STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

NEIGHBORS OF WOODCRAFT
OREGON CITY, OREGON

NAIC COMPANY CODE 57045

AS OF

December 31, 1999

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August 31, 2000

Honorable, Alfred Gross Commissioner
Chairman, NAIC Financial Condition (Ex 4) Subcommittee
Virginia Bureau of Insurance
State Corporation Commission/Bureau of Insurance
300 Capital Mall, Suite 1500
PO Box 1157
Richmond, Virginia 23218

Honorable Jose Montemayor, Commissioner
Secretary, NAIC Western Zone 4
Texas Department of Insurance
PO Box 149104
Austin, Texas 78714

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

Dear Commissioners:

In accordance with your instructions and pursuant to the provisions of ORS 748.501, we have examined the business affairs and financial condition of

NEIGHBORS OF WOODCRAFT
911 Main Street
Oregon City, Oregon 97045

NAIC Company Code 57045

hereinafter referred to as the "Society." The following report is respectfully submitted.

SCOPE OF EXAMINATION

This regular triennial examination of the Society was conducted as of December 31, 1999, covering the three-year period then ended, and included a review of material transactions or events which occurred subsequent to the date of examination.

The examination was conducted pursuant to ORS 748.501 and in accordance with procedures and guidelines prescribed by the National Association of Insurance Commissioners (NAIC) for the purpose of determining the Society's financial condition, ability to fulfill its obligations, the nature of its operations, and compliance with the Insurance Code. Accounting methods, internal control procedures, records, and other supporting evidence were examined or tested by appropriate methods to the extent deemed necessary and appropriate for the type, volume, and complexity of the accounting system and operations utilized by the Society. The record testing included, but was not limited to, assets, liabilities, income and expense related items. A review was also made of the corrective actions taken by the Society with respect to comments and/or recommendations in the previous report of examination as of December 31, 1996.

In addition to the above, work papers were reviewed that were prepared by Talbot, Korvola, & Warwick, LLP, the Society's independent auditors, in their audit of the Society's accounts for the year ended December 31, 1999. A portion of the auditors' work papers have been incorporated into our work papers, and have been utilized in determining the scope and areas of emphasis in conducting the examination.

Mr. Ralph Kopp, FSA, MAAA, actuary for the State of Oregon, Department of Consumer and Business Services participated in this examination by evaluating Life Insurance Premiums deferred and uncollected and various liabilities. The results of his analyses are found under the relevant section of this report.

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

HISTORY

The Society was originally a Colorado corporation incorporated in 1897 under the name "Pacific Circle of the Pacific Jurisdiction Woodmen of the World." Later the name was changed to "Pacific Circle Women of Woodcraft," and then to "Women of Woodcraft." The Society was reincorporated in the State of Oregon on September 22, 1905, as a non profit fraternal benefit society for the purpose of facilitating the insurance needs and social objectives of its members. The present name was adopted in 1917. The Society is maintained on a lodge system with a ritualistic form of work and a representative form of government pursuant to ORS 748.106.

The Society classifies its members as benefit, junior benefit, adult social, and junior social. These members are organized geographically into circles.

MANAGEMENT AND CONTROL

Grand Circle

The ultimate control of the Society is vested in a supreme governing body called the Grand Circle. This body is composed of grand officers, members of the committee on laws and elected grand representatives. The Grand Circle meets every four years to transact Society business and elect grand officers.

Grand Board of Managers

The management of the Society is controlled by a board of directors called the Grand Board of Managers comprised of the Grand Guardian, Grand Clerk/Banker and six Grand Managers. The Board meets twice a year. As of December 31, 1999, the following managers served on the Board:

Name and Address	**Position and Affiliation**
James B. Collier 3949 SE Pinehurst Milwaukie, OR 97267	Grand Guardian Neighbors of Woodcraft
Sherry L. Moore 6605 SE Clinton Portland, OR 97206	Grand Clerk/Banker Neighbors of Woodcraft
Grace E. Helms* 2150 Monterey Road, Space 265 San Jose, CA 95112	Retired
Eva L. Bergquist 14202 SE Powell Blvd. Portland, OR 97236	Retired
Marjorie L. Martin 3700 Elizabeth Avenue SE, Space 29 Olympia, WA 98501	Retired
Margaret E. Devous 81451 Gallatin Road Bozeman, MT 59715	Retired
Elizabeth A. Grimes 10138 Marion Ave. Montclair, CA 91763	Retired
Carol V. Hughes 2932 E Gettysberg Avenue Fresno, CA 93726	Retired

*Chairperson

In addition to the two annual meetings of the Grand Board of Managers, the executive committee of the Grand Board generally meets once a month. The executive committee is comprised of the Grand Guardian, Grand Clerk/Banker and the Vice President of Operations.

Grand Officers

Officers elected and serving the Society at December 31, 1999, were as follows:

Name	Title
James B. Collier	Grand Guardian
Sherry L. Moore	Grand Clerk/Banker

MANAGEMENT AFFIRMATION

CONFLICT OF INTEREST

The Society has a conflict of interest policy that requires essential employees and directors to report conflicts of interest to the Society. During the period examined, all directors and officers signed conflict of interest statements.

