



transmitted to the Exchange electronically (PDF file, via e-mail) on April 28, 2008 to Mr. John R. Graham, President and Attorney-in-Fact. The verified Report is attached hereto and incorporated herein as Exhibit A.

#### WAIVER

Attached hereto and incorporated herein as Exhibit B, is a Waiver signed by Mr. Graham on May 2, 2008 and received by the Department on May 5, 2008 (via U.S. First Class mail). Based upon the Waiver/Exhibit B, this is a final order, and the Exchange has waived its rights to seek reconsideration and judicial review of this order.

#### ORDER

NOW THEREFORE, after carefully reviewing the above described Report of Examination, attached hereto as Exhibit A, and good cause appearing therefor, it is hereby ordered that the above described report, which includes the findings, conclusions, comments and recommendations supporting this order, is hereby ADOPTED as the final examination report and as an official record of the Department under Idaho Code § 41-227(5)(a).

DATED and EFFECTIVE at Boise, Idaho this 8<sup>TH</sup> day of May 2008.

  
\_\_\_\_\_  
William W. Deal, Director  
IDAHO DEPARTMENT OF INSURANCE

**CERTIFICATE OF SERVICE**

I hereby certify that on this 8<sup>th</sup> day of May 2008, I caused to be served the foregoing document on the following parties in the manner set forth below:

John R. Graham, President	<u>  X  </u>	certified mail
Attorney-in-Fact	<u>      </u>	first class mail
Associated Loggers Exchange	<u>      </u>	hand delivery
3380 Elder Street	<u>      </u>	Facsimile
Boise, Idaho 83705	<u>      </u>	
e-mail: alejrg@aol.com	<u>  X  </u>	e-mail

Georgia Siehl, CPA, CFE	<u>      </u>	certified mail
Bureau Chief / Chief Examiner	<u>      </u>	first class mail
Idaho Department of Insurance	<u>  X  </u>	hand delivery
700 W. State St., 3 <sup>rd</sup> Floor	<u>      </u>	facsimile
Boise, Idaho 83720-0043	<u>      </u>	
e-mail: Georgia.Siehl@doi.idaho.com	<u>  X  </u>	e-mail



William R. Michels, MBA, CPA, CFE  
Examination Supervisor  
IDAHO DEPARTMENT OF INSURANCE

DEPARTMENT OF INSURANCE

STATE OF IDAHO



REPORT OF EXAMINATION

of

ASSOCIATED LOGGERS EXCHANGE  
(a domestic reciprocal insurer)

NAIC Company Code: 37370

as of

December 31, 2006

FILED	4/25/08	ks
	date	initial
ADOPTED	5/8/08	ks
	date	initial
STATE OF IDAHO Department of Insurance		

EXHIBIT

A

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*State of Idaho*  
**DEPARTMENT OF INSURANCE**

**C.L. "BUTCH" OTTER**  
Governor

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**WILLIAM W. DEAL**  
Director

Boise, Idaho  
April 28, 2008

The Honorable William W. Deal  
Director of Insurance  
State of Idaho  
700 West State Street  
Boise, Idaho 83720

Dear Director:

Pursuant to your instructions, in compliance with Section 41-219(1), Idaho Code, and in accordance with generally accepted examination practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2006 of:

Associated Loggers Exchange  
3380 Elder Street  
Boise, Idaho 83705

hereinafter referred to as the "Exchange" at its offices in Boise, Idaho.

The following Report of Examination is respectfully submitted.

## SCOPE OF EXAMINATION

This examination covered the period January 1, 2002, through December 31, 2006. The examination was conducted at the Boise, Idaho office of the Exchange by an examiner from the State of Idaho. The examination was conducted in accordance with Section 41-219(1), Idaho Code, the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook*, and the NAIC *Accounting Practices and Procedures Manual*. We performed our testing in order to achieve a confidence level commensurate with the risk assessed through utilization of the NAIC *Examiners Handbook*. Verification and valuation of assets, determination of liabilities and reserves, and an analysis and review of such other accounts and records as appropriate to the examination were also performed.

A letter of representation attesting to the Exchange's ownership of all assets and to the nonexistence of unrecorded liabilities or contingent liabilities was signed by and received from management.

The actuarial review of reserves, related liabilities, risk transfer with regards to reinsurance contracts and other actuarial items was performed by Taylor-Walker & Associates, Inc., consulting actuaries, for the Idaho Department of Insurance. There was some reliance placed on the 2006 certified public accountant's statutory audit report and work papers during the examination of the Exchange.

In addition to the Report of Examination, the Department issued a Management Letter to the Exchange which covered items that were not included in the Report due to the examination materiality threshold or items that were related to proprietary, operational issues.

## PRIOR EXAMINATION

A review was made to ascertain what action was taken by the Exchange with regard to comments and recommendations made by the Department in the prior exam report. Unless otherwise mentioned in the COMMENTS AND RECOMMENDATIONS section of this report, the prior report exceptions were adequately addressed by the Exchange.

## HISTORY AND DESCRIPTION

### General

The Exchange was organized as a Casualty-Workers' Compensation Only, Reciprocal Insurer under the laws of the State of Idaho.

Pursuant to Section 41-2909, Idaho Code, the Certificate of Authority was issued through its Attorney-in-Fact, Associated Loggers Management Corporation (ALMC), in the name of the Exchange on July 24, 1979.

On May 24, 1994, the Exchange purchased all of the outstanding capital stock of its corporate Attorney-in-Fact, ALMC. This transaction was approved by the Idaho Department of Insurance.

On June 29, 2001, the Exchange obtained a Certificate of Authority from the State of Montana to write casualty business, limited to workers' compensation only. The Exchange started writing premium in the State of Montana in 2002.

Distributions to Subscribers

During the period January 1, 2002 through December 31, 2006, the Board of Governors declared and paid the following premium returns to subscribers of the Exchange:

<u>Date Declared</u>	<u>Date Approved</u>	<u>Date Paid</u>	<u>Cash Distribution</u>	<u>Non-Cash Distribution</u>
04/25/02	05/06/02	06/01/02	\$1,000,000	Not Applicable
03/21/03	05/09/03	06/01/03	\$ 750,000	Not Applicable
04/23/04	05/24/04	06/01/04	\$ 750,000	Not Applicable
03/18/05	05/09/05	06/01/05	\$1,000,000	Not Applicable
04/27/06	05/11/06	06/01/06	\$1,250,000	Not Applicable

Subsequent to the examination date of this report (December 31, 2006), the following premium returns were declared and paid to subscribers of the Exchange:

<u>Date Declared</u>	<u>Date Approved</u>	<u>Date Paid</u>	<u>Cash Distribution</u>	<u>Non-Cash Distribution</u>
04/26/07	05/29/07	06/01/07	\$1,300,000	Not Applicable

These distributions, as permitted under Section 41-2927, Idaho Code, were properly authorized by the Board of Governors and were approved by the Department of Insurance.

