

Report  
of the  
Examination of  
Wisconsin Physicians Service Insurance Corporation  
Madison, Wisconsin  
As of December 31, 2010

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

**Scott Walker**, Governor  
**Theodore K. Nickel**, Commissioner

**Wisconsin.gov**

May 3, 2012

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Honorable Theodore K. Nickel  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
Madison, Wisconsin 53703

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

WISCONSIN PHYSICIANS SERVICE INSURANCE CORPORATION  
Madison, Wisconsin

and this report is respectfully submitted.

## I. INTRODUCTION

The previous examination of Wisconsin Physicians Service Insurance Corporation (the company or WPS) was conducted in 2007 as of December 31, 2006. The current examination covered the intervening period ending December 31, 2010, and included a review of such 2011 transactions as deemed necessary to complete the examination. The company's two insurance subsidiaries, The EPIC Life Insurance Company and WPS Health Plan, Inc., were examined concurrently with this examination.

The examination was conducted using a risk-focused approach in accordance with the NAIC Financial Condition Examiners Handbook, which sets forth guidance for planning and performing an examination to evaluate the financial condition and identify prospective risks of an insurer. This approach includes the obtaining of information about the company including corporate governance, the identification and assessment of inherent risks within the company, and the evaluation of system controls and procedures used by the company to mitigate those risks. The examination also included an assessment of the principles used and significant estimates made by management, as well as an evaluation of the overall financial statement

presentation and management's compliance with statutory accounting principles, annual statement instructions, and Wisconsin laws and regulations.

The examination consisted of a review of all major phases of the company's operations and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

#### **Independent Actuary's Review**

An independent actuarial firm was engaged under a contract with the Office of the Commissioner of Insurance. The actuary reviewed the adequacy of aggregate life and annuity reserves, aggregate accident and health reserves, dividends to policyholders, asset adequacy analysis, and deferred life insurance premiums. The actuary's results were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuary's conclusion.

## II. HISTORY AND PLAN OF OPERATION

Wisconsin Physicians Service was created as a division of the State Medical Society in 1946 under the authority of ch. 148, Wis. Stat. Wisconsin Physicians Service Insurance Corporation (WPS or the company), a successor non-profit service insurance corporation, was incorporated on April 27, 1977, and commenced business the same day.

The company issues traditional indemnity and managed care health policies. The majority of health insurance business involves Preferred Provider Organization (PPO) type managed care products. In addition the company provides claims administration services for self-insured employer groups and for the federal government's TRICARE and Medicare programs.

Although licensed in five states, Wisconsin, Illinois, Indiana, Michigan and Ohio, the company only writes direct premium in Wisconsin and Michigan. In 2010 total direct written premium was \$464,971,508 of which 99.9% or \$464,452,025 was written in Wisconsin. The company also assumes business written in other states by its subsidiary, The EPIC Life Insurance Company (EPIC), and health business written by one external insurance company, Delta Dental of Wisconsin, Inc.

The following chart is a summary of premium income as reported by the company in 2010. The growth of the company is discussed in the "Financial Data" section of this report.

<b>Premium Income</b>				
<b>Line of Business</b>	<b>Direct Premium</b>	<b>Reinsurance Assumed</b>	<b>Reinsurance Ceded</b>	<b>Net Premium</b>
Comprehensive (Hospital & Medical)	\$325,238,685	\$ 35,804	\$10,767,732	\$314,506,757
Medicare Supplement	92,406,311	0	0	92,406,311
Dental Only	0	6,099,154	0	6,099,154
Other	<u>47,326,512</u>	<u>0</u>	<u>1,890,041</u>	<u>45,436,471</u>
<b>Total All Lines</b>	<b><u>\$464,971,508</u></b>	<b><u>\$6,134,958</u></b>	<b><u>\$12,657,773</u></b>	<b><u>\$458,448,693</u></b>

## **TRICARE**

WPS bids on contracts to process claims for the U.S. Department of Defense (DOD) health care program known as TRICARE. TRICARE provides civilian health benefits for military personnel, retirees, and their dependents. WPS is continually bidding on new contracts as they become available. These contracts are generally for a period of 5 to 10 years and are separated by regions and/or benefit. During the examination period, WPS was providing claims administrative services through three separate contracts.

WPS has partnered with a company known as TriWest Healthcare Alliance (TriWest) to process all claims for active duty service members and their families under age 65 in the West region. The West region includes all states west of Mississippi, except Texas and Oklahoma. TriWest holds the contract and WPS provides claims processing to TriWest.

WPS has partnered with International SOS, a London-based company, for processing all international TRICARE claims. This contract covers all active duty personnel and families stationed overseas and any retirees who now live in a foreign country.

