

STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**CASCADE EAST HEALTH PLANS, INC.  
HERMISTON, OREGON**

**NAIC COMPANY CODE 47096**

AS OF

DECEMBER 31, 1999

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October 30, 2000

Honorable Mary C. Neidig, Director  
Department of Consumer and Business Services  
State of Oregon  
350 Winter Street NE, Room 440  
Salem, Oregon 97301-3883

Dear Director:

In accordance with your instructions and pursuant to ORS 731.300, I have examined the business affairs and financial condition of

**CASCADE EAST HEALTH PLANS, INC.  
610 NW 11<sup>th</sup> Street  
Hermiston, Oregon 97838**

**NAIC Company Code 47096**

hereinafter referred to as the "Plan/Company." The following report of examination is respectfully submitted.

## **SCOPE OF EXAMINATION**

The examination of the Company was conducted as of December 31, 1999, covering the two-year and two month period then ended, and included a review of material transactions or events which occurred subsequent to the examination cut-off and were noted during the examination.

The examination was conducted pursuant to ORS 731.300 and in accordance with procedures and guidelines prescribed by the National Association of Insurance Commissioners (NAIC) for the purpose of determining the Company's financial condition, ability to fulfill and the manner of fulfillment of its obligations, the nature of its operations, and compliance with the Insurance Code. Accounting methods, internal control procedures, records, and other supporting evidence were examined or tested by appropriate methods to the extent deemed necessary and appropriate for the type, volume, and complexity of the accounting system and operations utilized by the Company.

Mr. Ralph Kopp, FSA, MAAA, actuary for the State of Oregon, Department of Consumer and Business Services participated in this examination by evaluating unpaid claims and aggregate write-ins for other liabilities. The results of his analyses are found under the relevant section of this report.

A management affirmation attesting to the Company's compliance with Oregon laws relating to location of accounts and records, conduct of the Company's affairs in a nonhazardous manner, and exercise of managerial control by a duly qualified and constituted Board of Directors was signed by and received from the Chairman of the Board of Directors.

## **COMPANY HISTORY**

The Plan was granted a Certificate of Authority, effective April 27, 1998, on the basis of the results of a qualifying report of examination dated November 15, 1997. During that examination, it was determined the Plan possessed assets of \$528,228 and \$537 in liabilities and unassigned funds in the

form of contributed capital of \$527,691 and no net income. Subsequent to that examination, the Plan filed its annual statement with the Oregon Insurance Division, for the period ending December 31, 1998, and reported reserves and unassigned funds of \$49,545. That amount was below the minimum capital and surplus required by the provisions of ORS 750.045(3)(a). This section of ORS Chapter 750 required the Plan to possess and thereafter maintain capital and surplus of not less than \$250,000 or an amount equal to 50% of average incurred claims for the preceding 12 month period, whichever was greater. As a result, on March 12, 1999, the director issued an order to cure impairment.

Pursuant to the order, a target examination was conducted on March 15, 1999. It was concluded during the target examination that the Plan's decision to record a liability of \$524,557 for management services provided by the parent caused the impairment. On March 16, 1999, the management services agreement was canceled and the liability for the above amount was written off. Due to corrective action taken by the Plan, it was determined that the Plan's capital and surplus was \$574, 102.

### **Funding Agreement**

As a result of the target examination, the Plan signed a funding agreement with the parent. According to the terms of the agreement, the parent agreed to undertake the operating expenses of the Plan, including, but not limited to salaries, rents, licenses, and taxes, until such time as the Plan generates sufficient revenue to support its operating expenses without drawing on capital or surplus. The funds provided by the parent for the operating expenses of the Plan, pursuant to the agreement, shall not be liabilities of the Plan nor shall the Plan be required, at any time to repay such funds to the parent. The Plan shall notify the Oregon Insurance Department at least 30 days in advance before it undertakes responsibility and payment for its operating expenses in whole or in part. In addition, the parent agreed to provide any and all future funds to the Plan as needed to maintain the capital and surplus of the Plan as required by the Oregon Insurance Code. Funds provided by the parent pursuant to this agreement shall not be liabilities of the Plan nor shall the Plan be required, at any time to repay to the parent.

## CAPITALIZATION

Good Shepherd Community Hospital, the sponsor and corporate member of Cascade East Health Plans, Inc., made unconditional capital contributions to the Plan of \$250,000 during 1995 and an additional contribution of \$250,000 during 1997.

## AFFILIATED COMPANIES

Good Shepherd Community Hospital – The sole voting member of the Plan and an Oregon nonprofit charitable corporation, operating as an acute hospital.

