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FILED

JUL 03 2012 *WMA*

Department of Insurance
State of Idaho

BEFORE THE DIRECTOR OF THE DEPARTMENT OF INSURANCE

STATE OF IDAHO

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)	
In the Matter of:)	Docket No. 18-2780-12
)	
VISION SERVICE PLAN OF IDAHO, INC.)	ORDER ADOPTING
)	REPORT OF EXAMINATION
Idaho Certificate of Authority: 1902)	AS OF DECEMBER 31, 2010
NAIC Company Code: 47783)	
)	
)	
)	
)	

The Report of Examination as of December 31, 2010 (Report) of VISION SERVICE PLAN OF IDAHO, INC. (Company) was completed by an examiner of the Idaho Department of Insurance (Department) and signed the 4th day of April 2012 by the Examiner-in-Charge, Kelvin Ko, CFE. The verified, attested, copy of the Report was filed with the Department effective April 4, 2012. Previously, a draft copy of the Report was delivered to the Company, and the verified Report was transmitted to the Company via U.S. Certified Mail on April 6, 2012, to Mr. James Robinson Lynch, President. The verified Report, attached hereto as Exhibit A and incorporated

herein, contains minor changes for clarification purposes requested by the insurer in a letter dated May 1, 2012, (see WRITTEN SUBMISSION section below) as well as e-mailed correspondence on May 3, 2012.

WRITTEN SUBMISSION

The Company made a written submission from Ms. Laura Olson, Controller, as provided for under Idaho Code § 41-227(5), containing responses to the examination report, in the form of a letter dated May 1, 2012, and received via e-mail on May 2, 2012. The written submission is attached hereto as Exhibit B and incorporated herein. The Company requested on June 29, 2012, via e-mail, that the written submission become a public record of the Department.

ORDER

NOW THEREFORE, after carefully reviewing the above-described Report, 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 2ND day of July, 2012.

STATE OF IDAHO
DEPARTMENT OF INSURANCE



William W. Deal
Director

NOTIFICATION OF RIGHTS

This is a final order of the Director. Any party may file a motion for reconsideration of this final order within fourteen (14) days of the service date of this order. The Department will dispose of the petition for reconsideration within twenty-one (21) days of its receipt, or the petition will be considered denied by operation of law. *See* Idaho Code § 67-5246(4).

Pursuant to Idaho Code §§ 67-5270 and 67-5272, any party aggrieved by this final order or orders previously issued in this case may appeal this final order and all previously issued orders in this case to district court by filing a petition in the district court of the county in which:

- i. A hearing was held,
- ii. The final agency action was taken,
- iii. The party seeking review of the order resides, or operates its principal place of business in Idaho, or
- iv. The real property or personal property that was the subject of the agency action is located.


An appeal must be filed within twenty-eight (28) days of (a) the service date of this final order, (b) an order denying petition for reconsideration, or (c) the failure within twenty-one (21) days to grant or deny a petition for reconsideration, whichever is later. *See* Idaho Code § 67-5273. The filing of an appeal to district court does not itself stay the effectiveness or enforcement of the order under appeal.

CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of July, 2012, I caused the foregoing document to be served on the following parties in the manner set forth below:

Ms. Laura Olson, Controller	<u> X </u>	certified mail
Vision Service Plan of Idaho, Inc.	<u> </u>	first class mail
3333 Quality Drive	<u> </u>	hand delivery
Rancho Cordova, CA 95670	<u> </u>	facsimile
e-mail: laurol@vsp.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 rd 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

EXHIBIT A

DEPARTMENT OF INSURANCE

STATE OF IDAHO



REPORT OF EXAMINATION

of

VISION SERVICE PLAN OF IDAHO, INC.
(A domestic non-profit, non-stock professional service corporation)

NAIC Company Code: 47783

as of

December 31, 2010

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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

Boise, Idaho
April 4, 2012

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

Dear Director:

Pursuant to your instructions and in conformity with the provisions of the Insurance Laws and Rules of the State of Idaho, an examination has been made of the administrative affairs, books, records and financial condition of

Vision Service Plan of Idaho, Inc.
3333 Quality Drive
Rancho Cordova, California 95670

The following Report of Examination is respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period January 1, 2007 through December 31, 2010. Material transactions and/or events occurring subsequent to the examination date(s) were also reviewed.

The examination was conducted at the Corporation's administrative office by an examiner from the State of Idaho. The Idaho Department of Insurance coordinated with the State of Washington's Office of Insurance Commissioner for some portions of the examination. The examination was conducted in accordance with Sections 41-219(1) and 41- 3426, Idaho Code, the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook*, the NAIC *Accounting Practices and Procedures Manual* and the NAIC *Market Regulation Handbook*.