In addition, WPS contracts directly with DOD for the processing of all Medicare-eligible military personnel. This program known as TriCare-for-Life is a Medicare supplement plan that pays secondary to Medicare.

WPS pays benefit dollars for claims using a federal government letter of credit and receives an administrative fee per claim. The company administered \$6.3 billion of TRICARE claims in 2010. The TRICARE administration business resulted in net income of \$19.6 million for calendar year 2010.

## **Medicare**

WPS provides claims administrative services for Medicare recipients under various cost-reimbursement type contracts with the Centers for Medicare and Medicaid Services (CMS). WPS is reimbursed for administrative expenses based on a budget set by Medicare each fiscal year. During 2010 WPS administered around \$49 billion in net benefits on behalf of 10 million beneficiaries and received \$154.5 million for administrative expenses from CMS. During the examination period, WPS was providing claims administrative services for the following programs:

- Medicare Part B of Wisconsin, Illinois, Minnesota and Michigan Programs
- Medicare Part A and B in the states of Nebraska, Iowa, Missouri and Kansas
- Medicare Part A and B in the states of Michigan and Indiana, awarded November 2011

Through a subcontract to an agreement between Mutual of Omaha and CMS, beginning November 2007 WPS began providing claim administrative services for Mutual of Omaha's existing Medicare Part A business which covers most states except New York.

**Administrative Service Contracts (ASC)**

WPS also provides claims administration for private self-insured employer groups and governmental entities. During 2010, they administered approximately \$604 million of claims. This line of business resulted in a net operating loss of \$6.9 million for 2010.

### III. MANAGEMENT AND CONTROL

#### Board of Directors

The board of directors consists of 13 members. Four directors are elected annually to serve a three-year term, except for the President. The President as an ex-officio member will remain a director for as long as he remains in his current position with WPS. Officers are elected at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the holding company group. The board members currently receive \$1,500 per board and/or committee meetings with an additional \$750 if two or more meetings are held on the same day, not to exceed \$2,250 in any one day. Each board member also receives an additional \$250 for each meeting they chair, and the chairman of the board receives a \$40,000 annual retainer. Employees on the board are not paid director's fees.

Currently the board of directors consists of the following persons:

<b>Name and Residence</b>	<b>Principal Occupation</b>	<b>Term Expires</b>
Kristine A. Euclide Madison, Wisconsin	Attorney Madison Gas & Electric	2011
James A. Lord, D.D.S. Middleton, Wisconsin	Private Dentist Practice	2011
John A. Matthews Madison, Wisconsin	Executive Director Madison Teachers Inc.	2011
Eugene J. Norby, M.D. Madison, Wisconsin	Retired Surgeon	2011
David L. Vogel Madison, Wisconsin	Civil Engineer and President Vogel Bros. Building Co.	2011
Brad E. Anderson Lake Mills, Wisconsin	Human Resources Consultant Partnerships in Human Resources	2012
Thomas G. Belot Kohler, Wisconsin	Retired Business Executive	2012
Leland H. Kauth Wisconsin Rapids, Wisconsin	Retired Financial Consultant	2012
John J. McGloin, M.D. Treasure Island, Florida	Retired Surgeon	2012
John J. Brandabur, M.D. Madison, Wisconsin	Retired Physician	2013

<b>Name and Residence</b>	<b>Principal Occupation</b>	<b>Term Expires</b>
Timothy T. Flaherty, M.D. Neenah, Wisconsin	Retired Physician	2013
William H. Haight, III Madison, Wisconsin	President Magna Publications, Inc.	2013
Edwin Hill, Jr. Madison, Wisconsin	Assistant Treasurer and Retired Bank Vice President	2013
James Riordan Madison, Wisconsin	President and Chief Executive Officer Wisconsin Physicians Service Ins. Corp.	Ex-Officio

### **Officers of the Company**

The officers serving at the time of this examination are as follows:

<b>Name</b>	<b>Office</b>	<b>2010 Compensation</b>
James R. Riordan	President and Chief Executive Officer	\$787,844*
William C. Beisenstein	Senior Vice President and Treasurer	377,166*
David L. Vogel	Secretary	23,000**

\* Compensation is total salary and is allocated between affiliates.

\*\* Compensation is all directors' fees paid by the company.

### **Committees of the Board**

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

#### **Executive Committee**

Timothy Flaherty, M.D., Chair  
Brad Anderson  
Kristine Euclide  
Edwin Hill, Jr.  
Leland Kauth  
Eugene Nordby, M.D.  
John Matthews  
James Riordan  
David Vogel

#### **Audit Committee**

Leland Kauth, Chair  
Kristine Euclide  
Timothy Flaherty, M.D.  
William Haight  
Edwin Hill, Jr.  
James Lord, D.D.S.  
Eugene Nordby, M.D.