Surplus Notes

Only one class of surplus note was outstanding during the current examination period. These surplus notes represented amounts originally contributed to the Exchange to fund its minimum surplus requirements. The notes were issued to original and early subscribers of the Exchange, and amounts were based on a percentage of estimated annual premiums. These notes do not bear interest and were subordinated to all liabilities of the Exchange.

Redemption of surplus notes was dependent upon Board of Governor determination, certain surplus requirements, and Department of Insurance approval. During the examination period of January 1, 2002 through December 31, 2006 the Exchange redeemed the following surplus notes pursuant to Section 41-2916, Idaho Code:

[See schedule on following page.]

**Schedule of Surplus Note Redemptions (2002-2006):**

	<u>Date Board Authorized</u>	<u>Date DOI Approved</u>	<u>Date Redeemed</u>	<u>Number of Surplus Notes</u>	<u>Amount Redeemed</u>	<u>Balance Per Examination</u>
<b>Balance @ 12/31/01 *</b>	.....					<b>\$305,975</b>
	11/09/01	07/05/02	08/06/02	1	\$ 858	
	Various dates in 03	Various dates in 03	Various dates in 2003	3	11,593	
	06/19/04	05/18/04	06/22/04	1	329	
	02/20/04	Various dates in 2004	Various dates in 2005	82	162,199	
	02/20/04	Various dates in 2005	Various dates in 2006	54	<u>28,984</u>	
<b>Total Redemptions</b>	.....					<u>203,963</u>
<b>Balance @ 12/31/06 *</b>	.....					<u>\$ 102,012</u>

\* Balance per examination

As the above schedule reflects, the balance of the surplus notes as of December 31, 2006 was \$102,012.

It was noted by the examiner during a review of 2007 subsequent events that surplus notes in the amount of \$1,992 were redeemed without prior approval of the director of the Idaho Department of Insurance (which is required by Idaho Code, Section 41-2916). The examiner notified the Exchange of this problem during the fieldwork portion of this examination; the Exchange followed-up with a letter to the Idaho Department of Insurance on November 14, 2007 and obtained approval for these redemptions.

Since the Exchange subsequently obtained approval from the Department, there was no recommendation made regarding the above comment.

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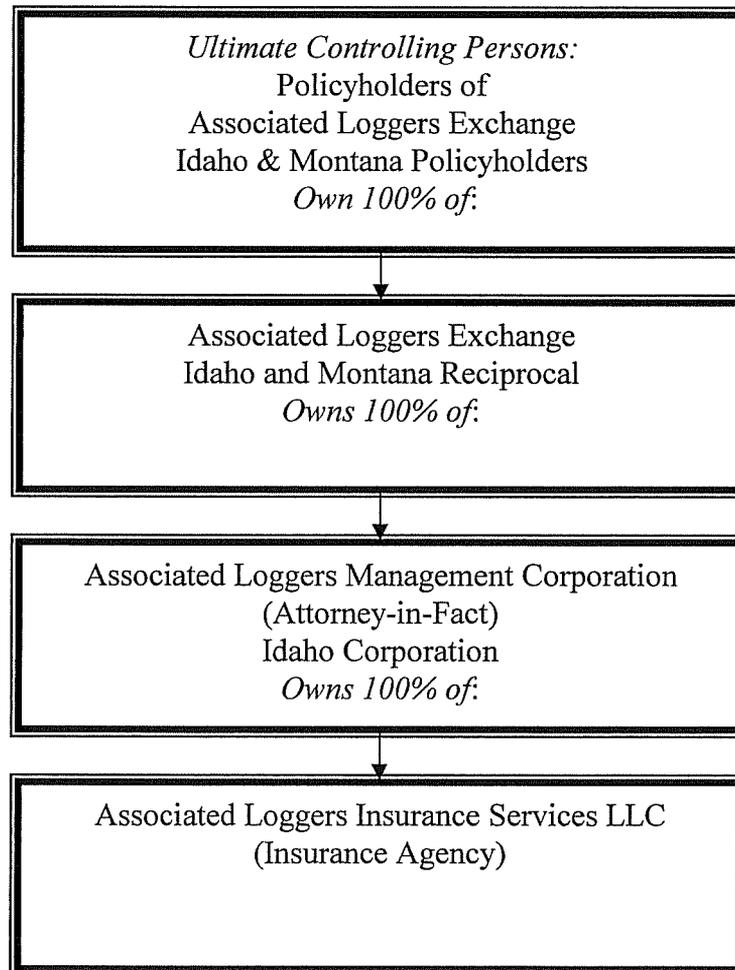
MANAGEMENT AND CONTROL

The Exchange became a member of an insurance holding company system on May 24, 1994, through purchase of its Attorney-in-Fact, ALMC. The Idaho Department of Insurance, however, does not require the Exchange to comply with the requirements of Section 41-3806, Idaho Code, with respect to registration.

As a reciprocal insurance company, the Exchange operated through and was managed by its Attorney-in-Fact. The following individuals were serving as Directors and Officers of the Attorney-in-Fact at December 31, 2006:

Jack Buell	Director and Chairman
John Graham	President
Merlyn Colpron	Director and Secretary
Raymond Coon	Director and Treasurer

The Exchange was an unincorporated aggregation of subscribers acting individually and collectively through their Attorney-in-Fact. The “Ultimate Controlling Persons” therefore, were the policyholders of the Exchange as shown in the following organizational chart:



The Rules of the Exchange provided for a Board of Governors, consisting of a minimum of nine members, who shall supervise the finances and operations of the Exchange. A minimum of two members shall be appointed by the Attorney-in-Fact, and one member shall be the Executive Director of Associated Logging Contractors of Idaho, Inc.

The remaining members of the Board of Governors shall be duly elected by the membership of the Exchange. No Governor shall serve for more than two consecutive terms, with the exception of the two members appointed by the Attorney-in-Fact and the Executive Director of Associated Logging Contractors of Idaho, Inc. No person shall serve as an elected member of the Board unless he or she is a member, or a partner of, or an officer of a member.