All accounts and activities of the Corporation were considered in accordance with the NAIC's risk-focused examination process. The *Financial Condition Examiners Handbook* requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Corporation by obtaining information about the Corporation including corporate governance, identifying and assessing inherent risks within the Corporation, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and NAIC Annual Statement instructions as governed and prescribed by Idaho law.

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

PRIOR EXAMINATION

A review was made to ascertain what action was taken by the Corporation 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 Corporation.

HISTORY AND DESCRIPTION

The Corporation was organized and incorporated as a non-profit, non-stock professional service corporation on January 26, 1968, under the laws of the State of Idaho. The Corporation commenced business as Idaho Vision Services, Inc. on April 1, 1968.

The Articles of Incorporation were amended and restated in 1990, whereby Vision Service Plan (VSP), formerly California Vision Service, a nonprofit California corporation, became the Corporation's sole member. The amendment was approved by the Department of Insurance on July 20, 1990.

The Articles of Incorporation were amended and restated effective May 27, 1993, whereby the name of the Corporation was changed from Idaho Vision Services, Inc., to Vision Service Plan of Idaho, Inc. This amendment was approved by the Department of Insurance on September 7, 1993. The Bylaws were also amended May 6, 1993, to reflect the name change and were accepted as filed by the Department of Insurance on September 7, 1993.

On May 26, 1998, the Bylaws were amended to require panel members to render services to subscribers as well as recipients and beneficiaries of the Corporation's social welfare and community benefit programs. Further comments relating the changes in the Bylaws are included under the caption.

The Internal Revenue Service (IRS) has been conducting an examination of Vision Service Plan (VSP), the company's parent and its affiliates with regard to their tax-exempt status under Section 501(c)(4) of the Internal Revenue Code. In August 2002, the IRS issued a technical advice memorandum stating that VSP no longer qualifies for tax exempt status because it has not established that it is operated primarily for the purpose of bringing about civic betterment and social improvement. The IRS considered that VSP provides benefits primarily to its enrollees and that its activities were similar in nature to activities carried on by for-profit businesses. As a result, VSP was formally notified on October 22, 2002 that the IRS has revoked its tax-exempt status, effective for the tax year beginning January 1, 2003. As a result, VSP began recording federal and California state income taxes in 2003. On September 24, 2004, VSP filed an action for refund of federal income tax and interest for the tax year ended December 31, 2003 in the United States District Court for the Eastern District of California challenging the IRS on its revocation of tax exemption. The court granted a summary judgment in favor of the United States on December 12, 2005. VSP filed a notice of appeal of this decision on February 17, 2006. On January 30, 2008, the U.S. Court of Appeals for the Ninth Circuit released their opinion affirming the decision in the above summary judgment holding that VSP was not entitled to continued recognition of exemption as a social welfare organization. On March 13, 2008, VSP filed a petition in the United States Court of Appeals for the Ninth District for a rehearing en banc, or by all judges of the court. On April 9, 2008, the United States Court of Appeals for the Ninth District denied VSP's petition for a hearing en banc. VSP petitioned the Supreme Court of the United States for a Writ of Certiorari for a hearing before that Court regarding federal tax-exempt status. On January 9, 2009, the U.S. Supreme court denied VSP's petition for hearing on the revocation of its tax-exempt status by the IRS. The subsidiaries' claims for refund were denied on various dates.

In 2009, an IRS agent left the Corporation's parent company a voicemail indicating the IRS's intent to revoke the Corporations tax-exempt status. The IRS is seeking retroactive revocation such that the 2006 and 2007 federal income tax years could be affected. A liability has been accrued for the 2006 and 2007 tax returns and taxes have filed and paid since 2008. The Corporation is pursuing prospective treatment for its tax liability similar to its affiliates' having obtained prospective treatment.

MANAGEMENT AND CONTROL

Insurance Holding Company System

The Corporation was a member of an insurance holding company system as defined in Section 41-3801, Idaho Code. The ultimate controlling person was Vision Service Plan (VSP), formerly

California Vision Service, a California non-profit corporation. Corporation records indicated that no one person or entity had the power to direct the management of the ultimate parent.

The Corporation's Form B Registration Statements have been filed with the Idaho Department of Insurance for the period under examination.

The following abbreviated organizational chart identifies the non-profit, non-stock corporations controlled or owned by VSP as of December 31, 2010:



Members

As provided in the amended and restated Articles of Incorporation and the Bylaws, VSP was the Corporation's sole member. The Bylaws further provided that the member shall have one vote, which can be exercised in person or by proxy.