#### **Finance Committee**

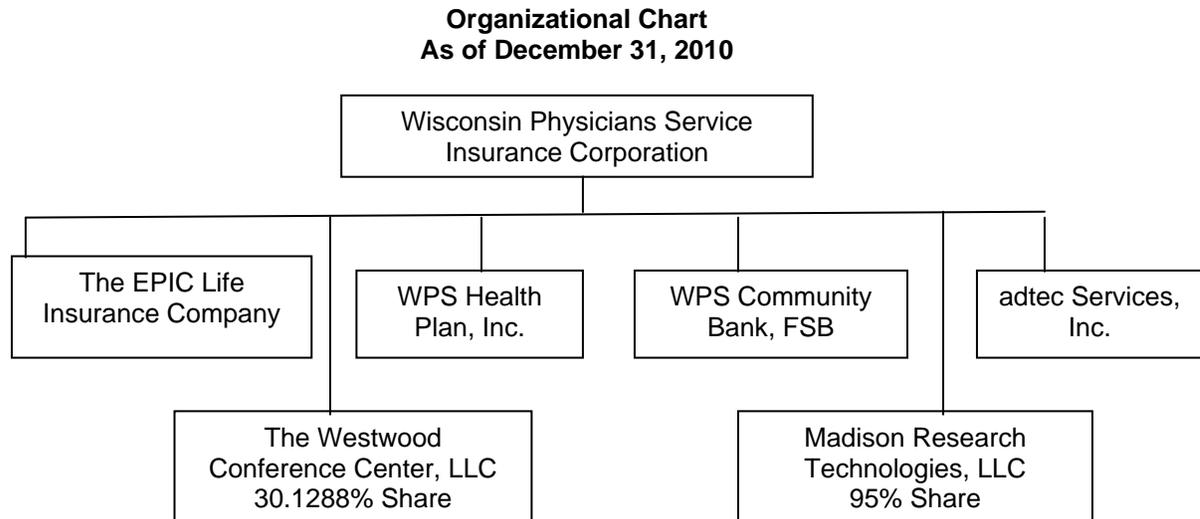
Edwin Hill, Jr., Chair  
Brad Anderson  
Thomas Belot  
John Brandabur, M.D.  
Timothy Flaherty, M.D.  
William Haight  
Leland Kauth  
John Matthews  
Eugene Nordby, M.D.  
James Riordan

#### **Planning Committee**

David Vogel, Chair  
Brad Anderson  
Thomas Belot  
Timothy Flaherty, M.D.  
John Matthews  
John McGloin, M.D.

#### IV. AFFILIATED COMPANIES

Wisconsin Physicians Service Insurance Corporation is the ultimate parent in the holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of affiliates deemed significant follows the organizational chart.



#### **The EPIC Life Insurance Company (EPIC)**

EPIC was incorporated under the laws of Wisconsin in 1984 as a wholly owned subsidiary of WPS. EPIC offers term life, long-term and short-term disability, dental and vision insurance products, to group subscribers and life conversion policies to individuals in 27 states with a concentration in Wisconsin and surrounding Midwestern states. EPIC also offers medical products, which are assumed and administered by WPS. In addition, EPIC offers Administrative Services Contracts products marketed to larger groups. As of December 31, 2010, the audited financial statements of EPIC reported assets of \$51,534,641, liabilities of \$25,666,318, and capital and surplus of \$25,868,323. Operations for 2010 produced net income of \$1,083,387.

#### **WPS Health Plan, Inc. (the Plan)**

WPS Health Plan, Inc., is described as a for-profit mixed model health maintenance organization (HMO) insurer. The Plan provides group health insurance products to employers and individuals in northeast Wisconsin under the trade name Arise Health Plan. The Plan uses a

mixed distribution force consisting of selected agencies in the northeastern and north central Wisconsin areas. As of December 31, 2010, the audited financial statements of WPS Health Plan reported assets of \$26,238,160, liabilities of \$16,447,352, and capital and surplus of \$9,790,808. Operations for 2010 produced net income (loss) of \$(1, 283,791).

**WPS Community Bank, FSB (the Bank)**

WPS Community Bank, FSB (the Bank) was incorporated on January 20, 2009, as a wholly owned subsidiary of WPS. The Bank was capitalized with a \$10 million investment by WPS. The Bank grants commercial and consumer loans and accepts deposits from customers primarily in the Bank's local area of Dane County. The Bank is subject to competition from other financial institutions and nonfinancial institutions providing financial products and services. Additionally, the Bank is subject to the regulations of certain regulatory agencies and undergoes periodic examination by those agencies.