The Rules of the Exchange also provided for appointment of a Board of Alternate Governors, consisting of a minimum of five and a maximum of fifteen members who are members of the Exchange, the exact number of which shall be determined by the board. Members of the Alternate Board may be selected to appear and vote in place of any Governor unable to attend a meeting of the Board of Governors.

Each member of the Exchange shall have one vote upon any matter submitted to a vote. At any meeting, the presence in person or by proxy of 30 percent or more of the membership shall constitute a quorum.

The annual meeting of the Exchange shall be held during March, April or May of each year, at a time determined by the Board of Governors.

#### Board of Governors

The following persons were serving as members of the Board of Governors at December 31, 2006:

<u>Name and Business Address</u>	<u>Principal Occupation</u>
Frank Howerton, Chairman* Athol, Idaho	Owner Howerton Logging Inc.
Steve Sherich, Vice Chairman Hayden Lake, Idaho	Owner Sherich Logging
Shawn Keough, Secretary Coeur d'Alene, Idaho	Executive Director Associated Logging Contractors of Idaho, Inc.
Jack Buell St. Maries, Idaho	Owner JMF Co., Inc.
Merlyn D. Colpron Boise, Idaho	Owner Colpron & Associates

Raymond F. Coon Pierce, Idaho	Owner RF Coon Logging, Inc.
Dave Johnson Coeur d'Alene, Idaho	Owner Johnson Contractors Inc.
Greg Kelso Weippe, Idaho	Owner Greg Kelso
Capella Ikola McCall, Idaho	Owner G. Ikola, Inc.
Richard Nordstrom Post Falls, Idaho	Owner Richmond A. Nordstrom Logging
Robert Peterson Cascade, Idaho	Owner Valley Logging, Inc.
Barry Smith Missoula, Montana	Owner Barry Smith Logging
Rick Smith Kalispell, Montana	Owner Smith Logging Inc.
Kenneth B. Swanstrom Kalispell, Montana	Owner Kenneth B. Swanstrom

\* At the annual meeting held on April 27, 2007, John Larson was elected to the Board of Governors to replace Frank Howerton, whose term had expired.

The number of Governors serving on the Board at December 31, 2006 met the requirements of the Rules of the Exchange and Section 41-2835, Idaho Code.

#### Board of Alternate Governors

The following persons were appointed as members of the Board of Alternate Governors at December 31, 2006:

Tim E. Christopherson	John Larson	Norman Tomlinson
Bob Danielson	Mark Mahon	Kenneth J. Weller
James C. Finke	G. Bruce McLaughlin, Jr.	Mike Newton
Dan R. Holdeman	Kelly F. Scott	

Subsequent to the examination date, Frank Howerton was appointed to the Alternate Board of Governors to replace John Larson, who was elected to the Board. Mike Newton resigned from the alternate board on September 21, 2007 and there has been no replacement.

## Officers

The following persons were serving as officers of the Exchange at December 31, 2006:

Frank Howerton	Chairman
Steve Sherich	Vice-Chairman
Shawn Keough	Secretary

Subsequent to the examination date, Steve Sherich replaced Frank Howerton as Chairman and Capella Ikola replaced Steve Sherich as Vice-Chairman.

## Committees

The following persons were appointed to the Investment Committee at December 31, 2006:

Frank Howerton*	Mark Mahon
Steve Sherich	John Graham
Shawn Keough	Scott Brassey
Chad Neptune, CPA	Jack Buell
Tim Christopherson	Merlyn Colpron

\*Subsequent to the examination date, Frank Howerton was replaced by Capella Ikola.

Pursuant to Article IV, Section 2 of the Rules of the Exchange, the Board of Governors established and appointed an Advisory Committee on December 14, 1998. The following persons were appointed to the Advisory Committee at December 31, 2006:

Chester Barnett	Kelly Kelso	Donald Jensen
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## Conflict of Interest Policy

On June 4, 1999, the Board of Governors adopted a conflict of interest policy whereby members of the Board of Governors and Alternate Governors must complete conflict of interest statements every year they serve on the Board. Conflict of interest statements completed during this examination period (2002-2006) were reviewed. They appeared to appropriately disclose any possible conflicts of interest.

## Contracts and Agreements

The Exchange had the following agreements in effect at December 31, 2006:

### Management Agreement

Under the terms of this agreement, Associated Loggers Management Corporation (ALMC) agreed to act as Attorney-in-Fact for the Exchange and its subscribers. Pursuant to the agreement, the Attorney-in-Fact was responsible for production, underwriting, and servicing of insurance, as well as servicing and handling insurance claims and losses. In consideration for these services, the Attorney-in-Fact

received 11.5 percent and 12.5 percent of the Exchange's gross paid premium written in the states of Idaho and Montana respectively.

The Exchange was responsible for expenses including, but not limited to losses and claim payments; loss prevention expenses; governmental charges; taxes; audit and attorney fees; board fees and expenses; reinsurance premiums; investment counsel fees; officers' expenses, and subscriber meeting expenses.

The management agreement was effective July 1, 2006 through June 30, 2007, and may be terminated by either party for reasons specified therein. This agreement was renewed on June 15, 2007 that covered the period from July 1, 2007 through June 30, 2008. No changes were made on the renewal.

#### Publicity Agreement

The Exchange executed this agreement with Associated Logging Contractors of Idaho, Inc. for the contract period July 1, 2005 through June 30, 2007.

Under terms of this agreement, Associated Logging Contractors publicized activities of the Exchange, informed new members of the Exchange's existence, and encouraged recognition at meetings and certain sponsored occasions. In addition, Associated Logging Contractors aided in development and implementation of the Exchange's safety program, and consulted with the Exchange regarding legislative matters.

For services provided, Associated Logging Contractors was paid 1 percent of the Exchange's gross paid premiums for business written in the State of Idaho. This agreement may be cancelled by either party with 30 days written notice. This agreement was renewed on June 15, 2007 that covered the period from July 1, 2007 through June 30, 2009. No changes were made on the renewal.

#### Safety Engineering Services Agreement

A service agreement was executed between the Exchange and Safety Engineering, Inc. (SEI). SEI is a wholly-owned subsidiary of Associated Logging Contractors, Inc. Under terms of the agreement, Safety Engineering, Inc. provided loss prevention services through development and administration of a safety program for the Idaho insureds of the Exchange.