Directors

The following persons were duly elected members of the Board of Directors at December 31, 2010:

<u>Name and Business Address</u>	<u>Principal Occupation</u>
James R. Lynch Rancho Cordova, California.	President and Chief Executive Officer VSP Global
Gary N. Brooks Rancho Cordova, California	President VSP Vision Care
Donald J. Ball, Jr. Rancho Cordova, California	Chief Financial Officer VSP Global
Lawrence Donald Price Rancho Cordova, California	Retired
Cheryl Ann Johnson Rancho Cordova, California	Vice President – Provider Services VSP Vision Care

Officers

The following persons were serving as officers at December 31, 2010:

James R. Lynch	President
Gary N. Brooks	Vice-President and Secretary
Lester E. Passuello	Chief Financial Officer and Treasurer

Corporate Governance

As part of the NAIC's risk focused exam approach, a review of the Company's corporate governance was conducted. Interviews were conducted with the parent company (VSP Global) senior management team, including selected Board members. The interviews were accomplished subsequent to the examination entrance conference at the parent company headquarters in Rancho Cordova, California. Inherent risk, mitigating controls and residual risk related to corporate governance were assessed

though a joint effort by examiners from the Idaho Department of Insurance and the State of Washington's Office of Insurance Commissioner.

Senior management and Board members interviewed included:

<u>Name</u>	<u>Position Being Interviewed</u>
James R. Lynch	Chief Executive Officer of VSP Global, Director and President
Gary N. Brooks	Director, President of VSP-Vision Care, Vice-President and Secretary
Lester E. Passuello	Chief Financial Officer and Treasurer
Leslie Murphy	Chair of Audit Committee, VSP Global
Don Ball	Director, Chief Financial Officer, VSP Global
Jim McGrann	Chief Technology Officer, VSP Global
Steve Scott	Former Chief Information Officer, VSP Global
Ric Steere	Senior Vice President of VSP Global-Sales Development

Conflict of Interest

On December 13, 1993, the Board of Directors adopted a conflict of interest policy whereby each of the directors, officers and responsible employees to annually complete a disclosure statement of any conflicts or possible conflicts with the performance of their duties and responsibilities. Conflict of interest statements completed during this examination period (2007-2010) were reviewed. They appeared to appropriately disclose any possible conflicts of interest.

The rest of this page has been intentionally left blank.

Contracts and Agreements

An administration and Marketing Agreement was amended and executed on December 31, 2007 between the Corporation and its parent, Vision Service Plan (VSP). The following summarized the agreement which was in effect as of December 31, 2010:

Administration and Marketing Agreement

Under terms of the agreement, the Corporation was granted a non-exclusive license to use VSP's federally registered service marks in connection with the activities of the Corporation in providing vision care through its panel of doctors.

VSP provided for all administrative and marketing services and expertise required to operate the Corporation and to market its vision service plans to non-subscriber beneficiary groups in the Plan Area. In this connection, the following services were rendered:

1. All administrative services including, but not limited to:
 - a) Pay all accounts payable, including claims of subscribers, doctors, and optical laboratories and collect all of its accounts receivable, in a timely and professional manner.
 - b) Maintain accurate records of all transactions and separate books and records, and prepare quarterly and annual financial statements prepared in accordance with generally accepted accounting principles.
2. Marketing Services:
 - a) Provide all sales/marketing personnel with needed support to maximize needed sales.
 - b) Pay all of its normal operating expenses and all recurring and routine expenses incurred in the ordinary conduct of business including salaries, other compensation, and business and travel expenses of employees of VSP.
 - d) Provide all necessary services relating to Corporation's social welfare or community benefit activities, such as charitable or educational.

In consideration for services specified in the agreement, the Corporation paid to VSP a per claim charge equal to the total general and administrative expenses of VSP and its subsidiaries, excluding specifically charged expenses such as, but not limited to; commissions, taxes, audit and legal fees, divided by the total number of claims paid.

VSP shall retain the Corporation's books and records required to be maintained by any state or federal law.

The agreement may be terminated without cause by either party upon sixty days prior written notice.

