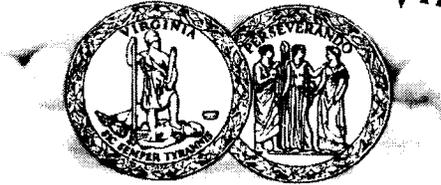


**EXAMINATION REPORT**  
**of**  
**VML INSURANCE PROGRAMS**  
**GROUP SELF-INSURANCE RISK POOL**  
**GLEN ALLEN, VIRGINIA**  
**as of**  
**JUNE 30, 2012**

**COMMONWEALTH OF VIRGINIA**  
**STATE CORPORATION COMMISSION**  
**BUREAU OF INSURANCE**

# COMMONWEALTH OF VIRGINIA

JACQUELINE K. CUNNINGHAM  
COMMISSIONER OF INSURANCE  
STATE CORPORATION COMMISSION  
BUREAU OF INSURANCE



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I, Jacqueline K. Cunningham, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of VML Insurance Programs Group Self-Insurance Risk Pool as of June 30, 2012, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand  
and affixed to the original the seal of the Bureau at the City  
of Richmond, Virginia this 7th day of June, 2013

---

Jacqueline K. Cunningham  
Commissioner of Insurance

(SEAL)

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Richmond, Virginia  
February 28, 2013

Honorable Jacqueline K. Cunningham  
Commissioner of Insurance  
Richmond, Virginia

Dear Madam:

Pursuant to your instructions and by authority of Section 38.2-1317 of the Code of Virginia, an examination of the records and affairs of:

**VML INSURANCE PROGRAMS  
GROUP SELF-INSURANCE RISK POOL**

Glen Allen, Virginia

hereinafter referred to as the Pool, has been completed. The report is hereby submitted for your consideration.

**DESCRIPTION**

The Pool is a local government group self-insurance pool licensed to provide risk management and liability insurance coverage to its members pursuant to Section 15.2-2706 of the Code of Virginia and 14 VAC 5-360-10 et seq. (Rules Governing Local Government Group Self-Insurance Pools) promulgated by the State Corporation Commission (the "Commission").

The Pool was last examined by representatives of the Commission's Bureau of Insurance (the "Bureau") as of June 30, 2009. This examination covers the period from July 1, 2009 through June 30, 2012.

**HISTORY**

The Pool was licensed by the Bureau on July 1, 1986. According to its bylaws, the Pool was formed:

"... to provide for cooperative action in providing risk management services as well as insurance coverage for pool members and employees of pool members for acts or omissions arising out of the scope of their employment..."

Effective July 1, 2010, the Members' Supervisory Boards of both the Pool (formally known as the Virginia Municipal Liability Pool) and the Virginia Municipal Group Self-insurance Association (the "Association") approved a merger of the Pool and the Association, with the Pool being the surviving entity. The merger allowed for the combined pooling of liability claims, property losses and liabilities arising out of the Virginia Workers' Compensation Act.

### MANAGEMENT AND CONTROL

Control of the Pool is vested in a Members' Supervisory Board (the "Board") elected by the members of the Pool. The by-laws provide for no less than six nor more than nine Board members, of which all shall be elected or appointed officials of members of the Pool. The Board members serve three year terms or until their successors are elected. In addition to the elected Board members, the Executive Director of the Virginia Municipal League ("VML") shall serve as an ex-officio board member with the full power to vote on all matters which come before the board and whose presence shall be counted in the determination of a quorum at any meeting.

The Board and officers were as follows at June 30, 2012:

<u>Representative</u>	<u>Affiliation</u>
Samuel W. Adams, III	Mayor City of Emporia Emporia, Virginia
R. Michael Amyx, Ex-officio	Executive Director VML Richmond, Virginia
Cecil R. Harris, Jr.	County Administrator Hanover County Hanover, Virginia
John W. McCarthy, III	County Administrator Rappahannock County Washington, Virginia
Charles A. Moore	Town Manager Town of Mount Jackson Mount Jackson, Virginia