From a review of the completed conflict of interest questionnaires, it appeared that the affected personnel performed due diligence in completing the conflict of interest statements. No material conflicts were noted.

CORPORATE RECORDS

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

Articles of Incorporation

The Articles of Incorporation were in conformance with Oregon statutes. No amendments were made to the articles during the period covered by this examination.

Constitution and Bylaws

The Society's Constitution was amended at the twenty-seventh session of the Grand Circle of Neighbors of Woodcraft held on August 6, 1997, and approved by the executive council on July 1, 1998. The primary purpose of amending Chapter 1, section 5, of the constitution was to define the common bond, objectives and purposes of the Society.

Constitution and Bylaws are included in the work papers which support this examination. The amended Constitution and Bylaws comply with Oregon statutes.

Board Minutes

Minutes of the Grand Board of Managers meetings were reviewed for the period under examination. Meetings were held periodically and a quorum was achieved at each meeting. These minutes support the transactions of the Society and actions taken by its officers. All investments were approved by the Grand Board of Managers in accordance with the provisions ORS 733.730.

FIDELITY BONDS AND OTHER INSURANCE

The examination of insurance coverages involved a review of adequacy of limits and retentions, and the solvency of the insurers providing the coverages. The Society is insured up to $175,000 per occurrence against losses from acts of dishonesty and fraud by its employees. Fidelity bond coverage was found to meet the minimum coverage recommended by the NAIC. In addition, the Society is covered against directors and officers liability for $3,000,000. Other insurance coverages in force at December 31, 1999, were as follows:

Auto liability and physical damage	Workers' compensation
Errors and omissions	Commercial general liability
Commercial inland marine (computer equipment)	Commercial property

The above coverages were found to be adequate as of December 31, 1999.

PENSION PLANS AND OTHER POST RETIREMENT BENEFITS

All eligible employees of the Society are participants in a noncontributory retirement program. Costs of the plan are charged to the current operations. As of December 31, 1999, the plan was fully funded.

During 1998, the Society adopted a 401K program, whereby all employees over 21 years of age and at least six months of service can participate. A participant can contribute from 1% to 15% of their gross salary. The Society may, at its sole discretion, contribute and allocate to each eligible participate a percentage of the participant's elective deferral contributions. Matching contributions, if any, shall be determined as of the end of the plan year. To date, the Society has not made any matching contributions.

The Society does not provide any other post-retirement benefits to its employees.

GROWTH OF THE SOCIETY

The growth of the Society is reflected in the following schedule. The statistics were derived from Society filed annual statements except in those years where a triennial report of examination has been filed with the Oregon Insurance Division.

Year	Admitted Assets	Liabilities	Surplus	Net Income
1996*	$21,559,784	$17,534,881	$4,024,903	$(459,428)
1997	19,052,758	15,486,105	3,566,653	(502,971)
1998	17,154,077	14,005,841	3,148,236	(481,418)
1999*	15,623,796	13,009,768	2,614,028	(567,895)

*Per examination

LOSS EXPERIENCE

The following exhibit reflects the annual underwriting results of the Society since 1996. The amounts were compiled from copies of the Society's filed annual statements.

Year	(1) Premiums	(2) Losses	(2/1) Ratio
1996*	$1,918,909	$2,157,877	112.45%
1997	1,677,328	1,615,922	96.34
1998	1,128,883	1,381,031	122.34
1999*	1,047,801	1,214,227	115.88

*Per examination

The high loss ratios for 1996, 1998 and 1999 are attributable to a high volume of policy surrenders during these years.

TERRITORY AND PLAN OF OPERATION

As of the date of this examination, the Society was licensed to transact the business of a fraternal life insurer in the following states:

California	Colorado	Idaho
Montana	Nevada	Oregon
Utah	Washington*	Wyoming

*In 1996, the State of Washington enacted legislation that requires a fraternal to maintain at least $4,000,000 in unimpaired surplus in order to write new business. The Society's unimpaired surplus as of December 1999 was $2,614,028. Consequently, the Society, can only service existing business and sell policies to members who owned policies prior to the legislation.

The Society currently offers accidental death, annuities and ordinary life insurance which includes whole life and term. These policies were issued on a nonparticipating basis as of the examination date.

Financial Trends and Projection and Evaluation of Inforce Business

New products introduced in 1995 and 1996 benefited the Society with increased first year writings in 1997. However, total premiums and surplus have decreased steadily during the course of this examination. The following are exhibits of select annual statement components for the period from January 1, 1997 to June 30, 2000.

	1996	**1997**	**1998**	**1999**	**June 30, 2000**
Surplus	$4,024,903	$3,566,653	$3,148,236	$2,614,028**	$2,566,205
First year premiums	$ 53,298	$ 179,147	$ 139,263	$ 42,647	$ 107,126*
Total premium	$1,927,519	$1,645,612	$1,097,599	$1,017,937	$ 845,322*
Insurance expenses	$1,770,296	$2,056,275	$1,561,250	$1,442,697	$1,443,098*
Number of life certificates inforce	9,860	8,935	7,579	7,195	6,807

*Annualized figures (estimated) based on second quarter results. Some 2000 balances are annualized for comparative purposes.