As of December 31, 2010, the audited financial statements of WPS Community Bank, FSB, reported assets of \$34,452,000 liabilities of \$25,679,000 and stockholder's equity of \$8,772,807. Operations for 2010 produced net income (loss) of \$(485,117).

**adtec Services, Inc.**

adtec Services, Inc., is a wholly owned subsidiary of WPS incorporated in 1979 that sells temporary help services and computer consulting services to customers who are predominately small to middle market Wisconsin businesses. During 2009, adtec closed its offices and ceased operations in Green Bay, the Fox Valley and Milwaukee. As of December 31, 2010, the audited financial statements of adtec reported assets of \$2,256,364, liabilities of \$288,690, and stockholders' equity of \$1,967,674. Operations for 2010 produced net income (loss) of \$(75,875).

**The Westwood Conference Center, LLC (Westwood)**

Westwood is a Wisconsin limited liability company operating the Westwood Conference facility in Wausau, Wisconsin. Westwood was established in 2004 and the company's ownership share is 30.1288%. As of December 31, 2010, the company's share of the unaudited financial statements of Westwood reported total assets of \$2,429,523, total liabilities of

\$901,384 and partners' equity of \$1,528,139. WPS' share of operations for 2010 produced net income (loss) of \$217,784. Since Westwood did not have audited statements, it was treated as a nonadmitted asset by WPS as of December 31, 2010.

### **Madison Research Technologies, LLC**

Madison Research Technologies, LLC, is a limited liability company engaged in research and development activities. It was organized under the laws of the state of Wisconsin on April 29, 2009. The primary activities since inception have been organizational along with research and development. No revenues have been generated from planned principal operations. As of December 31, 2010, the company's share of Madison Research Technologies audited financial statements of reported total assets was \$181,502, total liabilities of \$45,237 and partners' equity of \$136,265. As of December 31, 2010, Madison Research Technologies continues to be in the development stage.

### **Agreements with Affiliates**

WPS has a Service and Supplies Agreement with EPIC, adtec, the Bank and WPS Health Plan, Inc., under which WPS provides management, investment, administrative, and other services and supplies to each company. EPIC, adtec, the Bank and WPS Health Plan, Inc., reimburse WPS for the actual cost of the services and supplies provided, including a reasonable allocation of overhead expenses. Settlement is to be made within 20 days after the invoice billing is exchanged but no less often than quarterly.

WPS has an intercompany tax allocation agreement with its wholly owned subsidiaries for the purpose of filing consolidated federal income tax and combined Wisconsin franchise and income tax returns. Pursuant to that agreement each subsidiary will either pay to or receive refunds based on calculations performed by WPS at the end of every month. The determination of any deferred tax benefit or liability for either The EPIC Life Insurance Company or WPS Health Plan, Inc., is also determined at this time. Payments are to be made within 30 days of the financial statement close date, defined in the agreement, or no later than each estimated quarterly due date.

## V. REINSURANCE

The company's major reinsurance treaties in force at the time of the exam are summarized below. The contracts contained proper insolvency provisions.

### **Affiliated Assuming Contracts**

The company assumes under a quota share agreement from EPIC accident and health coverage defined as CORE business. CORE business is medical business in the states of Minnesota, Iowa, Illinois (excluding certain zip codes), and Wisconsin. WPS assumes the premiums and pays 100% of the losses on this business.

### **Non-Affiliated Assuming Contracts**

The company has a joint venture agreement with Delta Dental of Wisconsin, Inc. (Delta). Part of this agreement is a reinsurance contract whereby WPS covers 100% of the old group dental business issued by WPS and then transferred to Delta policy forms with initial effective dates of January 1, 1996, or after. WPS also covers 50% of the new group dental plans solicited by WPS and written on Delta policy forms.

### **Non-Affiliated Ceding Contracts**

The company has an excess of loss contract with Axis Insurance Company that covers all health business, including employee group coverages but excluding Medicare supplement. The contract contains three coverage layers as follows: 1) first layer is 90% of \$500,000 in excess of \$500,000 for each covered person; 2) second layer covers 100% of \$1 million excess of \$1 million for each covered person; 3) third layer covers \$3 million excess of \$2 million for each covered person. The limit on the contract is \$5 million per covered person per contract year. The contract contains a profit-sharing arrangement under which the reinsurer will pay the company a contingent commission equal to 30% of the reinsurer's net profit as calculated per the terms of the contract.

