region |
| DeAnne G. Petersen<br>Gaithersburg, Maryland | Chief Financial Offer<br>Kaiser Permanente Health Plan of<br>Mid-Atlantic States |
| Jeffrey S. Selevan M.D.<br>Pasadena, California | Medical Director of Business Management<br>Southern California Permanente Medical<br>Group |
| William G. Wright M.D.<br>Centennial, Colorado | Executive Director<br>Colorado Permanent Medical Group |

Principal Officers

| Name | Title |
|---|---|
| Mitchell J. Goodstein | President and Chairman of the Board |
| William E. Juram | Chief Financial Officer |
| Victoria B. Zatkin | Vice President and Secretary |
| Daniel E. McDermott | Controller |

Intercompany Agreements

*Administrative and Management Services Agreements:* The Company and its parent, Kaiser Foundation Health Plan, Inc. (KFHP), entered into an Administrative and Management Services Agreement on November 30, 1994. Pursuant to 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 agrees to pay KFHP for the actual cost of these services. 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 California Insurance Code Section (CICS) 1215.5(b)(4) for amendments involving either a positive or negative financial impact on the insurer. The total cost to the Company for services under this agreement in 2010 was $2,141,639.

*Joint Administration Agreements:* The Company and its parent, KFHP, entered into a Joint Administration Agreement effective February 3, 1995. The agreement, which includes the Northern California region, pairs KFHP's prepaid health care programs with the Company's indemnity products for the purposes of joint marketing and administration. Pursuant to the agreement, both companies' health benefit programs are combined to create various health care products. Similar agreements are in place between the Company and KFHP's regions in Southern California, effective August 1, 1996; and Hawaii, effective January 1, 1996; and its affiliated health plans in Colorado, effective October 4, 1996; Georgia, effective November 1, 1996; Mid-Atlantic States (Maryland, Virginia, and District of Columbia), effective June 1, 1996; and Ohio, effective May 6, 2002. An agreement between the Company and the affiliated health plan of Oregon was not required because Oregon allows health plans to issue indemnity products. In these agreements, the regions and affiliated health plans agree to provide the following services to the Company: marketing, advertising, enrollment, underwriting, pricing, billing, utilization management, collections, and claims adjudication in some circumstances. It was noted in the two previous examination reports, the compensation clause in these agreements did not indicate the amounts to be paid to the affiliates for the services rendered and did not comply with CICS 1215.5(a). It was also previously recommended that the Company amend the agreements in order to specify the basis on which the affiliates are to be reimbursed and file with the CDI for approval in accordance with CICS 1215.5(b)(4).

During 2010, the Company began phasing out these agreements by entering into Joint Marketing and Administration Agreements which specified the basis on which the affiliates are to be reimbursed. The total cost to the Company for services under these agreements in 2010 was $4,591,703.

*Joint Marketing and Administration Agreements:* As of March 2, 2012, all of the Joint Administration Agreements have been replaced by the Joint Marketing and Administration Agreements discussed below. The Company and its affiliate, Kaiser Foundation Health Plan of Colorado (KFHP-CO), entered into a Joint Marketing and Administration Agreement effective October 31, 2010. The agreement pairs KFHP-CO’s prepaid health care programs with the Company's indemnity products for purposes of joint marketing and administration. Pursuant to the agreement, KFHP-CO will provide certain administrative services related to the indemnity products of the Company that are offered in Colorado. These administrative services include, but are not limited to: product development, rating and underwriting, sales and marketing, claims adjudication, member services, utilization management, and premium billing and collection. This agreement was approved by the CDI on October 27, 2010.

Subsequent to December 31, 2010, the Company submitted and the CDI approved three additional Joint Marketing and Administration Agreements in accordance with CICS 1215.5(b)(4). The approved agreements were with the following affiliated health plans: Kaiser Foundation Health Plan of Georgia, Inc., effective January 17, 2011; Kaiser Foundation Health Plan of Ohio, effective June 1, 2011; and Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc., effective March 14, 2012. The CDI approved the agreements on January 7, 2011, May 18, 2011, and June 13, 2011, respectively. The Company submitted its final agreement with KFHP to the CDI on March 2, 2012. This agreement covers the regions of Northern California, Southern California, and Hawaii that operate separately, but are all legally part of KFHP.