Good Shepherd Community Health Foundation – A nonprofit corporation, organized to provide scholarships and support to the community.

The organizational chart at the end of this report depicts the composition of the group.

## MANAGEMENT AND CONTROL

### *Board of Directors*

The Board is comprised of nine directors, of which one third of the persons shall be representatives of the public residing in the Plan's service area who are not practicing doctors or employees, or officers or trustees of a particular hospital, including Good Shepherd Community Hospital. The Board members serve for a staggered, three-year period and are elected at an annual meeting. Directors elected and serving at December 31, 1999, were as follows:

<u>Name and Address</u>	<u>Position and Affiliation</u>	<u>Representatio n</u>
Charles J. Stine* 1073 SW W. Highland Avenue Hermiston, OR 97838	Chairman/Retired Principal Hermiston School District Good Shepherd Community Hospital Trustee	Non-Public
Thomas F. Gilleese 940 E. Pine Hermiston, OR 97838	Vice-Chairman Vice-President Columbia River Bank	Public
John W. Smallmon 895 SW 7 <sup>th</sup> Street Hermiston, OR 97838	Secretary/Retired Attorney Good Shepherd Community Hospital Trustee	Non-Public

<u>Name and Address</u>	<u>Position and Affiliation</u>	<u>Representation</u>
Richard J. Ferranti 870 Quince Hermiston, OR 97838	Ferranti-Leavitt Insurance Agency Good Shepherd Community Hospital Trustee	<u>n</u> Non-Public
Victoria L. Smith Route 4 Box 4034 Hermiston, OR 97838	Smitty's Ace Hardware Owner Hermiston, Oregon	Public
Phillip A. Hawman 84917 Highway 37 Hermiston, OR 97838	Hawman Farms Owner Hermiston, Oregon	Public
Robert W. Reese 1010 NW King Pendleton, OR 97801	Treasurer Business Manager of Pendleton Schools	Public
Robert L. Veale MD** 82638 B Street Hermiston, OR 97838	Chief of Staff Good Shepherd Community Hospital	Ex officio
Theodore D. Flaiz, MD 595 NW 9 <sup>th</sup> Hermiston, OR 97838	Practicing Physician Good Shepherd Community Hospital Trustee	Non-Public
Robert E. Jenson 2126 NW 21 <sup>st</sup> Street Pendleton, OR 97801	State Legislature	Public

\*Chairman  
\*\*Ex officio

More than one-third of the Plan's directors are nonparticipating doctors or nonemployees or trustees of a participant hospital. Therefore, the Company is in compliance with ORS 750.015(1).

### Officers

Operating management of the Plans as of December 31, 1999, was under the direction of the following personnel:

<u>Name</u>	<u>Title</u>
Dennis E. Burke	President
Frederick Q. Rice	Chief Operating Officer
Mark B. Saylor	Chief Financial Officer
Robert W. Reese	Treasurer
Charles J. Stine	Chairman

Thomas F. Gilleese

Vice-Chairman

**MANAGEMENT AFFIRMATION**

## **CONFLICT OF INTEREST**

The Company has an established policy requiring disclosure of any material interest or affiliation on the part of any of its directors and officers which is in, or is likely to, conflict with official duties. After a review of such forms, which were completed by management, no exceptions were noted.

## **CORPORATE RECORDS**

The corporate records, including the Articles of Incorporation, Bylaws, and minutes of Board of Directors meetings were reviewed for the period under examination.

### **Articles of Incorporation**

The Articles of Incorporation were in conformity with Oregon statutes. No amendments were made to the articles during the course of this examination.

### **Bylaws**

The Bylaws appeared to be in conformity with Oregon statutes. No amendments were made to the Bylaws during the course of this examination.

### **Board Minutes**

Minutes of the Board of Directors meetings were reviewed for the period under examination. Meetings were held monthly and a quorum was achieved at each meeting. These minutes support the transactions of the Plan and actions taken by its officers. Investments were approved by the Board in accordance with the provisions ORS 733.730.

## **FIDELITY BONDS AND OTHER INSURANCE**

The examination of insurance coverages involved a review of the adequacy of limits and retentions, and the solvency of the insurers providing the coverages.

The Plan, through its parent, has directors and officers coverage that indemnifies directors and officers for aggregate losses up to \$1,000,000. The Plan also has coverage for insuring loss from employee dishonesty for up to \$25,000. The fidelity coverage met the minimum limits recommended by the NAIC Examiners Handbook, page I-105.