Karen L. Pallansch

General Manager  
Alexandria Sanitation Authority  
Alexandria, Virginia

Peter M. Stephenson

Town Manager  
Town of Smithfield  
Smithfield, Virginia

R. Clarke Wallcraft

Executive Director  
Pepper's Ferry Wastewater Authority  
Radford, Virginia

Thomas E. West

Board of Supervisors  
Halifax County  
Nathalie, Virginia

#### Officers

Peter M. Stephenson  
Karen L. Pallansch  
R. Michael Amyx

Chairperson  
Vice-Chairperson  
Secretary

### **TERRITORY AND PLAN OF OPERATION**

The operation of the Pool is confined to Virginia where it is licensed to transact the business of commercial multiple peril, inland marine, liability other than auto, automobile liability, automobile physical damage, fidelity, surety, boiler and machinery, and workers' compensation and employers' liability. Membership in the Pool is available to political subdivisions of the Commonwealth of Virginia, or agencies thereof. Members are required to enter into member agreements which set forth the rights, privileges and obligations of the members, as well as the terms, coverages, limits, and deductibles of the plan.

The Pool has a contractual agreement with an administrator who shall administer and manage the affairs of the Pool in accordance with the policies adopted and established by the Board. The administrator also functions as the claims service agent. The Pool's operations are conducted on a fiscal year basis ending June 30.

## **ADMINISTRATIVE AND OTHER SERVICES AGREEMENT**

Effective July 1, 2010, the Pool entered into an administrative and other services agreement with the VML. This agreement is effective for a period of five years unless prior to the end of such term, the parties mutually agree in writing to an extension. Either party may terminate this agreement with 180 days prior written notice. According to the agreement, VML is responsible for, but not limited to, the following:

- Accepting service of process on behalf of the Pool and binding the Pool and its members in transactions relating to or arising out of the operation of the Pool as designated by the Board.
- Administering the Pool's financial and administrative affairs.
- Representing the Pool before the Commission and the Bureau.
- Supervising the filing of all necessary forms and reports required by any governmental agencies.
- Filing financial statements with the Commission within 180 days of the Pool's fiscal year-end.
- Investing and reinvesting the Pool's funds.
- Billing and collecting contributions from members.
- Organizing and conducting a marketing program to encourage continuation of membership by all current Pool members and for solicitation of all other eligible potential Virginia political subdivisions for membership.
- Compiling and summarizing all necessary data and preparing submissions for excess insurance or reinsurance on behalf of the Pool to reinsurers and/or excess carriers as approved by the Pool.
- Providing complete underwriting services as shall be reasonably required to insure the Pool's financial well being on a fund year basis.
- Providing complete loss control services, which shall include conducting loss control evaluation of members, providing comprehensive formal loss control workshops for members, preparing and monitoring computer loss runs and furnishing complete claims handling services and administration for all workers' compensation, liability and casualty claims to conclusion.
- Performing other duties and powers as may be assigned by the Board.

As compensation for its services, VML shall receive 1.25% of the aggregate annual gross contributions paid by all members. Only member contributions attributable to the coverages provided by the Pool shall be used as the basis for calculating the fee. This fee shall not include any amount in respect to any excess liability coverages or any separate surplus or other assessment levied on the members of the Pool. In addition to this fee, VML shall be reimbursed for the actual reasonable expenses incurred in connection with the provision of the duties noted above.

For the 2011/2012 fiscal year, the Pool incurred \$6,072,614 in administrative fees related to this agreement representing 11.2% of the aggregate annual gross contribution paid by members.

### **OTHER SERVICE AGREEMENTS**

#### **Medical Bill Review Service**

Effective March 21, 2011, the Pool entered into a medical bill review service agreement with ACS CompIQ Corp. ("CompIQ"). The initial term of the agreement is for three years unless terminated by either party upon 90 days written notice. According to the agreement, CompIQ will perform medical cost containment services to include medical bill audits and retrospective utilization reviews. After any applicable adjustments, CompIQ shall process the medical payments directly on behalf of the Pool through access to a claims disbursement account established by the Pool specifically for this purpose. As compensation for paying medical claims and performing cost containment services, CompIQ receives an agreed upon percentage of the gross savings resulting from its reviews, with the remaining cost savings retained by the Pool. For the 2011/2012 fiscal year, the Pool incurred \$683,812 in fees related to this agreement.