**Per examination

Change Between Years

Period	**1996/1997**	**1997/1998**	**1998/1999**	**1999/2000** *	**Four Year Trend**
Surplus	-11.39%	-11.73%	-16.96%	-1.82%	Decreasing
First year premiums	236.12%	-22.26%	-69.38%	+151.11%	Fluctuating
Total premium	-14.63%	-33.30%	-7.83%	-16.96%	Decreasing
Insurance Expenses	16.15%	-24.07%	-7.59%	.-03%	Fluctuating
Number of life certificates	-9.39%	-15.18%	-5.07%	-5.39%	Decreasing

**A negative percentage indicates a decrease from the prior year.

Analysis

The preceding exhibits generally display an adverse trend with respect to the Society's surplus. The exhibits indicate a declining surplus at an increasing rate. The principal cause for the decreasing surplus appears to be the Society's decreasing premium income combined with the level of general insurance expenses incurred for the period examined and an increasing number of surrenders.

Without the production of new business, the Society's expenses must be funded by its surplus or investment income. However, the Society's declining number of certificates in-force, mainly brought about by the high number of surrenders from the college fund program, has reduced the Society's base for investment income.

HOLDING COMPANY REGISTRATION

The Society is not a member of "a controlled group" or "an insurance holding company system," therefore, no holding company registration was required to be filed with the Oregon Insurance Division.

REINSURANCE

The following is a summary of the significant reinsurance agreements, by line of business, in effect as of December 31, 1999.

Whole Life

The Company is afforded excess of loss coverage for losses that exceed $50,000 per individual up to four times the Society's retention. Losses are subject to an aggregate limit of $10,000,000. This treaty also covers losses from waiver of premium riders.

Universal Life

The Society reinsures its risk for universal life policies under a 50% coinsurance agreement. Under this agreement, the Society's retention is limited to $25,000. Losses in excess of $25,000 are reinsured for up to four times the Society's retention. In addition to this reinsurance agreement, the Society entered into a servicing agreement with the reinsurer for the purposes of performing certain administrative functions associated with its universal life policies. As of the date of this examination, the Society no longer offers a universal life insurance plan.

Individual Ordinary Life

The Society is indemnified against losses for ordinary life in excess of $50,000 up to $100,000 per life. The agreement provides for aggregate loss limits of $750,000 for insureds - ages 0 to 20 and $2,000,000 for ages 21 to 60. In addition to the life coverage, this treaty provides reinsurance for waiver of premium and accidental death. The Society cedes 100% of the risk for accidental death.

Catastrophe Coverage

The Society has reinsurance coverage for catastrophe losses in excess of $150,000, $50,000 per life and $750,000 aggregate. Catastrophe is defined as an accident arising out of one event and resulting in the death of three or more people.

Facultative Coverage

In addition to treaty coverage, the Society has facultative arrangements to cede higher limits of life and disability risks if necessary.

Assumed Reinsurance

The Society did not assume business during the period covered by this examination.

Risk Retention

The Society's maximum retention on any of its policies is $50,000 per risk. As such, the Society does not retain risk on any one subject in excess of 10% of its surplus to policyholders as prohibited by ORS 731.504.

Insolvency Clauses

All of the Society's reinsurance agreements contained insolvency clauses which specified payment to a statutory successor without diminution in accordance with the provisions of ORS 731.508.

INSURANCE CODE LIMITATIONS

Pursuant to ORS 748.603, the Society is not subject to many Insurance Code requirements, as are other insurers. By way of example only, the Society is not subject to several of the provisions which limit insurer investments. These exempt provisions include the limitations ordinarily imposed on investment in real property (ORS 733.610), stocks of corporations (ORS 733.620), data processing system (ORS 733.660), noninvestment grade securities (ORS 733.695), and many other such items. The Society is exempt from the "prudent investor" and prohibited investments standards. See ORS 733.670 and 733.780.

Additionally, in the event of an impairment or insolvency, the Society is not subject to the statutory requirements of minimum required capital or surplus (ORS 731.554), or supervision, rehabilitation or liquidation, see ORS 734.043, 734.150, and 734.170. Ordinarily, the claims of an insolvent insurer are protected by the Oregon Insurance Guaranty Association, see ORS 734.550. These provisions are not applicable to the Society, see ORS 748.603. The Society is not subject to the provisions of ORS 731.554 or 731.558. Therefore, the Society is not required to maintain a minimum surplus.

ACCOUNTS AND RECORDS

The Company's records and source documentation in general support the amounts presented in the December 31, 1999. In addition, as of December 31, 1999, all disbursements in excess of $100 were supported by signed vouchers or related documents as required by ORS 732.320. Also, the Society has a system in place to account for the funds subject to escheat pursuant to the provisions of ORS 98.352.

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

Custodial Agreement

During the course of this examination, the Society changed the holder of its custodial account. The custodial agreement with the new bank does not incorporate the safeguards as required by the NAIC. The agreement should include safeguards that the bank, as custodian, is obligated to indemnify the Company for any loss of the Company's securities in the bank's custody occasioned by the negligence or dishonesty of the bank's officers or employees, burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction. No recommendation will be as made as the Society has subsequently secured a new custodial agreement incorporating the required safeguards.