Other types of coverages provided the Plan include:

Employment practices liability                      Healthcare system excess liability insurance  
 General liability

The Company's insurance coverages were determined to be adequate as of December 31, 1999.

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

The Plan operates as a community health plan, serving Umatilla and Morrow counties, in North Central Oregon. Services are provided through the Oregon Trail Independent Physicians Association and other physicians based on negotiated rates. In addition, the Plan contracts with hospitals in the two county area on a capitated risk arrangement. Provider contracts contain a hold harmless clause as required by ORS 750.095(2).

### **GROWTH OF THE PLAN**

The following exhibit reflects the growth of the Company since October 23, 1997. The stated amounts were compiled from copies of the Plan's filed annual statement and, where indicated, financial examination reports.

<b><u>Year</u></b>	<b><u>Assets</u></b>	<b><u>Liabilities</u></b>	<b><u>Surplus</u></b>	<b><u>Net Income</u></b>
1997*	\$528,228	\$ 537	\$527,691	\$ 0
1998**	574,102	0	574,102	26,224
1999***	832,767	136,427	696,340	104,946

\*Per qualifying examination

\*\*Target examination

\*\*\*Per examination as of December 31, 1999

The Plan during the course of these two years and two months has increased its asset base by \$304,539.

### **LOSS EXPERIENCE**

The Plan commenced business on April 23, 1998, but did not write any business until January 1, 1999. Consequently, no premium or losses were recorded for the years 1997 or 1998. The loss ratio for 1999 is reflected in the chart below. The stated amounts were compiled from copies of the Company's filed annual statement and where indicated, financial examination reports.

<b><u>Year</u></b>	<b><u>Earned Premium</u></b>	<b><u>Loss</u></b>	<b><u>Ratio</u></b>
1997	\$ 0	\$ 0	0
1998	0	0	0
1999*	\$702,476	\$626,261	89.15%

\*Per examination

A loss ratio of \$89.14% was determined to be reasonable.

### **RETIREMENT PLANS AND POST RETIREMENT BENEFITS**

The Plan does not have retirement plans or post retirement benefits as all work performed for the Plan is done by employees of the parent.

### **REINSURANCE**

The Company has an excess risk reinsurance agreement that provides reinsurance coverage for a percentage of inpatient hospital expenses in excess of a \$40,000 deductible and \$10,000 for physicians expenses. Once the deductible amount has been reached for the agreement year, the reinsurer shall reinsure 90% of eligible charges. The reinsurer's lifetime maximum benefit per member is \$2,000,000. The reinsurance contract contained a proper insolvency clause in accordance with ORS 731.508(3). The Plan does not retain risk on any one subject of insurance in an amount exceeding 10% of its surplus to policyholders in accordance with ORS 731.504.

### **STATUTORY DEPOSIT**

As of the date of this examination the Company maintained a deposit with the Oregon Insurance Division, Department of Consumer and Business Services in the sum of \$255,000. The deposit is in the form of two US Treasury Bills held at US National Bank. The deposit was verified from the records of the Insurance Division.

### **ACCOUNTS AND RECORDS**

In general, the Company's records and source documentation supported the amounts presented in the Company's December 31, 1999, annual statement and were maintained in a manner by which the financial condition was readily verifiable as required by ORS 733.170. All records were held in Oregon pursuant to ORS 732.245(2).

The Company is in compliance with ORS 733.580 which relates to "investment of required capitalization."

The Plan has adopted a policy which will enable them to be compliant with unclaimed property laws and report to the Division of State Lands in accordance with ORS 98.302 to 98.342.

However, attention is directed to the following issues as a result of this examination.

#### **Funds Held In Excess Of 10% Of The Insurer's Assets**

At December 31, 1999, the Company held funds in a checking account that was in excess of 10% of its admitted assets. This is contrary to the provisions of ORS 733.770, which states in part that: an insurer shall not have any combination of investments in or secured by the stocks, obligations and property of any one corporation in excess of 10%. No recommendation will be made as the Plan, subsequent to year end received conditional approval from the Insurance Division granting an increase to 20% of admitted assets (see subsequent events).