*Amended and Restated Joint Marketing and Administration Agreement:* The Company and its parent, KFHP, entered into an Amended and Restated Joint Marketing and Administration Agreement effective January 1, 2009. Pursuant to the agreement, the Company and KFHP jointly offer the Company's Exclusive Provider Organization (EPO) indemnity product in conjunction with KFHP's health maintenance organization products. The Company's EPO product is an individually underwritten group plan providing exclusive provider benefits and services that will utilize KFHP's provider network. In addition to the joint marketing, KFHP will provide administrative services, provider network services and integrated care management services to the Company in connection with the product. The administrative services include: underwriting and pricing, producer's commissions computation and payment, appointment and cancellation of agents or brokers, issuance and cancellation of policies and endorsements, collection and handling of premiums, advertising, utilization management, insured appeals and grievances, customer service, and other services, such as joint marketing, network management, and integrated care management. This agreement was approved by the CDI on August 23, 2010. The total cost to the Company in 2010 for services under this agreement was $458,574.

*Amended and Restated Administrative Services Only (ASO) Services Agreement:* The Company and its parent, KFHP, entered into an Amended and Restated Administrative Services Only (ASO) Services Agreement effective July 1, 2009. Pursuant to the agreement, the Company will provide administrative and provider network administrative services to KFHP in connection with the self-funded health benefits plans where KFHP acts as the sponsor or administrator. Under this agreement, the Company provides services related to self-funded health benefit plans covering certain employees of KFHP and its affiliates, Kaiser Foundation Health Plan of Georgia, Inc., Kaiser Foundation Hospitals, and KP OnCall, LLC. This agreement superseded the 2008 ASO Services Agreement filed by the Company which covered only services provided to employees of Kaiser Foundation Health Plan of Georgia, Inc. The 2009 ASO Services Agreement was approved by the CDI on June 29, 2009. The total fees received by the Company for services under this agreement in 2010 were $41,572,524.

*Self-Funded Administrative Services Agreement:* The Company and its parent, KFHP, entered into Self-Funded Administrative Services Agreements with KFHP and the following affiliated health plans: Kaiser Foundation Health Plan of Georgia, Inc., Kaiser Foundation Health Plan of Colorado, Kaiser Foundation Health Plan of the Northwest, and Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc. Under the terms of the agreement, the Company is to administer the self-funded plans using the respective health plan's administrative services. The Company was granted exemption from filing these agreements pursuant to CICS 1215.5(i). The total cost to the Company in 2010 for services under these agreements was $33,668,302.

*Service Agreement, Permanente Advantage LLC:* The Company and its affiliate, Permanente Advantage, LLC (PA), entered into a Services Agreement effective January 1, 2010. Pursuant to the Service Agreement, PA provides services to the Company relating to healthcare utilization management, case management, revision of pre-certification requirements and related activities of the health insurance coverage and self-funded plans offered by the Company in the following three regions: Northern California, Southern California, and Hawaii; and to the affiliated health plans in Colorado, Georgia, Ohio, and Mid-Atlantic States (Virginia, Maryland and Washington, D.C.). The agreement was approved by the CDI on December 2, 2009. The total cost to the Company in 2010 for services under this agreement was $1,010,673.

*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. As noted in the previous examination, it is again recommended that the Company file this agreement with the CDI pursuant to CICS 1215.5.

Unaffiliated Service Agreements

The Company has a service agreement with Delta Dental Plan of California (Delta). Pursuant to the agreement, Delta agrees to process and pay all of the Company's dental claims. Claims are paid by Delta and are later reimbursed by the Company.