SEI was paid compensation in an amount equal to 5.5 percent of gross paid premium on Idaho workers' compensation insurance collected during the proceeding month.

The term of the agreement was July 1, 2005 through June 30, 2007 and may be cancelled by either party with ninety days prior written notice. This agreement was renewed for the period from July 1, 2007 through June 30, 2009; the new agreement carries the same terms as the expired agreement. SEI's name has been changed to ALC Services, Inc. effective January 1, 2007.

### Safety Services Agreement

A service agreement was executed between the Exchange and MLA Services, Inc. (MSI) effective on July 1, 2006. MSI is a Montana corporation specializing in insurance and safety services products for Montana's logging industry. Under terms of the agreement, MSI provided loss prevention services through development and administration of a safety program for the Montana insureds of the Exchange.

MSI was paid compensation in an amount equal to 4 percent of gross paid premium on Montana workers' compensation insurance collected during the proceeding month.

The term of the agreement was July 1, 2006 through June 30, 2008 and may be cancelled by either party with ninety days prior written notice.

### Investment Management Contract

This contract, dated May 6, 1981, was executed between the Exchange and Burroughs & Hutchinson, Inc. Under its terms, Burroughs was retained as personal investment counsel to manage funds and securities of the Exchange. Burroughs had the power to invest and reinvest funds and to buy, sell, and trade securities for the benefit of the Exchange. A management fee of 1/4 of 1 percent of the total value of funds and securities under management was paid quarterly. Either party may terminate the contract upon written notice.

The Exchange did not have any agents. Through the following agreements, the Exchange's attorney-in-fact, Associated Loggers Management Corporation (ALMC), appointed its agents to promote the Exchange's business:

### Policy Services Agreements

A policy services agreement was executed between Associated Loggers Management Corporation (ALMC) and Associated Loggers Insurance Services, LLC (ALIS). Under the terms of this agreement, ALMC appointed ALIS as its exclusive agent for workers' compensation insurance for the Idaho forest products industry written with the Exchange. ALIS was authorized to act as ALMC's agent in connection with the administration of the Exchange's business. For the services rendered, ALMC agreed to pay ALIS 3 percent of the Exchange's gross paid premium from business written in Idaho. This 3 percent was included in the 11.5% which the Exchange agreed to pay ALMC under the aforementioned management agreement. The term of this agreement was July 1, 2006 through June 30, 2007 and may be cancelled by either party with ninety days prior written notice. This agreement was renewed in July, 2007 that covered the period from July 1, 2007 through June 30, 2008 with the same terms.

Another policy services agreement was executed between ALMC and MLA Services, Inc. (MSI), a Montana corporation. Under the terms of this agreement, ALMC appointed MSI as its exclusive Montana producer for workers' compensation insurance written with the Exchange. For the services rendered by MSI, ALMC agreed to pay MSI 4 percent of the Exchange's gross paid premium from business written in Montana. This 4% was included in the 12.5% which the Exchange agreed to pay

ALMC under the aforementioned management agreement. The term of this agreement was July 1, 2006 through June 30, 2008 and may be cancelled by either party with ninety days prior written notice.

## CORPORATE RECORDS

### Rules of the Associated Loggers Exchange

The Exchange was organized pursuant to Title 41, Chapter 29, Idaho Code, as a casualty-worker's compensation only, reciprocal insurer. As such, the Exchange was an unincorporated aggregation of subscribers and did not have articles of incorporation. The Exchange, however, operated under the Rules of the Exchange, which were analogous to bylaws of a corporation.

The Exchange's records indicated that the Rules of the Exchange were amended three times during the period under examination. Article III, Section 1 and Section 20 were amended to ensure that both the Board and the Alternate Board would always have at least two-thirds majority of its members employed in the Idaho forest products industry. These amendments were approved by the Board on February 20, 2004. Article III, Section 6 was amended so that there is no longer a limitation of having to hold the Board meetings in Idaho. This amendment was approved by the Board on April 23, 2004.

The Exchange was not required to submit amended Rules of the Exchange to the Idaho Department of Insurance for approval.

### Power of Attorney

Pursuant to Section 41-2910, Idaho Code, the rights and powers of the attorney of a reciprocal insurer shall be as provided in the power of attorney given it by the subscribers. The power of attorney was contained in the workers' compensation and employers' liability insurance policy, and was, therefore, executed by the member by acceptance of the policy.

### Minutes of Meetings

A review of the minutes of the meetings of the Members, the Board of Governors, and the Investment Committee for the period January 1, 2001 through December 31, 2006 indicated compliance with the Rules of the Exchange with respect to annual membership and board meeting dates, the election of the Board of Governors and Officers, and the appointment of Alternate Governors and Committee members.

This review of the minutes also indicated that a quorum was present at all Board of Governors' meetings held during the examination period and that business transactions conducted by the Exchange were authorized. Specifically, contracts and agreements were approved, return of premium was declared, and redemption of surplus notes was properly authorized. In addition, investments of the Exchange were authorized by the Board of Governors and Investment Committee as required by Section 41-704, Idaho Code.

The Minutes of the Governors' meeting held March 21, 2003 indicated that the Examination Report as of December 31, 2001, conducted by the Idaho Department of Insurance was formally accepted.

## FIDELITY BOND AND OTHER INSURANCE

Insurance coverage for the protection of the Exchange had been maintained through the period under examination. Coverages in effect as of December 31, 2006 included a financial institution bond and management and employment practices liability together with directors and officers errors and omissions professional liability.

The financial institution bond covered forgery or alteration and securities losses up to \$1,000,000, with a deductible of \$10,000 for all coverages. The financial institution bond coverage met the suggested minimum limits recommended by the NAIC *Financial Condition Examiners Handbook*.

In addition to the coverages noted above, the Attorney-in-Fact maintained workers' compensation and employers' liability; business property and liability; and employment practices liability insurance. The Attorney-in-Fact also maintained surety bond coverage pursuant to Section 41-2912, Idaho Code during the period under examination.

The insurance companies providing coverage to the Exchange and to the Attorney-in-Fact were licensed or otherwise authorized in the State of Idaho.

[The rest of this page was intentionally left blank.]