### Premiums Receivable

The current method of using several spreadsheets and databases to track premiums receivable is labor intensive, error prone and lacks proper controls to ensure that the individual group balances are correct. **I recommend the Plan devote resources to computerize the premium accounting system to ensure proper accounting for premium receivables. This recommendation is made pursuant to the provisions of ORS 733.170.**

### Income Taxes

The Plan filed its Federal income taxes in accordance with Internal Revenue Rules, but did not file an Oregon Excise Tax Form 20. **I recommend the Plan file an Oregon Excise Tax Form 20 and become compliant with Oregon rules governing Oregon Excise Tax. This recommendation is made pursuant to the provisions of ORS 317.056.**

### Evaluation of Controls in Information Systems

A review of the Information Systems Questionnaire notes the following weaknesses:

1. The Plan does not have a disaster recovery program in place to insure continuity of business operations. **I recommend the Plan develop and test a disaster recovery plan.**
2. The Plan does not have a conventional computer room. Instead the server for the local area network is in an unlocked room. **I recommend a lock be placed on the door to the room where the local area network is located.**
3. The Plan on a weekly basis back-ups data from their computer systems. However, the back-up is stored at an individual's house. **I recommend the Plan initiate steps to insure back-ups are stored offsite in a secured environment.**

These recommendations are made pursuant to the provisions of ORS 731.302(1) and the NAIC Examiners Handbook (pg. I-108, I-109 and I-122).

In addition to the comments and recommendations noted above, several observations considered housekeeping in nature, were mentioned in a separate management letter issued on October 30, 2000.

These findings do not warrant a comment in the report and have been brought to the attention of the Company.

**CASCADE EAST HEALTH PLANS, INC.**  
**STATEMENT OF ASSETS, LIABILITIES & UNASSIGNED FUNDS**  
**AS OF DECEMBER 31, 1999**

<u>ASSETS</u>	<u>Annual Statement</u>	<u>Examination Adjustments</u>	<u>Net Admitted Assets</u>
Bonds (Note 1)	\$312,973		\$312,973
Common stock	196,188		196,188
Cash on hand & on deposit	323,606		323,606
Interest income due and accrued	<u>0</u>	<u>0</u>	<u>0</u>
Total Assets	<u>\$832,767</u>	<u>0</u>	<u>\$832,767</u>
 <u>LIABILITIES</u>			
Claims unpaid (Note 2)	\$ 66,860	69,567	\$136,427
Loss adjustment expenses (Note 3)			
Aggregate write-ins for other Liabilities (Note 3)	<u>69,567</u>	<u>(69,567)</u>	<u>0</u>
Total Liabilities	<u>\$136,427</u>	<u>0</u>	<u>\$136,427</u>
 <u>RESERVES &amp; OTHER FUNDS</u>			
Statutory funds	\$250,000		\$250,000
Unassigned funds	<u>446,340</u>	<u>0</u>	<u>446,340</u>
Total Reserves & Other Funds	<u>\$696,340</u>	<u>0</u>	<u>\$696,340</u>
Total Liabilities, Reserves and Other Funds	<u>\$832,767</u>	<u>0</u>	<u>\$832,767</u>

**THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL  
STATEMENTS**

**CASCADE EAST HEALTH PLANS, INC.**  
**UNDERWRITING AND INVESTMENT EXHIBIT**  
**STATEMENT OF INCOME**  
**FOR THE YEAR ENDED DECEMBER 31, 1999**

**UNDERWRITING INCOME**

Premiums earned	\$702,476
<u>Deductions</u>	
Claims incurred	626,261
Total Underwriting Deductions	<u>626,261</u>
Net Underwriting Loss	\$ 76,215

**INVESTMENT INCOME**

Net investment income earned	24,804
Net realized capital gains	<u>3,827</u>
Net Investment Gain	\$ 28,631

**OTHER INCOME OR EXPENSE**

Aggregate write-ins for other income expense	<u>100</u>
Net gain or (loss)	<u><u>\$104,946</u></u>

**CASCADE EAST HEALTH PLANS**  
**RESERVES AND UNASSIGNED FUNDS**  
**AS OF DECEMBER 31, 1999**

Reserves & unassigned funds – December 31, 1998	\$ 569,454
Net Gain	104,946
Net unrealized capital gains or losses	<u>21,940</u>
Change in reserves & unassigned funds for 1998	<u>\$ 126,886</u>
Reserves & unassigned funds – December 31, 1999	<u><u>\$ 696,340</u></u>

**THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS**

## NOTES TO FINANCIAL STATEMENTS

### Note 1 - Investments

The Plan's bond portfolio is composed 100.00% of high quality investments in U.S. government instruments. A quality distribution of bonds is presented below:

<u>Year</u>	<u>Total Book Value</u>	<u>Market Value</u>	<u>Noninvestment Grade Securities*</u>	<u>Percentage of Portfolio</u>
1997*	\$ 0	\$ 0	0	0
1998	265,859	270,885	0	0
1999**	312,973	302,829	0	0

\*Per qualifying examination

\*\*Per examination

\*Investment grade is defined by the NAIC as those securities with an NAIC Securities Valuation Office (SVO) rating of "1" or "2."