Working Trial Balance

The Society does not prepare a working trial balance showing all adjustments, instead they show the assets and liabilities with one balancing amount for surplus. As a consequence, the Society can not provide the details of some income, expense, and surplus items reported on the annual statement. **I recommend the Society prepare a working trial balance which enables the examiners to**

trace amounts from the Society's trial balance to the annual statement. This recommendation is made pursuant to the provisions of ORS 733.170.

Real Estate

In September 1998, the Society leased a portion of their headquarters to Paul Solomon Associates (PSA). In addition, the Society also provides PSA with parking spaces, janitorial services, reception and incoming mail service. According to the contract, monthly lease payments are due in advance on the first working day of each month. Charges for all copier services will be invoiced monthly and will be due net 5 days. PSA provides the Society with planning, marketing, communications and implementation services. Any amounts due lessee or lessor may be applied towards future work/services or lease amounts. However, the Society only invoices PSA for a portion of the space they occupy and for copier services. The unrecorded rent is used to offset unrecorded consulting fees invoiced by PSA. This practice results in an understatement of rental income, marketing expenses and an unrecorded liability or asset depending on the "of-the-books" balance between the parties. **I recommend the Society record all transactions relating to the rental of the office space, in addition to all planning, marketing, communications and implementation services in the Society's general ledger and follow the terms of the lease contract. This recommendation is made pursuant to the provisions of ORS 733.030(5) which states in part that liabilities for taxes, expenses and other obligations due or accrued at the date of the statement be recorded and by ORS 733.170 (Accounts & Records).**

Certificate Loans

This account represents amounts borrowed by policyholders against the surrender value of their policy. Several loans were found to be in excess of the policy's cash surrender value or loans on policies not in-force. In cases where policy indebtedness exceeds the cash surrender value, the excess is a nonadmitted asset. **I recommend the Society nonadmit any policy indebtedness in excess**

of the surrender value. This recommendation is made pursuant to the provisions of the NAIC Accounting and Practices Procedures manual for Life and Accident and Health Insurance Companies (Pg. 7.1) and ORS 731.302(1).

<u>Life Insurance Premiums Deferred & Uncollected</u>

Ordinarily, this asset is equal to a total of the net due and deferred premium. However, because the reserve is calculated as an interpolated reserve, rather than a mean reserve, there is no need for a net deferred premium asset. The due premium asset should be equal to the amount of net due premium pro-rated between the due date and the valuation date. The Society did correctly pro-rate the due premium. However, the amount of net premium assets is overstated in two ways: (1) the amount is reported as gross premium instead of net premium, and (2) it includes premium more than 90 days past due. **I recommend the Society adjust its calculations from a gross basis to a net basis. This recommendation is made pursuant to the provisions of the NAIC Annual Statement Instructions for Life & Accident & Health Insurance Companies (Pg. 32) and ORS 731.302(1). I recommend the Society not include premiums due in excess of 90 days. This recommendation is made pursuant to the provisions of ORS 733.010(5) and the NAIC Examiners Handbook.**

<u>Premium & Annuity Considerations Received in Advance</u>

The reported balance represents the general ledger amounts for advance premium and premium with applications. In prior years the Society had a report which calculated and listed premiums received in advance. However, in 1999 the old report would not allow premiums to be recorded as paid past December 31, 1999. When this occurred, the Society began using the advance premium account to record premiums paid after December 31, 1999, in much the same way a suspense account is used. When the annual statement was prepared the Society reported only amounts in the two general ledger accounts. No report was prepared that calculated the premiums received in advance, as a result the liability as reported in the annual statement was understated which is contrary to the provision of ORS 733.030(3)(d). No recommendation will be made as subsequent to the date of this examination the Society has produced reports which accurately reflect premiums and annuity consideration received in advance.

Interest Maintenance Reserve

The amount of amortization reported in the summary of operations is correct. However, the net realized capital gain or (loss) which excludes the amount transferred to the IMR is incorrect as the Society only reduces it by the amount amortized into income rather than the amount transferred to the IMR. As a result, the realized gain or loss is not reported correctly into the Summary of Operations. This is contrary to the NAIC Annual Statement Instructions for Fraternal Organizations (pg. 144) and ORS 731.302(1). **I recommend the Society report the net realized capital gains or (loss) which excludes the amount transferred to the IMR. This recommendation is made pursuant to the provisions the NAIC Annual Statement Instructions for Fraternal Organizations and ORS 731.302(1).**

Internal Controls

The following lines in the annual statement reflect weaknesses in the internal controls of the Society:

1. Amounts Withheld or Retained by Society: The Society sets up a liability for student loan fees and if it's a government backed loan the U.S. Department of Education will reimburse the Society for interest on the loan until the student graduates. From the proceeds received from the U.S. Department of Education the Society clears the origination fees by a debit to cash, origination fees and a credit to college fund interest. This account has not been reconciled with the remittances from the U.S. Department of Education on a regular basis.