#### **Broker Services**

Effective July 1, 2010, the Pool entered into a broker services agreement with Alliant Insurance Services, Inc. ("Alliant"). The initial term of the agreement is for three years unless terminated by either party upon 90 days written notice. The Pool shall have the option to extend the agreement for two additional one-year periods by written notification prior to the anniversary date. According to the agreement, Alliant shall provide technical assistance in various areas including the placement of reinsurance, marketing, underwriting, filing of required reports and additional broker services as agreed upon by the parties. For these services, Alliant received a fee of \$425,000 for the 2011/2012 fiscal year.

### Managed Care Services

Effective March 15, 2010, the Pool entered into a managed care services agreement with Coventry Health Care Workers Compensation, Inc. ("Coventry"). The initial term of the agreement was for two years unless terminated by either party upon 90 days written notice. According to the agreement, Coventry shall perform the first report of injury program, provide access to a toll-free telephone service by which injuries can be reported, provide promotional and information packages to members for notice of claims reporting and provide the Pool monthly first report of injury reports. For these services, Coventry shall receive a stipulated fee per call. For the 2011/2012 fiscal year, the Pool incurred \$161,470 in fees related to this agreement.

### CONFLICT OF INTEREST

The Pool has adopted a conflict of interest policy. The objective of this policy is to ensure that each director and officer faithfully serve the Pool and refrain from doing anything which is adverse or prejudicial to the Pool's interest. To ensure compliance with the policy, the Pool has established procedures which require directors and officers to sign a conflict of interest disclosure form annually. The disclosure forms are reviewed to determine if a potential or real conflict of interest exists.

### DIVIDENDS TO MEMBERS

Any surplus assets accumulated within a fiscal year may be declared refundable by the Board. Payment of this surplus in the form of dividends, however, may not be made until certified by an actuary and the Pool has received acknowledgement from the Bureau. During the examination period, no dividends were acknowledged by the Bureau.

### FIDELITY BOND COVERAGE

At June 30, 2012, the Pool was listed as a named insured on a fidelity bond with a \$2,000,000 limit of liability, subject to a \$25,000 deductible, to insure against losses arising from dishonest acts of its administrator and employees.

### SPECIAL RESERVES AND DEPOSITS

At June 30, 2012, the Pool had securities in the amount of \$160,000 on deposit with the Treasurer of Virginia as required by 14 VAC 5-360-45.

## REINSURANCE COVERAGE

The Pool had reinsurance coverage in force at June 30, 2012 as set forth in the following schedules:

<u>Class of Business</u>	<u>Pool's Retention</u>	<u>Reinsurer's Limits</u>
Automobile Liability, General Liability, Public Officials Liability, Law Enforcement Liability, School Board Legal Liability, Employee Benefits Liability	\$1,000,000 each occurrence	\$10,000,000 per occurrence in excess of \$1,000,000 of the Pool's retention, subject to various annual aggregate limits

Each Pool member has the option of increasing its liability coverages to a higher limit than the basic \$1,000,000 limit offered by the Pool. The additional umbrella limits of up to \$10,000,000 excess are placed through the reinsurer, subject to their approval, with the first \$1,000,000 of coverage retained by the Pool.

<u>Class of Business</u>	<u>Pool's Retention</u>	<u>Reinsurer's Limits</u>
General Property	\$1,000,000 per occurrence before exhaustion of the annual aggregate pool deductible of \$4,000,000 after which a \$25,000 maintenance deductible applies. The flood occurrence limit is \$500,000.	\$1,000,000,000 per occurrence all perils, coverages and members combined, subject to various sub-limits.
Auto Physical Damage	\$150,000 per vehicle- comprehensive/collision	Replacement cost basis per member's schedule of insured vehicles with purchase cost greater than \$75,000.

For the above Property and Auto Physical Damage business, pool members select deductibles between \$0 and \$100,000.

<u>Class of Business</u>	<u>Pool's Retention</u>	<u>Reinsurer's Limits</u>
Fidelity & Crime	\$300,000 per occurrence	\$1,000,000 each occurrence
Boiler & Machinery	\$100,000 per occurrence	\$100,000,000 each occurrence

For Boiler & Machinery business, the Pool's retention limit on insured equipment varies between \$100,000 and \$350,000 depending on the equipment size and output rating.