### Note 2 - Claims Unpaid

Per Plan	\$ 66,860
Per examination	<u>136,427</u>
Difference	<u>\$ 69,567</u>

At December 31, 1999, the Plan had a liability identified as capitation payable. This liability was reported on line 14, aggregate write-ins for other liabilities. This liability represented both capitation payable (\$36,638) and a liability of drug premium due (\$32,929) to the provider pharmacy, RxAmerica. These liabilities should be included as part of the unpaid claims liability.

(See also Note 4)

The total claims unpaid liability of \$136,427 was determined to be reasonable by Ralph Kopp, actuary for the Oregon Insurance Division.

### Note 3 - Loss Adjustment Expenses

Per Plan	\$0
Per examination	0
Difference	\$0

Due to the funding agreement, no accrual was made for claims adjustment expenses.

### Note 4 - Aggregate Write-ins for Other Liabilities

Per Plan	\$69,567
Per examination	<u>0</u>
Difference	<u>\$69,567</u>

A reclassification is being made to claims unpaid (See Note 2).

### **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

The following is a summary of issues and concerns the examiner believes should be brought to management's attention as a result of this and prior examinations.

#### **Page**

- 12 I recommend the Plan devote resources to computerize the premium accounting system to ensure proper accounting for premium receivables. This recommendation is made pursuant to the provisions of ORS 733.170.
- 13 I recommend the Plan file an Oregon Excise Tax Form 20 and become compliant with Oregon rules governing Oregon Excise Tax. This recommendation is made pursuant to the provisions of ORS 317.056.
- 13 I recommend the Plan develop and test a disaster recovery plan.
- 13 I recommend a lock be placed on the door to the room where the local area network is located.
- 13 I recommend the Plan initiate steps to insure back-ups are stored offsite in a secured environment.

The above recommendations are made pursuant to the provisions of ORS 731.302(1) and the NAIC Examiners Handbook (pgs. I-108, I-109 and I-122)

### **CONCLUSION**

During the two year and two month period covered by this examination, the surplus of the Company has increased from \$527,691, as presented in the qualifying examination dated October 23, 1997, to \$696,340, as shown in this report of examination.

The comparative assets and liabilities are shown below:

	<b>December 31, 1999</b>	<b>October 23, 1997</b>	<b>Change</b>
Assets	\$832,767	\$528,228	\$304,539
Liabilities	<u>136,427</u>	<u>537</u>	<u>135,890</u>
Surplus	<u>\$696,340</u>	<u>\$527,691</u>	<u>\$168,649</u>

### **SUBSEQUENT EVENTS**

1. On May 30, 2000, the Plan requested an exemption from ORS 733.770, which in part states “an insurer shall not have any combination of investments in or secured by the stocks, obligations, and property of one person, corporation, or political subdivision in excess of 10%.” The Insurance Division conditionally approved the request granting the Plan a level of 20% of admitted assets.
2. On June 1, 2000, the parent requested that the Plan be able to begin paying some of its normal administrative expenses from excess revenues, which previously were absorbed by the parent through a funding agreement between the Plan and the parent. The Insurance Division approved the request on June 26, 2000. The approval was conditional on the Plan being able to maintain a premium to surplus ratio lower than 10:1 and to maintain more than three months of claims payments in reserves.

## ACKNOWLEDGMENT

The cooperation and assistance extended by the officers and employees of the Company during the examination process are gratefully acknowledged.

In addition to the undersigned, Michael P. Phillips, CPA, CFE, AES, Patricia G. Neesham, CPA, CFE, insurance examiners, and Ralph Kopp, FSA, MAAA, actuary, for the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in the examination.

Respectfully submitted,

---

Timothy R. Hurley, CFE  
Supervising Insurance Examiner  
Insurance Division  
Department of Consumer and Business Services  
State of Oregon

**AFFIDAVIT**

STATE OF OREGON            )  
  )  ss  
County of Marion            )

Timothy R. Hurley, being duly sworn, deposes and says that the foregoing report of examination as of December 31, 1999, of Cascade East Health Plans, Inc., Hermiston, Oregon, subscribed by him is true to the best of his knowledge and belief.

\_\_\_\_\_  
Timothy R. Hurley, CFE  
Supervising Insurance Examiner  
Oregon Insurance Division  
Department of Consumer and Business Services  
State of Oregon

Subscribed and sworn before me this \_\_\_\_\_ day of \_\_\_\_\_, 2000.

\_\_\_\_\_  
Notary Public for the State of Oregon