The company has an excess of loss contract with Westport Insurance Corporation that covers stop-loss policies issued to otherwise self-funded group health plans. Per the contract, there are two levels of retention. The first retention is an employer-specific retention under which the employer retains between \$10,000 and \$599,999 per covered employee. The

second is a \$300,000 retention by WPS per covered person, in excess of the employer-specific retention. The reinsurer then covers 100% of incurred losses per covered person up to the maximum specific benefit levels as defined in the stop-loss policy issued by the company to the employer. The maximum specific benefit levels in the stop-loss policy must be less than \$5,000,000, which is the reinsurance limit per covered person per agreement period under the contract.

## **VI. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2010, annual statement. Also included in this section are schedules which reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

**Wisconsin Physicians Service Insurance Corporation**  
**Assets**  
**As of December 31, 2010**

	<b>Assets</b>	<b>Nonadmitted Assets</b>	<b>Net Admitted Assets</b>
Bonds	\$ 76,830,681	\$	\$ 76,830,681
Stocks:			
Preferred stocks			
Common stocks	94,753,791		94,753,791
Real estate:			
Occupied by the company	22,781,211		22,781,211
Held for production of income	9,892,971		9,892,971
Cash, cash equivalents, and short-term investments	40,526,896		40,526,896
Other invested assets	1,679,546	1,528,140	151,406
Investment income due and accrued	1,101,325		1,101,325
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	2,625,946		2,625,946
Reinsurance:			
Amounts recoverable from reinsurers	2,214,702		2,214,702
Amounts receivable relating to uninsured plans	42,345,802	1,184	42,344,618
Current federal and foreign income tax recoverable and interest thereon	5,638,587		5,638,587
Net deferred tax asset	18,051,711	9,808,199	8,243,512
Electronic data processing equipment and software	31,979,922	31,072,316	907,606
Furniture and equipment, including health care delivery assets	4,015,833	4,015,833	
Health care and other amounts receivable	6,134,290	876,576	5,257,714
Write-ins for other than invested assets:			
Prepaid pension	14,119,531	14,119,531	
Deferred charges	3,820,026	3,820,026	
Prepaid expenses	1,636,212	1,636,212	
Leasehold improvements	740,244	740,244	
<b>Total Assets</b>	<b><u>\$380,889,227</u></b>	<b><u>\$67,618,261</u></b>	<b><u>\$313,270,966</u></b>

**Wisconsin Physicians Service Insurance Corporation**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 2010**

Claims unpaid (less \$2,873,000 reinsurance ceded)		\$ 45,281,000
Accrued medical incentive pool and bonus amounts		434,358
Unpaid claims adjustment expenses		1,758,141
Aggregate health policy reserves		11,164,522
Premiums received in advance		16,167,796
General expenses due or accrued		53,452,209
Ceded reinsurance premiums payable		844,138
Amounts withheld or retained for the account of others		670,038
Remittances and items not allocated		7,294,965
Amounts due to parent, subsidiaries and affiliates		277,762
Funds held under reinsurance treaties		570,007
Liability for amounts held under uninsured plans		3,869,392
Write-ins for liabilities:		
Additional pension liability		4,069,629
Reserve for escheatable items		<u>207,841</u>
Total liabilities (lines 1 to 23)		146,061,798
Unassigned funds (surplus)	<u>\$167,209,168</u>	
Total capital and surplus		<u>167,209,168</u>
Total Liabilities, Capital and Surplus		<u>\$313,270,966</u>

**Wisconsin Physicians Service Insurance Corporation  
Summary of Operations  
For the Year 2010**

Member months		2,067,624
Net premium income		\$458,448,693
Change in unearned premium reserves and reserve for rate credits		<u>(615,867)</u>
Total revenue		457,832,826
Hospital/medical benefits	\$239,107,813	
Other professional services	2,912,422	
Emergency room and out-of-area	93,841,429	
Prescription drugs	55,907,256	
Incentive pool	<u>188,574</u>	
Subtotal (hospital and medical)	391,957,494	
Net reinsurance recoveries	<u>6,071,355</u>	
Total hospital and medical	385,886,139	
Claims adjustment expenses, including \$8,045,290 cost containment expenses	20,661,575	
General administrative expenses	<u>65,524,345</u>	
Total underwriting deductions		<u>472,072,059</u>
Net underwriting gain or (loss)		(14,239,233)
Net investment income earned	8,409,133	
Net realized capital gains less capital gains tax of \$1,048,109	<u>1,348,474</u>	
Net investment gains		9,757,607
Aggregate write-ins for other income or expenses:		
Government lines		9,899,506
Disaster recovery services revenue		421,748
Gain (loss) on sale of fixed assets		(12,205)
Miscellaneous income		<u>(35,143)</u>
Net income after capital gains tax and before all other federal income taxes		5,792,280
Federal and foreign income taxes incurred		<u>(2,136,269)</u>
Net Income (Loss)		<u>\$ 7,928,549</u>