In addition, the Society has a vacation policy which allows the employee to take vacations prior to being earned. At year-end, the balance taken exceeded the amount earned. This would normally result in a receivable to the Society. However, in this case the receivable would be nonadmitted as it does not meet the requirements of ORS 733.010(8). The portion of vacation earned in excess of used represents a liability to the Society and the Society should reflect the balance in the amounts withheld or retained by Society. **I recommend the Society record the liability for vacations earned and not taken in the annual statement. The is recommendation is made pursuant to the provision of ORS 733.030(5).**

2. Amounts Held for Fieldworkers' Accounts: The amount reported in the annual statement did not reflect the correct amount as shown on the agents debit balance listing for the period ending December 1999, nor the final trial balance. The amount in the annual statement did not agree to the amount reflected on the listing or to the final trial balance.

3. Aggregate Write-ins for Liabilities: The amount as reflected in the annual statement includes two suspense accounts. Only one of the accounts has been reconciled on a regular basis and the other has not been reconciled, consequently, the Society does not know what items make up the liability.

The above clearly exemplifies the Society has not exercised controls as they relate to reconciliation of various accounts. **I recommend the Society reconcile all accounts to supporting documentation and accurately reflect amounts recorded in suspense accounts. This recommendation is made pursuant to the provision of ORS 733.170 which states in part "that in insurer shall keep its books, records, accounts and transaction source data in such manner that the director of the Department of Consumer and Business Services may readily verify its statement of financial condition."**

Asset Valuation Reserve

The examination of this line indicated three different errors which affected the balance: (1) a single class mortgage-backed security was classified as exempt contrary to the NAIC Annual Statement Instructions for Fraternal Organizations; (2) one security with an NAIC designation of 2 (high quality) was included with securities with a designation of 1 (highest quality) resulting in different reserve calculations; and (3) money market funds were improperly reported as cash rather than exempt bonds. Items 1 and 2 resulted in changes to the amount reflected in amount recorded. (see note 12). **I recommend the Society follow the NAIC Annual Statement Instructions for Fraternal Organization (Pg. 156) and ORS 733.302(1).**

Actuarial Report

The DCBS consulting actuary reviewed the Society's December 31, 1999, liability for supplementary contracts with life contingencies, and made the following findings:

Aggregate Reserves for Life Certificates

1. A supplementary listing of annuities with an effective date other than the valuation date was used to value reserves for those particular policies. Any transactions (deposits, withdrawals, interest crediting, etc) between the valuation date and the effective date of the report would lead to a difference in value.

2. Data errors and contract omissions were noted with the preparation of the Exhibit 8C.

3. A number of the Society's plans lacked reserve factors. Reserves were then determined on an approximate basis.

4. The description of the reserve basis in Exhibit B should properly reflect the correct mortality table and interest rate.

5. The description of the reserve basis in Exhibit 8C should properly reflect the correct mortality table and interest rate.

Supplementary Contracts Without Life Contingencies

The Society provided a listing of account balance for each participant. In reviewing the files, it was found that a number of balances had been paid years before and hence, no liability existed for those contracts.

The comments and errors noted above reflect inaccurate data is being used to support the numbers in the annual statement. Although the changes made to the financial statement are small, it illustrates a weakness in controls. **I recommend the Society strengthen its controls with regards to supporting documentation, recording accurate reserve amounts and in training employees responsible for the data. This recommendation is made pursuant to the provisions of ORS 733.030(3)(a) and ORS 733.170.**

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The recommendations presented in the 1996 report of examination are reproduced below followed by the Society's' resolution of these issues as of December 31, 1999.

1. I recommend the Society devise an amended business plan that addresses a strategy to reverse its declining surplus and submit this plan to DCBS for review.

   The Society submitted an amended business plan and is furnishing the Insurance Division monthly financial statements.

2. The methodology for the calculation of reserves for supplementary contract involving life contingencies should be reviewed so that all reserves are calculated in a similar manner. This recommendation is made in accordance with the provisions of ORS 733.030(3)(a).

   As of the date of this examination corrective measures have been taken, however, errors still exist in the determination of reserves. (see page 24)

3. The Society should ensure that a reserve for all UL disability claims be set up as appropriate even though this product line is separate from the traditional life insurance. This recommendation is made in accordance with the provision of ORS 733.030(3)(a).

   The Society has taken the necessary steps to insure reserve are set up for all UL disability claims.

NEIGHBORS OF WOODCRAFT
STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
AS OF DECEMBER 31, 1999

ASSETS	**Annual Statement**	**Examination Adjustments**	**Net Admitted Assets**
Bonds **(Note 1)**	$10,673,350	$906,445	$11,579,795
Mortgage loans	14,067		14,067
Real estate	1,088,649		1,088,649
Certificate loans **(Note 2)**	808,243	(1,206)	807,037
Cash **(Note 3)**	953,303	(906,445)	46,858
Other invested assets **(Note 4)**	1,782,596	(4,694)	$1,777,902
Reinsurance recoverable	12,500		12,500
EDP equipment	29,926		29,926
Life insurance premiums and annuity considerations deferred and uncollected **(Note 5)**	17,859	(6,468)	11,391
Accident and health premiums due and unpaid	39		39
Investment income due and accrued	255,632		255,632
Other assets nonadmitted	0	0	0
TOTAL ASSETS	$15,636,164	$(12,368)	$15,623,796