## TERRITORY AND PLAN OF OPERATION

The Exchange is a reciprocal insurer organized under Idaho Statutes. It is an unincorporated association, organized pursuant to Chapter 29, Title 41 of the Idaho Code, and received its Certificate of Authority from the Idaho Department of Insurance on July 24, 1979. By statute, the Exchange operates through the Associated Loggers Management Corporation (ALMC), attorney-in-fact, which is a wholly owned subsidiary of the Exchange. Certain expenses incurred are reimbursed to the attorney-in-fact under a management agreement previously discussed under "Management and Control."

The Exchange is licensed to write worker's compensation insurance in Idaho and Montana. Operations of the Exchange were conducted from its main administrative office located in Boise, Idaho. In addition, an office to administer claims was maintained in Coeur d'Alene, Idaho.

As stated under the sub-caption, Contracts and Agreements, business was written on behalf of the Exchange through two policy services agreements. One was between the Associated Loggers Management Corporation (ALMC) and Associated Loggers Insurance Services, LLC on business produced in Idaho and the other one was between ALMC and MLA Services, Inc. on business produced in Montana. MLA Services, Inc. is a licensed producer (License # 66031) in the State of Montana.

## STATUTORY AND SPECIAL DEPOSITS

As of December 31, 2006, the Exchange had provided the following deposits in trust for the protection of all its policyholders and/or creditors through the office of the Director of Insurance, in compliance with Section 41-316A, Idaho Code:

<u>Description</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Statutory:			
Sears Roebuck Acceptance Corp., 7%, due 6/15/07	\$ 300,000	\$ 300,614	\$ 300,765
FNMA, 4.2%, due 5/4/09	250,000	248,886	245,625
FHLMC, 5%, due 1/30/14	<u>500,000</u>	<u>500,124</u>	<u>497,816</u>
Totals	<u>\$1,050,000</u>	<u>\$1,049,624</u>	<u>\$1,044,206</u>

The Exchange was also required to maintain a special deposit for the Idaho Industrial Commission. This deposit was not for the benefit of all policyholders. The following is a schedule of securities on deposit with the Office of the State Treasurer:

<u>Description</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
U. S. Treasury Note, 3.75%, due 5/15/08	\$ 115,000	\$ 113,985	\$ 113,239
U. S. Treasury Note, 3.13%, due 1/31/07	500,000	499,927	499,275

[Table is continued on next page]

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	500,000	498,478	496,700
U. S. Treasury Note, 4.38%, due 1/31/08			
U. S. Treasury Note, 4.63%, due 11/30/08	<u>300,000</u>	<u>300,360</u>	<u>298,911</u>
Totals	<u>\$1,415,000</u>	<u>\$1,412,750</u>	<u>\$1,408,125</u>

#### GROWTH OF THE EXCHANGE

The Exchange's growth for the years indicated, as taken from its Annual Statements, is shown in the following schedule:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital &amp; Surplus</u>	<u>Net Income(Loss)</u>
2001*	\$24,027,780	\$15,644,144	\$ 8,383,636	\$639,078
2002	23,704,946	15,169,445	8,535,501	562,159
2003	24,953,362	15,575,619	9,377,743	446,740
2004	26,269,374	16,317,415	9,951,959	613,934
2005	26,859,704	16,159,030	10,700,674	788,530
2006*	\$29,549,168	\$18,516,566	\$11,032,602	\$228,183

\*As determined by Examination.

Capital and surplus increases were due primarily to positive net income.

#### LOSS EXPERIENCE

The ratio of claims and underwriting expenses incurred to premiums earned, as reported in the Exchange's annual statements are scheduled below:

<u>Year</u>	<u>Premiums Earned</u>	<u>Losses &amp; LAE Incurred</u>	<u>Underwriting Expenses Incurred</u>	<u>Total Losses, LAE and Expenses</u>	<u>Ratio to Premiums Earned</u>
2001*	\$3,874,261	\$2,172,080	\$1,095,014	\$3,267,094	84.3%
2002	3,972,829	2,080,119	1,139,591	3,219,710	81.0%
2003	4,402,305	2,863,673	1,306,583	4,170,256	94.7%
2004	6,090,141	3,973,616	1,622,337	5,595,953	91.9%
2005	6,587,109	4,164,389	1,582,813	5,747,202	87.2%
2006*	\$7,966,173	\$5,759,176	\$1,735,231	\$7,494,407	94.1%

\*Per Examination

## REINSURANCE

### Assumed

The Exchange did not assume any reinsurance business during the period under examination.

### Ceded

At December 31, 2006, the Exchange's retention limit was \$1,000,000 per occurrence and ceded the excess to various reinsurers in accordance with the allocation percentages through four excess of loss reinsurance contracts.

The reinsurance contracts were written and administered by its reinsurance intermediary, Benfield Blanch Inc. (formerly E.W. Blanch Company), Minneapolis, Minnesota. Contracts in force during the examination period contained the standard insolvency clause, right of offset, arbitration, access to records, commutation, and errors and omissions provisions. The reinsurance contracts were in force for a one-year term commencing April 1 each year. They were renewed on a continuous basis, with substantially similar terms. The contracts also provided that for seven years after expiration, the Exchange would advise the reinsurers of any claims arising from occurrences which commenced during the contract term that had not been settled.

The reinsurers that participated in the Exchange's reinsurance contracts executed Interests and Liabilities Agreements; these agreements specified the reinsurer's percentage share in the interests and liabilities set forth in the subject reinsurance contracts.

The Department's consulting actuary, Taylor-Walker & Associates, Inc., performed a review of the excess-of-loss reinsurance agreements that were in effect for claims incurred between April 2006 and March 2007. Upon review of the agreements, Taylor-Walker determined that the treaties "contain no rating or coverage features which would bring into question the existence of risk transfer." Taylor-Walker went on to conclude: "Therefore, reinsurance accounting treatment is appropriate."

The coverage structure for the ceded business is summarized as follows:

[See table on next page.]