**Wisconsin Physicians Service Insurance Corporation**  
**Cash Flow**  
**For the Year 2010**

Premiums collected net of reinsurance		\$450,534,243
Net investment income		<u>8,644,822</u>
Total		459,179,065
Benefit- and loss-related payments	\$374,906,581	
Commissions, expenses paid, and aggregate write-ins for deductions	74,119,588	
Federal and foreign income tax paid	<u>(1,985,546)</u>	
Total deductions		<u>447,040,623</u>
Net cash from operations		12,138,442
Proceeds from investments sold, matured, or repaid:		
Bonds	\$25,230,351	
Stocks	28,490,102	
Other invested assets	<u>241,030</u>	
Total investment proceeds		53,961,483
Cost of investments acquired (long-term only):		
Bonds	28,385,344	
Stocks	28,800,666	
Real estate	906,855	
Other invested assets	<u>875,000</u>	
Total investments acquired		<u>58,967,865</u>
Net cash from investments		(5,006,382)
Cash from financing and miscellaneous sources:		
Other cash provided (applied)		<u>(8,680,425)</u>
Net cash from financing and miscellaneous sources		<u>(8,680,425)</u>
<b>Reconciliation:</b>		
Net change in cash, cash equivalents, and short-term investments		(1,548,365)
Cash, cash equivalents, and short-term investments:		
Beginning of year		<u>42,075,261</u>
End of year		<u>\$ 40,526,896</u>

**Wisconsin Physicians Service Insurance Corporation  
Compulsory and Security Surplus Calculation  
December 31, 2010**

Assets per annual statement			\$313,270,966
Add furniture and fixtures relating to TRICARE and Medicare per order			<u>15,262,369</u>
Total allowed assets			328,533,335
Less investments in insurance subsidiaries			35,668,848
Add security surplus excess of insurance subsidiaries			27,210,358
Less excess foreign investments			7,834,411
Less liabilities			<u>146,061,798</u>
Adjusted surplus			166,178,636
Annual premium:			
Individual life and health	\$156,348,790		
Factor		15%	
Total			\$23,452,319
Group life and health	268,089,550		
Factor		10%	
Total			26,808,955
Stand-alone Medicare Part D	34,010,353		
Factor		7%	
Total			<u>2,380,725</u>
Compulsory surplus (subject to a \$2,000,000 minimum)			<u>52,641,999</u>
Compulsory Surplus Excess or (Deficit)			<u>\$113,536,637</u>
Adjusted surplus (from above)			\$166,178,636
Security surplus (125% of compulsory surplus)			<u>65,802,499</u>
Security Surplus Excess or (Deficit)			<u>\$100,376,137</u>

**Wisconsin Physicians Service Insurance Corporation  
Reconciliation and Analysis of Surplus  
For the Five-Year Period Ending December 31, 2010**

The following schedule is a reconciliation of total capital and surplus during the period under examination as reported by the company in its filed annual statements:

	2010	2009	2008	2007	2006
Capital and surplus, prior reporting year	\$167,082,299	\$143,238,246	\$141,520,311	\$117,650,553	\$ 95,077,441
Net income or (Loss)	7,928,549	5,574,781	15,926,386	17,154,809	11,580,796
Change in net unrealized capital gains (losses) less capital gains tax	3,208,892	8,088,562	(11,881,691)	980,294	2,985,529
Change in net deferred income tax	9,926,526	(1,750,063)	13,604,791	3,994,769	3,106,356
Change in nonadmitted assets and related items	1,977,475	11,930,773	(15,931,551)	1,739,886	4,900,431
Cumulative effect of changes in accounting principles	10,863,918	0	0	0	0
Additional minimum pension surplus change	(33,778,491)	0	0	0	0
Net change in capital and surplus	<u>126,869</u>	<u>23,844,053</u>	<u>1,717,935</u>	<u>23,869,758</u>	<u>22,573,112</u>
Capital and Surplus, End of Year	<u>\$167,209,168</u>	<u>\$167,082,299</u>	<u>\$143,238,246</u>	<u>\$141,520,311</u>	<u>\$117,650,553</u>

**Growth of Wisconsin Physicians Service Insurance Corporation**

Year	Admitted Assets	Liabilities	Capital and Surplus
2010	\$313,270,966	\$146,061,798	\$167,209,168
2009	303,346,333	136,264,034	167,082,299
2008	284,072,617	140,834,371	143,238,246
2007	286,417,939	144,897,628	141,520,311
2006	247,824,445	130,173,892	117,650,553