LIABILITIES

Aggregate reserve for life certificates & contracts **(Note 6)**	$12,141,764	4,202	12,145,966
Aggregate reserves for accident & health certificates	2,722		2,722
Supplementary contract without life contingencies **(Note 7)**	82,144	(12,601)	69,543
Certificate & contract claims – life	53,174		53,174
Refund accumulations	323,545		323,545
Refunds due and unpaid	1,595		1,595
Provision for refunds payable – apportioned for payment	8,000		8,000
Not yet apportioned	30,328		30,328
Premiums & annuity considerations **(Note 8)**	29,779	75,252	105,031
Interest maintenance reserve **(Note 9)**	24,897	(24,897)	
General expenses	17,188		17,188
Unearned investment income	11,990		11,990
Amounts withheld or retained by Society **(Note 10)**	7,853	2,173	10,026
Amounts held for fieldworkers account **(Note 11)**	257	150	407
Asset valuation reserve **(Note 12)**	86,176	511	86,687
Aggregate write-ins for liabilities	143,566	0	143,566
TOTAL LIABILITIES	$12,964,978	$ 44,790	$13,009,768
Unassigned funds	$ 2,671,186	$(57,158)	$ 2,614,028

TOTAL LIABILITIES, SURPLUS & OTHER FUNDS	$15,636,164	$(12,368)	$15,623,796

NEIGHBORS OF WORDCRAFT
SUMMARY OF OPERATIONS
For the period ending December 31, 1999

Premium and annuity considerations **(Note 8)**	$942,685
Consideration supplementary contracts without life	29,864
Net investment income	1,162,712
Amortization of interest maintenance reserves	(246)
Aggregate write-ins for miscellaneous income	72,901
Total Income	$2,207,916
Death benefits	$ 281,222
Matured endowments	634,259
Annuity & old age benefits	42,455
Disability benefits and benefits under A&H policies	20,684
Surrender benefits	1,166,238
Interest on certificates or contract funds	3,503
Payments on supplementary contracts with life contingencies	1,312
Payments on supplementary contracts with life contingencies and refund accumulation	36,184
Increase in aggregate reserves for life & A&H certificates & contracts **(Note 6)**	(977,229)
Increase in reserves for supplementary contracts without life contingencies and for refund accumulation **(Note 7)**	(11,204)
Total	$1,197,424
Commissions on premiums and annuity considerations	10,480
General insurance expenses **(Note 10)**	1,444,811
Insurance taxes licenses and fees	76,059
Total	$2,728,774
Net gains before refund to members	$ (520,858)
Refund to members	35,185
Net gains after refund to members	$ (556,043)
Net realized capital gains	(5,513)
Net Income	$ (561,556)

SURPLUS ACCOUNT

Unassigned funds and special reserves December 31, 1998	$3,148,235
Net income/loss from operations	(561,556)
Change in net unrealized capital gains	(4,263)
Change in nonadmitted assets	35,621
Change in asset valuation reserves **(Note 12)**	(4,009)
Unassigned funds and special reserves December 31, 1999	$2,614,028

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NOTES TO FINANCIAL STATEMENTS

Note 1 - Bonds

Per Society	$10,673,350
Per examination	11,579,795
Difference	$ 906,445

A reclassification is being made from cash & short-term investments to reflect the proper classification of mutual bonds. Mutual funds, including money market funds, are typically classified as common stock and reported in Schedule D – Part 2 – Section 2. However, money market funds filed with the SVO that meet certain criteria may be receive more favorable reserve treatment. The Society's money market funds have been filed with the SVO and are eligible for the favored treatment and should be reported on Schedule D – Part 1 (Bonds).

Note 2 - Certificate Loans

Per Society	$808,243
Per examination	807,037
Difference	$ (1,206)

This account represents amounts borrowed by policyholders against the surrender value of their policy. Policy loans are of two types. Regular policy loans were the policyholder requests the loans or an automatic premium when the policyholder has not paid the premium due, and the policy has a provision for an automatic premium loan against the net surrender value. The amount of difference is due to several loans exceeded the policy's cash surrender value or loans on policies not in force. This is contrary to the annual statement instructions and ORS 733.302(1).

Note 3 - Cash & Short-term Investments

Per Society	$ 953,303
Per examination	46,858
Difference	$(906,445)

(See Note 1).

Note 4 - Other Invested Assets

Per Society	$1,782,596
Per examination	1,777,902
Difference	$ (4,694)

The reported balance represents the balance of student loans and a deposit held by the United Student Aid Funds. These student loans are fully guaranteed by the Federal government, except two loans that have lost their guarantee because the Society did not perform due diligence in accordance with the loan program. One loans was not current and should be treated as a nonadmitted assets in accordance with ORS 733.010(8) as this asset is unavailable for the payment of claims.

Note 5 – Life Insurance Premiums and Annuity Considerations Deferred and Uncollected

Per Society	$17,859
Per examination	11,391
Difference	$ 6,468

The amount of net premium asset is overstated in two ways: 1) the amount is reported as gross premium instead of net premium, and 2) it includes premium 90 days past due.