Coverage Structure of Reinsurance Program  
4/1/2006 – 3/31/2007

Type of Agreement	Reinsurer(s)	Exchange's Retention	Reinsurers' Limits
First Excess of Loss	Hannover Ruckversicherung AG (30%) Lloyd's Underwriter Syndicates (55%) Aspen Insurance UK Limited (15%)	\$1,000,000	\$1,000,000 per occurrence; \$1,000,000 maximum during the term of this contract
Second Excess of Loss	Hannover Ruckversicherung AG (35%) Odyssey America Reinsurance Corporation (30%) Lloyd's Underwriter Syndicates (35%)	\$2,000,000	\$3,000,000 per occurrence; \$3,000,000 maximum during the term of this contract
Third Excess of Loss	Midwest Employers Casualty Company (100%)	\$5,000,000	\$5,000,000 per occurrence; \$5,000,000 maximum during the term of this contract
Fourth Excess of Loss	Aspen insurance UK Limited (30%) Lloyd's Underwriter Syndicates(62.5%) Brit Insurance Limited (7.5%)	\$10,000,000	\$5,000,000 per occurrence; \$5,000,000 maximum during the term of this contract

INSURANCE PRODUCTS AND RELATED PRACTICES

A limited scope Market Conduct Examination was conducted in conjunction with the examination of the administrative affairs, books, records, and financial condition of the Exchange. Underlying data was also validated during the limited scope Market Conduct Examination.

Policy Forms and Underwriting

The Exchange offered worker's compensation and employer's liability insurance coverage to its subscribers. Coverage applied to worker's compensation laws and occupational laws of Idaho and Montana and applied to all private employment not exempt by Section 72-212, Idaho Code and Section 39-71-401, Montana Code respectively. For employer's liability insurance, the limits of liability were as follows:

Bodily injury by accident:	\$100,000, each accident
Bodily injury by disease:	\$100,000, each employee
Bodily injury by disease:	\$500,000, policy limit

On July 24, 1979, the Idaho Department of Insurance authorized the Exchange to omit provisions imposing contingent liability in its worker's compensation policies.

The Exchange subscribed to the National Council on Compensation Insurance (NCCI) rating organization. Rates developed by the NCCI were utilized in an advisory capacity. With regard to rates in Idaho, the Board of Governors approved deviations from those rates. Since the Exchange is an Idaho domestic reciprocal insurer transacting worker's compensation insurance only, it is not required to file its rates with the Department, or seek approval for rate deviations, according to Idaho Code Section 41-1601(2). For the policy year July 1, 2006 to July 1, 2007, the rates were deviated 15 percent downward from NCCI's filed rates. For rates in Montana, the Exchange developed its rates by multiplying the NCCI advisory rates by a loss cost multiplier. The loss cost multiplier used was approved by the Montana Department of Insurance; it was 1.092 during the period under examination.

A limited review of selected policies indicated compliance with the Exchange's underwriting guidelines, policy forms, and rates.

### Treatment of Policyholders

#### Claims

Random samples, using Audit Command Language (ACL) software, of open, paid, and denied claims incurred during the examination period were reviewed. This review indicated that, in general, claims were being settled properly and payments were being made in a timely manner as contemplated in Idaho Code Section 41-1329 (Unfair Claim Settlement Practices).

The State of Idaho Industrial Commission also regulated and enforced treatment of policyholders by hearing disputed claims, regulating benefit payments, and by enforcing and monitoring workers compensation insurance coverage. The exclusive remedy for injury claims was provided by the Workers Compensation Law, Title 72, Idaho Code.

#### Complaints

Complaints made by policyholders were filed either directly with the Exchange or with the Idaho Department of Insurance and/or the Idaho Industrial Commission. The Exchange's procedure for maintaining complaints was in compliance with Section 41-1330, Idaho Code.

Suspected fraudulent claims were reported to the Department of Insurance as required by Section 41-290, Idaho Code.

### Advertising and Sales Materials

As previously reported under the caption, "MANAGEMENT AND CONTROL", the Exchange executed a publicity agreement with Associated Logging Contractors of Idaho, Inc. Under terms of this agreement, Associated Logging Contractors publicized activities of the Exchange, informed new members of the Exchange's existence, and encouraged recognition at meetings and certain sponsored occasions. In addition, the Exchange published a newsletter that was periodically distributed to its members.

## ACCOUNTS AND RECORDS

### General Accounting

As previously reported, accounting, underwriting and claims administration services were provided to the Exchange by its Attorney-in-Fact, pursuant to the management agreement. Under this agreement, the Attorney-in-fact performed general accounting functions. However, an outside accountant compiled the financial statements and prepared the NAIC annual and quarterly statements, among other things.

Information technology services were provided to the Exchange under terms of the data processing agreement between the Attorney-in-Fact and Binary Options, Inc.

The information technology system utilized by the Attorney-in-Fact was comprised of IBM PC clones with a Windows XP operating system, and two servers running Windows 2000 Server. The claims management and underwriting systems use Microsoft Access Database with the Visual Basic Programming Language. There are 10 workstations on the local area network, and two workstations in the Coeur d'Alene satellite office and one in Montana that accesses the local network. There is also an additional network of computers connected to the Internet for email and information that is physically separated from the production network.

### Independent Accountants

The annual independent audits of the Exchange for the years 2002 through 2006 were performed by Presnell Gage Accounting and Consulting, Lewiston, Idaho. The financial statements in each report were on a statutory basis. There was some reliance on the 2006 audit report and workpapers in this examination of the Exchange.

### Actuarial Opinion

The policy reserves and related actuarial items were calculated by the Exchange and reviewed by Mark W. Mulvaney, FCAS, MAAA, with the firm of Milliman USA, Inc. The December 31, 2006 statement of opinion reported that the amounts carried in the balance sheet: (a) meet the requirements of the insurance laws of Idaho; (b) are consistent with reserves computed in accordance with Standards of Practice issued by the Actuarial Standards Board (including the Casualty Actuarial Society's Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves); and (c) make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The identified actuarial items in the Annual Statement were as follows:

Reserve for unpaid losses (Page 3, Line 1)	\$14,941,527
Reserve for unpaid loss adjustment expenses (Page, 3 Line 3)	2,276,136
Reserve for unpaid losses - direct and assumed (Schedule P, Part 1, totals from columns 13 and 15)	23,763,000
Reserve for unpaid loss adjustment expenses – direct and assumed (Schedule P, Part 1, totals from columns 17, 19, and 21)	2,444,000
The Page 3 Write-in item reserve, "Retroactive reinsurance reserve assumed"	0
Reserve for direct and assumed unearned premiums	0
Reserve for net unearned premiums	0

Anticipated salvage and subrogation included as a reduction to loss reserves as reported in various Annual Statement exhibits was zero. There was no discount for the time value of money reflected in the above and as reported in Schedule P.

The Exchange did not participate in any voluntary or involuntary pooling arrangements. The Exchange, therefore, did not have any liabilities arising from these sources.