Year	Net Premiums Earned	Medical Expenses	Net Underwriting Gain/(Loss)	Net Income
2010	\$457,832,826	\$385,886,139	\$(14,239,233)	\$ 7,928,549
2009	430,420,078	349,893,129	(8,813,368)	5,574,781
2008	450,004,605	366,127,253	(12,121,737)	15,926,386
2007	475,666,541	390,435,033	(15,670,765)	17,154,809
2006	470,623,748	382,984,263	(11,128,134)	11,580,796

### Operating Percentages (Percent of Premiums Earned)

Year	Medical Expense Ratio	Administrative Expense Ratio	Combined Ratio
2010	84.3%	18.8%	103.1%
2009	81.3	20.7	102.0
2008	81.4	21.3	102.7
2007	82.1	21.2	103.3
2006	81.4	21.0	102.4

In 2010 the company reported the smallest increase in surplus of \$126,889 since the previous examination. The primary factor for the comparatively small change in surplus for 2010 was due to the company electing to make a change in its pension accounting method. The accounting change was properly reported on the 2010 annual statement. The surplus adjustments included a \$10.9 million increase for a cumulative effect of a change in accounting principles offset by a \$33.8 million decrease for the change in additional minimum pension liability.

WPS' operating results are heavily influenced by its government contract lines contributions to overall corporate profit. During the examination period WPS was awarded a new TRICARE contract for which it started claims administration in July 2008. In regard to the July 2008 contract, 2009 was the first full year under new lower rates resulting in substantially less revenue to WPS. According to the company it is not uncommon for new federal contracts to be awarded with lower rates, which will reduce income in the early contract years. The 2009 decrease in other income from government lines combined with decreased net earned premium and changes to federal income tax expense resulted in a 65% decrease in total net income from 2008.

#### Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination. The amount of surplus reported by the company as of December 31, 2010, is accepted.

## VII. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

There were 15 specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Corporate Governance—It is recommended that the board include discussions and recommendations of committees.  
Action— Compliance
2. Corporate Governance—It is recommended that the company establish a board attendance policy to promote more complete contribution by all board members.  
Action— Compliance
3. Corporate Governance—It is recommended that the board members annually disclose potential conflicts on the conflict of interest disclosure statements and not enter “same as last year.”  
Action—Compliance
4. Corporate Governance—It is recommended that the company not sign engagement letters with indemnification clauses or other limitations on auditor liability in compliance with s. Ins 50.08 (1), Wis. Adm. Code.  
Action—Compliance
5. Unclaimed Funds—It is recommended that the company comply with NAIC Annual Statement Instructions-Health and report any escheat liability as a write-in.  
Action—Compliance
6. Cash and Short-Term Investments—It is recommended the company evaluate its internal control procedures for Cash and Short-Term Investments and implement remedial action to assure that 1) all checks issued over an established amount contain two authorized signatures, 2) all checks received are promptly deposited, 3) all transactions from all bank accounts are fully reflected in the appropriate accounting period, and 4) all bank accounts are reconciled by a person other than the person accounting for the transactions.  
Action—Compliance
7. Custodial Agreement—It is recommended that the company fully comply with s. 610.23, Wis. Stat., by executing proper custodial agreements containing satisfactory safeguards and controls in accordance with the NAIC Financial Condition Examiners Handbook.  
Action—Compliance

8. Bonds and Stocks—It is again recommended that the company comply with the Purposes and Procedures Manual of the NAIC Securities Valuation Office and report correct designations for each security on future annual statements.

Action—Compliance

9. Bonds and Stocks—It is recommended that the company designate foreign securities accurately in Schedule D of future annual statements as required by the NAIC Annual Statement Instructions-Health.

Action—Compliance

10. Bonds and Stocks—It is recommended that the company monitor its foreign investments, including foreign bank accounts, to assure that any excess over 2% of admitted assets are deducted in the calculation of compulsory surplus.

Action—Compliance

11. Premiums—It is recommended that the company include its ASC Refund Suspense in the Liability for Amounts Held under Uninsured Plans.

Action—Compliance

12. Premiums—It is recommended that the company review items not allocated at least quarterly and, for those items that could not be assigned to the proper income account within one year, report them as escheatable funds.

Action—Compliance

13. Premiums—It is recommended that Exhibit 3 be reported on the gross basis pursuant to the NAIC Health NAIC Annual Statement Instructions.

Action—Compliance

14. Premiums—It is recommended that the company follow the procedures noted in the agreement or amend the agreement to reflect the procedure currently being used.

Action—Compliance

15. HIRSP Accrual—However, it is recommended that the company accrue for HIRSP assessments in accordance with SSAP No. 35.