Workers' Compensation	\$1,000,000 maximum each accident and each employee for disease	Workers' Compensation Statutory Employers' Liability \$1,000,000
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**SCOPE**

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia and covers the period from July 1, 2009 through June 30, 2012. Assets were verified and liabilities were established at June 30, 2012. A review of income and disbursements for the period was made to the extent deemed necessary.

The items comprising the Balance Sheet have a medium or low risk assessment as determined from the principals of the risk based approach contained in the NAIC Financial Condition Examiners Handbook. Analytical review procedures were applied to non-material items.

In addition, the following items were reviewed, several of which are discussed separately under their respective captions in this report.

History  
Management and Control  
Territory and Plan of Operation  
Administrative and Other Services Agreement  
Other Service Agreements  
Conflict of Interest  
Dividends to Members  
Fidelity Bond Coverage  
Special Reserves and Deposits  
Reinsurance Coverage  
Financial Statements

**FINANCIAL STATEMENTS**

There follows a statement of financial condition of the Pool as of June 30, 2012, a statement of revenue and expenses for the fiscal year ended June 30, 2012, a statement of changes in members' equity for the period under review, a statement of cash flows for the fiscal year ended June 30, 2012 and a statement of Examiners' changes in unrestricted equity at June 30, 2012.

**BALANCE SHEET**  
**JUNE 30, 2012**

**ASSETS**

Current assets:	
Cash and cash equivalents	\$11,363,845
Investments	13,910,074
Accounts and contributions receivable	1,031,040
Accrued interest receivable	1,537,878
Reinsurance receivable	6,280,614
Prepaid expenses	9,892
Total current assets	<u>\$34,133,343</u>
Noncurrent assets:	
Property and equipment	\$5,360,838
Investments	202,238,018
Restricted deposit	160,000
Total noncurrent assets	<u>\$207,758,856</u>
Total assets	<u><u>\$241,892,199</u></u>

**LIABILITIES AND EQUITY**

Current liabilities:	
Liability for unpaid losses, net	\$28,948,498
Contributions collected in advance	3,345,502
Dividends payable	27,772
Program administrative costs payable	46,158
Compensated absences	337,271
Capital leases	117,164
Reinsurance payable	303,153
Other liabilities	1,080,211
Total current liabilities	<u>\$34,205,729</u>
Noncurrent liabilities:	
Liability for unpaid losses, net	131,876,492
Total liabilities	<u>\$166,082,221</u>
Equity:	
Unrestricted equity	\$58,497,435
Restricted equity	17,312,543
Total equity	<u>\$75,809,978</u>
Total liabilities and equity	<u><u>\$241,892,199</u></u>

**STATEMENT OF REVENUE, EXPENSES**  
**AND CHANGES IN EQUITY**  
**FOR THE YEAR ENDED JUNE 30, 2012**

Operating revenues:	
Member contributions	\$53,852,717
Total operating revenues	<u>\$53,852,717</u>
Operating expenses:	
Provision for losses and loss adjustment expenses	\$36,925,127
Program administration fees	8,791,837
Reinsurance premiums	9,047,674
Total operating expenses	<u>\$54,764,638</u>
Operating loss	<u>(\$911,921)</u>
Non-operating revenues:	
Investment income	\$8,378,258
Miscellaneous income	148,453
Net increase (decrease) in fair value of investments	4,389,408
Total non-operating revenues	<u>\$12,916,119</u>
Non-operating expenses	<u>903,319</u>
Non-operating income, net	<u>\$12,012,800</u>
Change in equity	\$11,100,879
Equity at beginning of year	<u>64,709,099</u>
Equity at end of year	<u><u>\$75,809,978</u></u>

**STATEMENT OF CHANGES IN MEMBERS' EQUITY**

	<u>2009/2010</u> <u>Fiscal Year</u>	<u>2010/2011</u> <u>Fiscal Year</u>	<u>2011/2012</u> <u>Fiscal Year</u>
Members' Equity, beginning of fiscal year	<u>\$28,366,884</u>	<u>\$34,675,160</u>	<u>\$64,709,099</u>
Adjustment for merger of Association's equity into Pool		26,683,081	
Excess of revenues over expenses	<u>6,308,276</u>	<u>3,350,858</u>	<u>11,100,879</u>
Members' Equity, end of fiscal year	<u><u>\$34,675,160</u></u>	<u><u>\$64,709,099</u></u>	<u><u>\$75,809,978</u></u>

**STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED JUNE 30, 2012**

Cash flows from operating activities:	
Receipts from members	\$53,289,650
Payments for reinsurance premiums	(8,943,587)
Payments from reinsured losses, net	(2,971,421)
Payments for claims and adjustment expenses	(26,607,453)
Payments for administrative and general expenses	(9,880,024)
Net cash provided by operating activities	<u>\$4,887,165</u>
Cash flows from noncapital financing activities:	
Payments for miscellaneous income	\$148,453
Net cash provided by noncapital financing activities	<u>\$148,453</u>
Cash flows from investing activities:	
Proceeds from calls and maturities of investments	\$73,351,541
Purchases of investments	(83,422,246)
Investment income	8,643,498
Receipts (payments) of furniture and equipment	(348,765)
Net cash used for investing activities	<u>(\$1,775,972)</u>
Net increase (decrease) in cash and cash equivalents	\$3,259,646
Cash and cash equivalents:	
Beginning of year	8,104,199
End of year	<u><u>\$11,363,845</u></u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	(\$911,921)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Provision for losses	36,925,127
Payments of claims and claims adjustment expenses	(26,607,453)
Payments for other operating expenses	(903,319)
Changes in assets and liabilities:	
Accounts and contributions receivable	(209,461)
Reinsurance recoverable	(2,971,421)
Prepaid expenses	173,053
Contributions collected in advance	(353,606)
Administrative fees payable	25,385
Reinsurance payable	104,086
Other liabilities	(383,305)
Net cash provided by operating activities	<u><u>\$4,887,165</u></u>

**STATEMENT OF EXAMINERS' CHANGES IN**  
**UNRESTRICTED EQUITY**  
**JUNE 30, 2012**

	Amount Per Pool	Amount Per Examiner	Increase (Decrease) Unrestricted Equity
	<u>          </u>	<u>          </u>	<u>          </u>
<u>Assets:</u>			
Accounts and contributions receivable	\$1,017,381	\$1,031,040	\$13,659
<u>Liabilities:</u>			
Contributions collected in advance	3,164,178	3,345,502	(181,324)
Other liabilities	1,133,101	1,080,211	<u>52,890</u>
Examiners' decrease in unrestricted equity			(\$114,775)
Examiners' reclassification of unrestricted equity to restricted equity (see Recommendation #s 2 and 3)			<u>(164,105)</u>
Examiners' total changes in unrestricted equity			<u><u>(\$278,880)</u></u>
Unrestricted equity per Pool			\$58,776,315
Unrestricted equity per Examiner			<u>\$58,497,435</u>
Decrease in unrestricted equity			<u><u>(\$278,880)</u></u>

## RECOMMENDATIONS FOR CORRECTIVE ACTION

### Management and Control

1. The results of this examination reflect a members' equity deficit for the 1984/1985, 1986/1987, 1987/1988, 1988/1989, 1990/1991, 1993/1994, 1999/2000, 2002/2003, 2009/2010 and 2010/2011 fiscal years of \$167,606, \$115,036, \$95,478, \$224,563, \$158,749, \$78,247, \$100,971, \$139,616, \$567,662 and \$2,483,359, respectively. The Board is reminded of its responsibility to assure that the Pool is financially sound and able to fulfill its obligations according to its by-laws.

### Accounts and Records

2. Unrestricted equity \$58,497,435

The above amount is \$278,880 less than the amount reported by the Pool in its June 30, 2012 filing. The Examiners reclassified the statutory deposit with the Treasurer of Virginia (market value of \$164,105) from Unrestricted equity to Restricted equity. The additional decrease of \$114,775 is the result of Recommendations #4 and #5 outlined below.

3. Restricted equity \$17,312,543

The above amount is \$164,105 more than the amount reported by the Pool in its June 30, 2012 filing. The Examiners reclassified the the statutory deposit with the Treasurer of Virginia (market value of \$164,105) that was reported by the Pool as Unrestricted equity. The Examiners' recommend that the Pool, in future filings with the Bureau, report the value of the statutory deposit as Restricted equity.