The Company has a master services agreement with Perot Systems Healthcare Services, LLC (Perot). Pursuant to the agreement, Perot agrees to provide medical claims processing services for the Company in California, Hawaii, Georgia, and the Mid-Atlantic States (Virginia, Maryland, and Washington D.C.).

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

The Company has a service agreement with Harrington Health Services, Inc. (Harrington), wherein Harrington agrees to provide medical claims processing services for plan sponsors of the self-funded product, on the Company's behalf.

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

## TERRITORY AND PLAN OF OPERATION

As of December 31, 2010, the Company was licensed to transact business 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 2010 totaled $250,216,355, of which California accounted for 45.8%, Ohio 19.1%, Georgia 9.0%, Colorado 8.0%, Virginia 7.5%, Maryland 4.8%, Hawaii 3.8%, District of Columbia 1.9%, and the remainder in Oregon. Of the $250,216,355 in direct premiums written, 18.4% or $45,942,196, 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, a preferred provider organization option, out-of-area health, an exclusive provider organization product, 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 KFHP's service area, but live in the United States. The Company's exclusive provider organization product is an individually underwritten group plan providing exclusive provider benefits and services that utilizes KFHP's provider network. KFHP providers bill the Company on a fee-for-services basis for medical and surgical services provided to the exclusive provider organization.

The Company began offering administrative services for the self-funded plans of employers and other plan sponsors in KFHP regions outside of California on September 1, 2008, and in California on January 1, 2009. The Company serves as the administrator, or Administrative Services Only (ASO), for the self-funded plans. As the ASO, the Company contracts with the plan sponsor to provide all of the administrative services needed for self-funding.

## REINSURANCE

### Assumed

The Company had no reinsurance assumed business.

Ceded

The Company had no reinsurance ceded business.

## ACCOUNTS AND RECORDS

A review was made of the Company's general controls over its information systems. As a result of this review, significant risk findings were noted in logical access security and program changes. These findings were presented to the Company along with recommendations to strengthen its controls. The Company should evaluate the recommendations and make appropriate changes to strengthen its information systems controls.

## FINANCIAL STATEMENTS

The financial statements prepared for this report include the following:

Statement of Financial Condition as of December 31, 2010

Summary of Operations and Capital and Surplus Account for the Year Ended December 31, 2010

Reconciliation of Capital and Surplus from December 31, 2007 through December 31, 2010

Statement of Financial Condition
as of December 31, 2010

| Assets | Ledger and Nonledger Assets | Non-Admitted Assets | Net Admitted Assets | Notes |
|---|---|---|---|---|
| Bonds | $ 100,213,295 | $ | $ 100,213,295 | |
| Cash and short-term investments | 5,830,677 | | 5,830,677 | |
| Investment income due and accrued | 469,849 | | 469,849 | |
| Uncollected premiums and agent's balances in course of collection | 19,792,605 | | 19,792,605 | |
| Amounts receivable relating to uninsured plans | 112,855 | | 112,855 | |
| Electronic data processing equipment and software | 3,057,318 | 3,057,318 | | |
| Aggregate write-ins for other than invested assets | 71,160 | 26,733 | 44,427 | |
| Total assets | $ 129,547,759 | $ 3,084,051 | $ 126,463,708 | |

| Liabilities, Surplus and Other Funds | | | Notes |
|---|---|---|---|
| Claims unpaid | | $ 39,146,708 | (1) |
| Accrued medical incentive pool and bonus amounts | | 312,584 | |
| Unpaid claims adjustment expenses | | 4,051,851 | (1) |
| Premiums received in advance | | 1,479,736 | |
| General Expenses due or accrued | | 4,746,961 | |
| Current federal and foreign income taxes | | 266,093 | |
| Net deferred tax liability | | 313,428 | |
| Amounts due to parent, subsidiaries and affiliates | | 5,934,887 | |
| Payable for securities | | 2,459,209 | |
| Liability for amounts held under uninsured plans | | 1,859,876 | |
| Total liabilities | | 60,571,333 | |
| Common capital stock | $ 48,000 | | |
| Preferred capital stock | 4,000,000 | | |
| Gross paid-in and contributed surplus | 16,000,000 | | |
| Unassigned funds (surplus) | 45,844,375 | | |
| Total capital and surplus | | 65,892,375 | |
| Total liabilities, surplus and other funds | | $ 126,463,708 | |