Action—Compliance

## **Summary of Current Examination Results**

This section contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

## **Management and Control**

The examination's review of the company's Report on Executive Compensation (Form OCI 22-010) for 2010 noted that the form is not being completed correctly. The company is required to report the total annual compensation for any officer or employee that is in excess of an amount based on the insurer's current year-end capital and surplus. For Wisconsin Physicians Services Insurance Corporation the 2010 amount was \$100,000. In addition, the total amount of compensation being reported for each individual did not include the amounts paid for various types of insurance coverage provided at no cost to the employee. According to the executive compensation report, "compensation shall consist of any and all gross direct and indirect remuneration paid and accrued for the benefit of an individual director, officer or employee." It is recommended that the company complete the Report on Executive Compensation in accordance with its instructions.

## **Real Estate**

The examination included a review of properties owned by the company on Schedule A of the 2010 annual statement. The company reported ownership of two properties as being held for the production of income. According to SSAP No. 40 the reporting entity must maintain an appraisal of no more than five years old as of the reporting date. The examination found that WPS had not obtained an appraisal for the South Towne Office Park property. It is recommended that the company comply with SSAP No. 40 and maintain appraisals of no more than five years old for all properties held for the production of income.

The examination found that the 2010 statutory book/carrying value for the South Town Office Park included the capitalization of "earnings." Since, the "earnings" were being capitalized, the company did not report the rental income as part of its investment income in

accordance with SSAP No. 22. It is recommended that the company report rental income on leased properties as investment income in accordance with SSAP No. 22.

## VIII. CONCLUSION

Wisconsin Physicians Service Insurance Corporation is the ultimate parent in a holding company system with two other insurance companies, The EPIC Life Insurance Company and WPS Health Plan, Inc. All three insurance companies were examined concurrently as of December 31, 2010. WPS added one new wholly owned subsidiary during the examination period. WPS Community Bank, FSB, was incorporated on January 20, 2009.

Since the previous examination the company has increased capital and surplus by 42%, consistently reported net income, and maintained a relatively stable medical expense ratio. However, the company reported decreased net earned premium for 2008 and 2009 year-end. By the end of 2010 the company had reported increased net earned premium.

WPS' operating results are heavily influenced by its government contracts. The income generated from this line of operations helped the company to offset the underwriting losses during the examination period. However, the start of a new TRICARE contract with lower rates resulted in a substantial decrease in government lines revenue for 2009 year-end resulting in the lowest net income reported over the past five years.

The examination resulted in three recommendations, no adjustments to surplus and found that the company was in compliance with all of the recommendations in the previous examination report.

## IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 23 - Management and Control—It is recommended that the company complete the Report on Executive Compensation in accordance with its instructions.
2. Page 23 - Real Estate—It is recommended that the company comply with SSAP No. 40 and maintain appraisals of no more than five years old for all properties held for the production of income.
3. Page 24 - Real Estate—It is recommended that the company report rental income on leased properties as investment income in accordance with SSAP No. 22.

## X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

<b>Name</b>	<b>Title</b>
Tom Houston	Insurance Financial Examiner
Rauf Mirza	Insurance Financial Examiner
Raymond Kangogo	Insurance Financial Examiner
Victoria Chi	IT Specialist
Jerry DeArmond	Reserve Specialist

Respectfully submitted,

Eleanor Opprecht  
Examiner-in-Charge

## **XI. SUBSEQUENT EVENTS**

In November 2011, WPS approved a plan to discontinue the current operations of its wholly owned subsidiary, adtec Services, Inc., during 2012 due to the declining need for either temporary or computer consulting services. A severance plan was also approved for employees that would be separated in 2012 as a result.

adtec Services, Inc., discontinued its temporary help operations on January 31, 2012, and intends to discontinue its computer consulting service by April 30, 2012. The assets and liabilities of the company will be liquidated and merged into the parent company (WPS) upon formal dissolution of adtec. WPS expects formal dissolution of the corporation to occur by year end. Operations have largely ceased.

On April 9, 2012, WPS announced the appointment of Mr. Michael Hamerlik as President and Chief Executive Officer, effective June 11, 2012. He will replace Mr. James Riordan, who will be retiring after serving more than 20 years in that role and 39 years with WPS. Mr. Riordan will remain at the company until the end of 2012 to help with the transition.

In early 2012 the Department of Defense announced that TriWest Healthcare Alliance, which includes WPS, did not win renewal of the TRICARE west region contract. Shortly thereafter, TriWest announced that it had filed an appeal with the DOD. This is standard practice for these contracts and until fully resolved, WPS will continue processing medical claims for TRICARE's west region as a subcontractor with TriWest Healthcare Alliance as primary.