The net reserves for losses and loss adjustment expenses that the Exchange carried for asbestos liabilities and environmental liabilities were zero. The total reserves for losses and loss adjustment expenses that the Exchange carried for the extended loss and expense reserve and which were reported in the Schedule P Interrogatories were also zero.

For comments regarding the review of the Company's loss reserving methodology by the Department's consulting actuary, see the NOTES TO FINANCIAL STATEMENTS section (Note 4) of this report.

### FINANCIAL STATEMENTS

The financial section of this report contains the following statements:

Statement of Financial Condition as of December 31, 2006

State of Income for the Year Ending December 31, 2006

Capital and Surplus Account for the Year Ending December 31, 2006

Reconciliation of Surplus as Regards Policyholders: December 31, 2001 through December 31, 2006

STATEMENT OF FINANCIAL CONDITION  
As of December 31, 2006

ASSETS

	<u>Assets</u>	Nonadmitted <u>Assets</u>	Net <u>Admitted</u>
Bonds	\$23,769,259	\$ 0	\$23,769,259
Common stocks (Note 1)	1,710,701	59,421	1,651,280
Cash and short-term investments	2,747,089	0	2,747,089
Investment income due and accrued	300,767	0	300,767
Uncollected premiums and agents' balances in course of collection (Note 2)	(38,780)	49,768	(88,548)
Premiums, agents' balances and installments booked but deferred and not yet due (Note 3)	834,970	0	834,970
Amounts recoverable from reinsurers	47,780	0	47,780
Current federal income tax recoverable	65,233	0	65,233
Net deferred tax asset	808,940	587,602	221,338
Totals	<u>\$30,245,959</u>	<u>\$696,791</u>	<u>\$29,549,168</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses (Note 4)	\$14,941,527
Loss adjustment expenses (Note 4)	2,276,136
Other expenses	248,278
Taxes, licenses and fees (Note 5)	117,868
Ceded reinsurance premiums payable (net of ceding commissions)	67,764
Funds held by company under reinsurance treaties	4,288
Amounts withheld or retained by company for account of others	309,060
Reserve for retrospective premium	551,645
Total liabilities	<u>\$18,516,566</u>
Surplus notes	\$ 102,012
Unassigned funds	10,930,590
Surplus as regards policyholders	<u>\$11,032,602</u>
Totals	<u>\$29,549,168</u>

STATEMENT OF INCOME  
For the Year Ending December 31, 2006

<u>UNDERWRITING INCOME</u>	<u>Per Exchange and Examination</u>
Premiums earned	\$7,966,173
Deductions:	
Losses incurred	\$4,826,557
Loss expenses incurred	932,619
Other underwriting expenses incurred	<u>1,735,231</u>
Total underwriting deductions	<u>\$7,494,407</u>
Net underwriting gain	<u>\$ 471,766</u>
<u>INVESTMENT INCOME</u>	
Net investment income earned	\$1,142,633
Net realized capital gains (losses)	<u>103,324</u>
Net investment gain	<u>\$1,245,957</u>
Net income before dividends to policyholders and before federal and foreign income taxes	<u>\$1,717,723</u>
Dividends to policyholders	<u>\$1,250,000</u>
Net income after dividends to policyholders but before federal and foreign income taxes	<u>\$ 467,723</u>
Federal and foreign income taxes incurred	<u>\$ 239,540</u>
Net income	<u>\$ 228,183</u>

## CAPITAL AND SURPLUS ACCOUNT

For the Year Ending December 31, 2006

	<u>Per</u> <u>Exchange</u>	Examination <u>Changes</u>	<u>Per</u> <u>Examination</u>
Surplus as regards policyholders, December 31, 2005	<u>\$10,700,674</u>	<u>\$ 0</u>	<u>\$10,700,674</u>
 <u>GAINS AND (LOSSES) IN SURPLUS</u>			
Net income	\$ 228,183	\$ 0	\$ 228,183
Change in net unrealized capital gains or (losses)	121,259	0	121,259
Change in net deferred income tax	134,150		134,150
Change in nonadmitted assets	(122,941)	0	(122,941)
Change in surplus notes	<u>(28,723)</u>	<u>0</u>	<u>(28,723)</u>
Change in surplus as regards policyholders for the year	<u>\$ 331,928</u>	<u>\$ 0</u>	<u>\$ 331,928</u>
Surplus as regards policyholders, December 31, 2006	<u>\$11,032,602</u>	<u>\$ 0</u>	<u>\$11,032,602</u>

RECONCILIATION OF SURPLUS AS REGARDS POLICYHOLDERS

From December 31, 2001 Through December 31, 2006

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Surplus as regards policyholders, December 31, previous year	<u>\$8,383,636*</u>	<u>\$8,535,501</u>	<u>\$9,377,743</u>	<u>\$9,951,959</u>	<u>\$10,700,674</u>
Net income	\$ 562,157	\$ 446,740	\$ 613,935	\$ 788,531	\$ 228,183
Net unrealized capital gains or losses	(358,672)	206,161	(50,620)	(63,310)	121,259
Change in net deferred income tax	0	145,312	319,260	(45,067)	134,150
Change in nonadmitted assets	(37,690)	10,350	(341,514)	231,021	(122,941)
Change in surplus notes	(858)	(11,593)	(329)	(162,460)	(28,723)
Aggregate write-ins for gains and losses in surplus	<u>(13,072)</u>	<u>45,272</u>	<u>33,484</u>	<u>0</u>	<u>0</u>
Change in surplus as regards policyholders for the year	<u>\$ 151,865</u>	<u>\$ 842,242</u>	<u>\$ 574,216</u>	<u>\$ 748,714</u>	<u>\$ 331,928</u>
Surplus as regards policyholders, December 31, current year	<u>\$8,535,501</u>	<u>\$9,377,743</u>	<u>\$9,951,959</u>	<u>\$10,700,674</u>	<u>\$11,032,602*</u>

\* = Per examination

NOTES TO THE FINANCIAL STATEMENTS

Note (1) – Common Stocks \$1,651,280

Common stocks included the market value of publicly traded common stock in the amount of \$1,290,310. The asset also included 100 percent of the outstanding stock of the Exchange's Attorney-in-Fact, ALMC. The stock was valued on the equity basis of \$420,391, less \$59,421 to non-admit furniture and equipment, prepaid expenses and software. Valuation of ALMC was in compliance with Section 41-614(3), Idaho Code.