Note 6 - Aggregate Reserves for Life Certificates and Contracts

Per Society	$12,141,764
Per examination	12,145,966
Difference	$ 4,202

The difference is the result of errors in the calculation of deferred annuities, supplementary Contracts with Life Contingencies and miscellaneous reserves.

a. Deferred annuities were determined using information as of February 14, 2000 rather than December 31, 2000.
b. Supplemental Contracts with Life Contingencies – The Society failed to establish a reserves for a contract holder receiving $109.36 each month payable for the rest of their life.
c. Miscellaneous – an amount of $6,400 is reported for surrender values in excess of reserves.

Note 7 - Supplementary Contracts Without Life Contingencies

Per Society	$ 82,144
Per examination	69,543
Difference	$(12,601)

The Society provides a listing of account balances for each participant. In reviewing the files supporting this listing a number of balances had been paid years before, hence no liability need exist for those contracts.

Note 8 - Premium and Annuity Considerations Received in Advance

Per Society	$ 29,779
Per examination	105,031
Difference	$ 75,252

In prior years the Society's data processing system calculated and listed premiums received. However, in 1999 the computer system would not allow premiums to be recorded as paid past 12/31/99. When, this occurred, the Society began using the advance premium account to record premiums paid after 12/31/99 in much the same way a suspense account is used. To determine the amount of adjustment a mid-point was established between June 30, 2000 and December 31, 1998.

Note 9 - Interest Maintenance Reserve

Per Society	$ 24,897
Per examination	0
Difference	$(24,897)

The difference is the result of a negative liability being reported as a liability. The negative liability for an IMR is treated as a nonadmitted assets and reported on Exhibit 13- Analysis of nonadmitted assets and related items.

Note 10 - Amounts Withheld or Retained by Society

Per Society	$ 7,853
Per examination	10,026
Difference	$ 2,173

Adjustment	Origination fees	$ 59
	Vacation accrual	2,114
	Total	$2,173

An adjustment of $2,173 is being made to this line item as a result of student loan origination fees not being reconciled with remittances from the U.S. Department of Education on a timely basis and an accrual for vacations which the Society did not record.

Note 11 - Amounts Held for Fieldworkers Account

Per Society	$257
Per examination	407
Difference	$150

The commission run as of December 31, 1999, reflected a balance payable of $406.77, a difference to the annual statement of $150. This amount reflects a correcting entry made in December 31, 1999, which corrected errors previously made in October and November.

Note 12 - Asset Valuation Reserve

Per Society	$86,176
Per examination	86,687
Difference	$ 511

Three errors were noted in the calculation for the asset valuation reserve. The errors included classifying single class mortgage-backed securities as exempt and to one security with an NAIC designation of 2 (high quality) was included with a designation of 1 (highest quality) resulting in different reserve calculations.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

The following are issues and concerns the examiner believes should be brought to management's attention as a result of this examination.

Page	
17	I recommend the Society prepare a working trial balance which enables the examiners to trace amounts from the Society's trial balance to the annual statement. This recommendation is made pursuant to the provisions of ORS 733.170.
18	I recommend the Society record all transactions relating to the rental of the office space, in addition to all planning, marketing communications and implementation services in the Society's general ledger and follow the terms of the lease contract. This recommendation is made pursuant to the provisions of ORS 733.030(5) which states in part that liabilities for taxes, expenses and other obligations due or accrued at the date of the statement be recorded and by ORS 733.170 (Accounts & Records).
18	I recommend the Society nonadmit any policy indebtedness in excess of the surrender value. This recommendation is made pursuant to the provisions of the NAIC Accounting and Practices Procedures manual for Life and Accident and Health Insurance Companies (Pg. 7.1) and ORS 731.302(1).
19	I recommend the Society adjust its calculations from a gross basis to a net basis. This recommendation is made pursuant to the provisions of the NAIC Annual Statement Instructions for Life & Accident & Health Insurance Companies (Pg. 32) and ORS 731.302(1).
19	I recommend the Society not include premiums due in excess of 90 days. This recommendation is made pursuant to the provisions of ORS 733.010(5) and the NAIC Examiners Handbook.
20	I recommend the Society report the net realized capital gains or (loss) which excludes the amount transferred to the IMR. This recommendation is made pursuant to the provisions the NAIC Annual Statement Instructions for Fraternal Organizations and ORS 731.302(1).
21	I recommend the Society record the liability for vacations earned and not taken in the annual statement. The is recommendation is made pursuant to the provision of ORS 733.030(5).

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21 I recommend the Society reconcile all accounts to supporting documentation and accurately reflect amounts recorded in suspense accounts. This recommendation is made pursuant to the provision of ORS 733.170 which states in part “that in insurer shall keep its books, records, accounts and transaction source data in such manner that the director of the Department of Consumer and Business Services may readily verify its statement of financial condition.”

22 I recommend the Society follow the NAIC Annual Statement Instructions for Fraternal Organization (Pg. 156) and ORS 733.302(1).