### Payroll Audit Changes-Workers' Compensation Line of Business

The adjustments in the following recommendations were determined by utilizing the member's final 2011/2012 fiscal year payrolls which were not fully completed until after the Pool's June 30, 2012 filing to the Bureau.

4. <u>Accounts and contributions receivable</u>	<u>\$1,031,040</u>
<u>Contributions collected in advance</u>	<u>\$3,345,502</u>

The above amounts have been increased by \$13,659 and \$181,324, respectively. The Examiners' amounts are based on a review of the subsequent 2011/2012 fiscal year member payroll audits and reflect differences between audited contributions and contributions paid by members as well as a review of the administrative fees paid compared to the fees required by the administrative agreement with the VML for the 2011/2012 fiscal year.

5. <u>Other liabilities</u>	<u>\$1,080,211</u>
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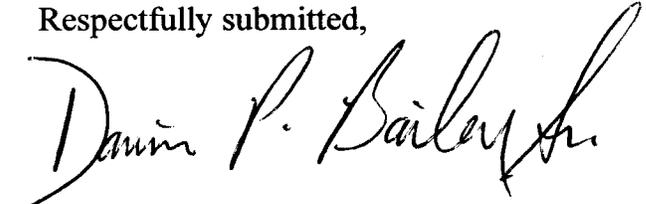
The above liability is \$52,890 less than the amount reported by the Pool in its June 30, 2012 filing. The Examiners' amount is based on a review of the calculation for workers' compensation taxes incurred and other expenses for the fiscal year ended June 30, 2012, but paid in the subsequent fiscal year. The Examiners recommend that the Pool accurately accrue the liability for all expenses payable as of its fiscal year end in future filings to the Bureau.

**CONCLUSION**

Acknowledgment is hereby made of the courteous cooperation extended by the Pool's administrator and staff during the course of the examination.

In addition to the undersigned, George E. Morgan, CFE and Milton Parker, Jr. participated in the work of the examination.

Respectfully submitted,

A handwritten signature in black ink that reads "Darrin P. Bailey, Sr." The signature is written in a cursive style with a large initial 'D' and a trailing flourish.

Darrin P. Bailey, Sr., CFE, MHP, AIAF  
Senior Insurance Examiner



STATE CORP COMMISSION  
BUREAU OF INSURANCE  
13 JUN -4 AM 8:12

May 10, 2013

Mr. David H. Smith, CFE, CPA, CPCU  
Chief Examiner  
State Corporation Commission  
Bureau of Insurance  
P. O. Box 1157  
Richmond, VA 23218

RE: VML Insurance Programs; Examination Report as June 30, 2012

Dear Mr. Smith,

We have received the examination report as of June 30, 2012 for VML Insurance Programs.

In response to the recommendations for corrective action on pages 16 and 17 of the report, the following is offered:

Item 1.

We hereby acknowledge deficit balances in certain years as shown on the annual statement. We also point out that with over \$75 million in total equity, the Pool is very financially sound and able to fulfill its obligations according to our bylaws. Nonetheless given the age and constancy of these deficits, the Pool will develop a plan to eliminate them and submit it for Bureau approval.

Items 2 and 3.

The market value of the statutory deposit will be reflected in the restricted equity on future filings.

Item 4.

Subsequent to the examination, the Pool received permission from the Bureau to issue the audited financial statements with estimated payroll information when the audited payroll information was not available. This action should significantly reduce the need for this recommendation in future examinations. The Pool is working to expedite the payroll audit process as much as possible to minimize how much estimated payroll information is included. However given that it is unlikely that we will ever get all payroll audits processed in time for the financial audit and annual statement filing,

Mr. David H. Smith, CFE, CPA, CPCU  
May 10, 2013  
Page 2

these types of adjustments will likely recur if the examiners continue to use final payroll audit amounts.

Item 5.

This adjustment is the result of information available to the examiners that was not known at the time of the annual statement filing. In the future every effort will be made to accurately accrue for other liabilities.

Please advise if you have questions or concerns with this course of action.

We would appreciate 15 (fifteen) copies of the examination report. Thank you for your cooperation.

Sincerely,

A handwritten signature in black ink, appearing to read "Karen L. Pallansch", with a long horizontal flourish extending to the right.

Karen L. Pallansch  
Chair, Members Supervisory Board