The net earnings of ALMC, including depreciation of nonadmitted assets, as of December 31, 2006 were \$109,473.

Note 2 – Uncollected Premium Balances \$ (88,548)

The negative balance in this line item consisted of the following:

Net balance due to premium overpayments or adjustments.....	\$ (38,780)
Less: Adjustment to non-admit past-due positive account balances...	<u>49,768</u>
Total Uncollected Premium Balance.....	<u>\$ (88,548)</u>

Note 3 – Premium Balances Booked But Not Yet Due \$ 843,970

This balance consisted of earned but unbilled premium at year-end. The underlying data of this balance were tested using a probability proportional to size (PPS) sampling methodology, utilizing ACL software. A 95% confidence level was specified. No exceptions were noted in the sample.

Note (4) – Losses & \$14,941,527  
Loss Adjustment Expense \$ 2,276,136

The Department's consulting actuary (Taylor-Walker & Associates, Inc.) reviewed the actuarial opinion and supporting actuarial reports of the Exchange's loss and loss adjustment expense reserves as of December 31, 2006. Taylor-Walker concluded that the loss and loss adjustment reserves reported by the Exchange as of December 31, 2006 were reasonable. In addition, the actuary reviewed the Exchange's loss experience and the 2007 actuarial rate study in order to determine whether the Exchange needed to book a premium deficiency reserve as of December 31, 2006. The actuary determined that no premium deficiency reserve need be recognized.

Note (5) - Taxes, Licenses and Fees \$117,868

The Exchange was exempt from premium taxes pursuant to Section 41-402(6), Idaho Code. Taxes based on net premiums written, however, were paid to the State of Idaho Industrial Commission.

## SUMMARY, COMMENTS AND RECOMMENDATIONS

### Summary

The results of this examination disclosed that as of December 31, 2006, the Exchange had admitted assets of \$29,549,168, liabilities of \$18,516,566, and surplus as regards policyholders of \$11,032,602. This amount met the minimum requirements of Sections 41-313 and 41-2906, Idaho Code.

### Comments and Recommendations

#### Page

- 4 It was noted by the examiner during a review of 2007 subsequent events that surplus notes in the amount of \$1,992 were redeemed without prior approval of the Director of the Idaho Department of Insurance (which is required by Idaho Code, Section 41-2916). The examiner notified the Exchange of this problem during the fieldwork portion of this examination; the Exchange followed-up with a letter to the Idaho Department of Insurance on November 14, 2007 and obtained approval for these redemptions.

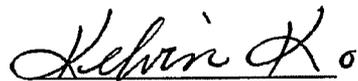
Since the Exchange subsequently obtained approval from the Department, there was no recommendation made regarding the above comment.

### CONCLUSION

The undersigned acknowledges the assistance and cooperation of the Exchange's officers, outside accountant, data processing consultant and the Attorney-in-Fact and its employees in conducting the examination.

In addition to the undersigned, Randall D. Ross, ACAS, MAAA, of Taylor-Walker & Associates, Inc., participated as the Idaho Department of Insurance's examining actuary.

Respectfully submitted,

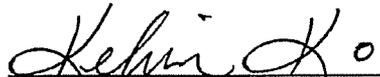


Kelvin Ko, CFE  
Senior Insurance Examiner  
Department of Insurance  
State of Idaho

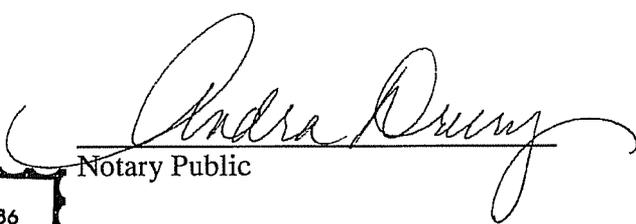
AFFIDAVIT OF EXAMINER

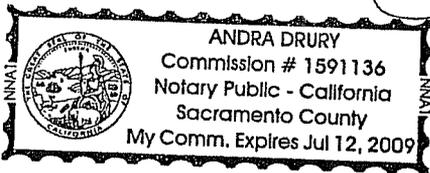
State of California  
County of Sacramento

Kelvin Ko being duly sworn, deposes and says that he is a duly appointed Examiner for the Department of Insurance of the State of Idaho, that he has made an examination of the affairs and financial condition of *Associated Loggers Exchange* for the period from January 1, 2002 through December 31, 2006, that the information contained in the report consisting of the foregoing pages is true and correct to the best of his knowledge and belief; and that any conclusions and recommendations contained in this report are based on the facts disclosed in the information.

  
\_\_\_\_\_  
Senior Insurance Examiner  
Department of Insurance  
State of Idaho

Subscribed and sworn to before me the 28<sup>th</sup> day of April, 2008, at  
Rancho Cordova, California. by Kelvin Ko

  
\_\_\_\_\_  
Notary Public



My Commission Expires: 7/12/09

State of Idaho  
**DEPARTMENT OF INSURANCE**

C.L. "BUTCH" OTTER  
Governor

700 West State Street, 3rd Floor  
P.O. Box 83720  
Boise, Idaho 83720-0043  
Phone (208)334-4250  
FAX # (208)334-4398

WILLIAM W. DEAL  
Director

**WAIVER**

In the matter of the Report of Examination as of December 31, 2006, of:

**Associated Loggers Exchange  
3380 Elder Street  
Boise, Idaho 83705**

By executing this Waiver, the Exchange hereby acknowledges receipt of the above-described examination report, verified as of the 28<sup>th</sup> day of April 2008, and by this Waiver hereby consents to the immediate entry of a final order by the Director of the Department of Insurance adopting said report without any modifications.

By executing this Waiver, the Exchange also hereby waives:

1. its right to examine the report for up to thirty (30) days as provided in Idaho Code section 41-227(4),
2. its right to make a written submission or rebuttal to the report prior to entry of a final order as provided in Idaho Code section 41-227(4) and (5),
3. any right to request a hearing under Idaho Code sections 41-227(5) and (6), 41-232(2)(b), or elsewhere in the Idaho Code, and
4. any right to seek reconsideration and appeal from the Director's order adopting the report as provided by section 41-227(6), Idaho Code, or elsewhere in the Idaho Code.

Dated this 2<sup>nd</sup> day of May, 2008

John Graham

Name (print)

John Graham

Name (signature)

Pres./Att-in-Fact

Title

EXHIBIT

**B**