## Statement of Revenue and Expenses and Capital and Surplus Account for the Year Ended December 31, 2010

### Statement of Revenue and Expenses

| | | |
|---|---|---|
| Net premium income | | $ 250,216,353 |
| Total revenues | | 250,216,353 |
| Deductions: | | |
| Hospital/medical benefits | $ 141,426,239 | |
| Other professional services | 27,098,295 | |
| Emergency room and out-of-area | 3,293,604 | |
| Prescription drugs | 36,204,118 | |
| Incentive pool, withhold adjustment and bonus amounts | 2,755,489 | |
| Claims adjustment expenses | 20,641,755 | |
| General administrative expenses | 18,437,672 | |
| Total underwriting deductions | | 249,857,172 |
| Net underwriting gain | | 359,181 |
| Investment Income | | |
| Net investment income earned | $ 3,193,919 | |
| Net realized capital gains | 1,898,053 | |
| Net investment gain | | 5,091,972 |
| Net income after capital gains tax and before all other federal income taxes | | 5,451,153 |
| Federal and foreign income taxes incurred | | 1,612,239 |
| Net income | | $ 3,838,914 |

### Capital and Surplus Account

| | | |
|---|---|---|
| Capital and Surplus, December 31, 2009 | | $ 60,069,287 |
| Net income | $ 3,838,914 | |
| Change in deferred income tax | (869) | |
| Change in nonadmitted assets | 1,985,043 | |
| Net change in capital and surplus | | 5,823,088 |
| Capital and Surplus, December 31, 2010 | | $ 65,892,375 |

Reconciliation of Capital and Surplus
from December 31, 2007 through December 31, 2010

| | Gain in Surplus | Loss in Surplus | |
|---|---|---|---|
| Capital and surplus, December 31, 2007, per Examination | | | $ 58,994,078 |
| Net income | $ 8,922,632 | $ | |
| Change in net deferred income tax | | 150,126 | |
| Change in nonadmitted assets | | 1,874,209 | |
| Total gains and losses in surplus | $ 8,922,632 | $ 2,024,335 | |
| Net increase in surplus | | | 6,898,297 |
| Capital and surplus, December 31, 2010, per Examination | | | $ 65,892,375 |

## 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, 2010 and concluded that the reserves were reasonable.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control – Settlement of Intercompany Transactions Agreement (Page 8): It is again recommended that the Company file this agreement with the California Department of Insurance (CDI) pursuant to California Insurance Code Section (CICS) 1215.5.

Accounts and Records (Page 11): As a result of the review of the Company's information systems controls, recommendations for improving these controls were presented to the Company. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

### Previous Report of Examination

Management and Control (Page 6): It was 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 CICS 1215.4. The Company is now in compliance.

Management and Control - Joint Administration Agreements (Page 6): It was 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 CDI for approval in accordance with CICS 1215.5(b)(4). The Company is now in compliance.

Management and Control - Joint Marketing and Administration Agreements (Page 6): It was recommended that the Company amend its Joint Marketing and Administration Agreements with Kaiser Foundation Health Plan of Georgia, Inc. and Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc. 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). The Company is now in compliance.

Management and Control – Settlement of Intercompany Transactions Agreement (Page 8): It is again recommended that the Company file this agreement with the CDI pursuant to CICS 1215.5.

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

Comments on Financial Statement Items - Amounts Due to Parent, Subsidiaries and Affiliates (Page 14): It was recommended that the intercompany balances be settled timely and with a specified due date in accordance with the Statements of Statutory Accounting Principles No. 25. The Company is now in compliance.

## ACKNOWLEDGEMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

/S/
Sandra Bailey, CFE
Examiner-in-Charge
Senior Insurance Examiner
Department of Insurance
State of California