22 I recommend the Society strengthen its controls with regards to supporting documentation, recording accurate reserve amounts and in training employees responsible for the data. This recommendation is made pursuant to the provisions of ORS 733.030(3)(a) and ORS 733.170.

CONCLUSION

During the three year period covered by this examination, the surplus of the Society has decreased from $4,024,903, as presented in the December 31, 1996, report of examination, to $2,614,028 as shown in this report of examination. The comparative assets and liabilities are shown below:

	December 31,		
	1999	1996	Change
Assets	$15,623,796	$21,559,784	$(5,935,988)
Liabilities	13,009,768	17,534,881	(4,525,113)
Surplus	$ 2,614,028	$ 4,024,903	$(1,410,875)

Adjustments have been made to the Society's financial statements as a result of this examination. In addition, the examiners have concerns with the Society's declining surplus and ability to produce new business. Please see the Territory and Plan of Operation section of this report for a discussion of these issues.

Mr. Kopp evaluated the expected future experience of the in-force business, impact of new business sales and the surplus position. Since December 31, 1995, the surplus of the Society has decreased from $4,385,815 million to $2,614,028 million as of this examination. Three approaches were taken: (1) evaluation of the future Company results as a whole; (2) evaluation of projected new business sales; and (3) evaluation of the in-force business, based on what it may be worth to a prospective buyer.

In-force Projection

Beginning with calendar year 2000, the statutory earning and balance sheet were projected into the future for the next 20 years. The Society surplus at December 31, 1999 (per annual statement), was $2,671,186. Expense assumptions are high, estimated at $180 per policy. However, this approximates expenses at a year 2000 level close to what the Society is experiencing. Three scenarios were run, the difference being the return on invested assets.

Scenario	Investment Return	Year 2000 Net Income	12/31/2000 Surplus	Year Surplus Reaches Zero
C1	7.0%	$(608,366)	$2,062,820	2004
C2	7.5%	$(534,723)	$2,136,463	2005
C3	8.0%	$(461,080)	$2,210,106	2006
C4*	7.5%	$(551,221)	$2,119,965	2005

*Lapse assumption is an additional 5% per year

As can be seen above, the future outlook for the Society is dismal, primarily due to the high level of expense relative to the small amount of in-force. The Society will continue to lose $400,000 to $600,000 per year until surplus reaches zero.

New Business Projection

The Society has been trying to reverse the negative earnings picture by increasing in-force through sales. To see how much new sales will help, projections were made of profits resulting from new sales plus the existing in-force. Beginning with the calendar year 2000, the statutory earnings for approximately $100,000 of annual premium were projected into the future for the next 20 years. Per policy expense assumptions for new issues were set at $40. Results for this scenario are below as N1, and is compared to the above result for Scenario C2.

Scenario	Investment Return	Year 2000 Net Income	12/31/2000 Surplus	Year Surplus Reaches Zero
N1	7.5%	$(552,445)	$2,118,741	2005
C2	7.5%	(534,723)	2,136,463	2005

Although new sales may develop profits over time, the impact will be relatively minor on surplus in the short term and will not reverse the trends in net income and surplus.

Inforce Business Projection

If the Society were to sell the business to another buyer, there should be a recognition of future profits of the business to the buyer. This is because the buyer should be able to administer the business at a reduced expense level. A projection of inforce business was developed, without surplus and with reduced expenses. This was meant to approximate the value of the business to a prospective buyer. Expenses were set a $40 per policy. Scenarios varied by the investment income assumption and the discount rate for profits.

Scenario	Investment Return	Present Value of 20 Years Profits	
		10% Discount	15% Discount
I1	7.0%	$1,278,830	$ 963,284
I2	7.5%	1,722,275	1,295,289
I3	8.0%	2,165,721	1,627,293
I4	7.5%	$1,193,938	$ 948,469

*Lapse assumption is an additional 5% per year

If the sale of the Society were considered, an addition to the present value of business would be the value of surplus, currently at $2.6 million. Assuming that the value of the inforce business is based on Scenario I2, discounted a 15% the overall value may be:

Value of Business Inforce	\$1.3 million
Value of Surplus	2.7 million
Total	\$4.0 million

As of December 31, 1999, the \$4 million figure my be adjusted up or down for a number of reasons. Some of the adjustments that could be made are: (1) realizable value of nonadmitted assets; (2) adjust surplus for market value of assets; and (3) tax implications.

The longer the Society operates and does not consider alternatives, the less potential value of the Society will remain. In a few years the estimated \$4 million value will have shrunk to less that \$1 million. It is possible, that if surplus goes negative, the Society members would have to be assessed contributions or additional premiums to maintain the Society.

ACKNOWLEDGMENT

The examiners wish to express their appreciation for the cooperation extended by the officers and employees of the Society during the course of the examination.

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

Respectfully submitted,

____

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

AFFIDAVIT

STATE OF OREGON)
) ss
County of Marion)

Timothy R. Hurley, being duly sworn, deposes and says that the foregoing report of examination as of December 31, 1999, of Neighbors of Woodcraft, Oregon City, Oregon, subscribed by him is true to the best of his knowledge and belief.

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

Subscribed and sworn before me this _______ day of _________________, 2000.

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Notary Public in and for the State of Oregon