Intercompany Tax Sharing Agreement

This tax allocation agreement was effective on August 15, 2008 and was made between Vision Service Plan (parent) and its affiliates, including the Corporation, for taxable years commencing on and after January 1, 2008. The following provides a summary of this agreement:

1. Parent files a consolidated federal income tax return on behalf of the affiliated group, including the parent and its affiliates.
2. Each affiliate shall be responsible for and shall reimburse the parent for its share of the affiliated group's consolidated tax liability and shall be determined as follows:
 - a. If the affiliated group's consolidated tax is for the regular tax, the affiliate's share of such tax shall be equal to its regular tax liability, computed on a separate return basis.
 - b. If the affiliated group's consolidated tax liability is for the AMT, the affiliate's share of such tax shall be the amount of AMT for which the affiliate would be liable if computed on a separate return basis and without regard to the regular tax for such taxable year, after taking into account all consolidated tax attributes available to such affiliate to reduce AMT.
3. The affiliate utilizing the tax attributes shall reimburse the parent, and the parent shall in turn reimburse each originating affiliate for the value of the consolidated tax attributes so utilized.
4. Payment by the parent of consolidated estimated tax for the consolidated group at the normal quarterly due dates will be reimbursed by the affiliates within ten days of receiving notice of such payment by the parent. As soon as the affiliated group's consolidated tax liability is determined, each affiliate shall make/receive payments to/from parent less amounts already paid for estimated tax.

This agreement shall remain in effect and shall be terminated upon written agreement among the parties.

It was noted that this agreement had not been approved by the board. It is recommended that both the parent and the Corporation boards approve this agreement. On May 3, 2012, Corporation management informed the examiner that the Corporation's parent had approved this agreement and subsequently the Corporation's board approved this agreement on April 10, 2012.

CORPORATE RECORDS

Bylaws

Effective June 14, 1999, the Corporation made amendments to the Bylaws as follows:

- 1) An introductory section, Purpose Declaration, was added to help define the mission statement of the Corporation.
- 2) Article IV, Section 1 was further defined to say, "Any two (2) or more offices may be held by the same person, except the offices of President and Secretary."

- 3) Article IV, Section 4 was amended to correct the prior language and removal procedures. The Directors may be removed from office by a vote of the Member, and the Officers may be removed by a majority vote of the Board of Directors.
- 4) Article IV, Section 7 was amended for gender purposes to more precisely reflect the makeup of the Board of Directors and Offices.

On May 4, 2002, the above amendments to the Bylaws were submitted to the Idaho Department of Insurance as required by Section 41-3409, Idaho Code.

There were no amendments to the Articles of Incorporation or the bylaws during the period under examination.

Minutes of Meetings

A review of the minutes of the meetings of the sole Member and of the Board of Directors for the period under examination indicated compliance with the Articles of Incorporation and Bylaws. These minutes also included approvals of the investment transactions.

FIDELITY BOND AND OTHER INSURANCE

Insurance coverages for the protection of the Corporation were maintained through the period under examination. The Corporation was a named insured on a Financial Institution Bond insuring VSP, which was provided by St. Paul Fire and Marine Insurance Company. The financial institution bond covered employee dishonesty, forgery or alteration, computer systems and trading loss claim up to \$2,500,000 per loss and \$4,000,000 in the aggregate. The deductible was \$75,000 for each loss.

Other coverages insuring the Corporation included general liability, auto liability, professional liability (managed care errors and omissions), directors, and office liability.

The fidelity bond coverage met the suggested minimum limits recommended by the NAIC, and the insurers providing the various coverages were licensed or authorized in the State of Idaho.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Corporation has no employees; it has no retirement plans, deferred compensation, postemployment benefits or compensated balances and postretirement benefit plans.

TERRITORY AND PLAN OF OPERATION

The Corporation was licensed only in the State of Idaho as a professional service corporation pursuant to Chapter 34, Title 41, Idaho Code. Operations of the Corporation were conducted from its main administrative office located in Rancho Cordova, California.

Vision care benefits were provided to enrollees and their eligible dependents by participating optometrists and ophthalmologists within the Plan Area, which is the State of Idaho. Enrollees may

also receive services from providers located outside the Plan Area, pursuant to reciprocal services procedures identified in the Administration and Marketing Agreement.

The Corporation also provided administrative expertise for eleven administrative service plan participants. The 2010 Corporation's administrative fee income of \$1,035,539 represented 13 percent of the overall cost and expense of the administrative service plans.

The Corporation marketed its vision plans through direct sales representatives and commissioned brokers. As of December 31, 2010, the Corporation had appointed one hundred and eighty eight producers to solicit business on its behalf.

GROWTH OF THE CORPORATION

The Corporation'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 & Surplus</u>	<u>Net Income(Loss)</u>
2006*	\$7,123,472	\$755,426	\$6,368,046	\$2,364,451
2007	10,562,674	1,021,765	9,540,909	3,213,835
2008	11,517,500	3,281,806	8,235,694	(1,536,479)
2009	12,278,452	3,369,343	8,909,109	726,152
2010*	12,652,147	3,019,889	9,632,258	543,371

*As determined by Examination.

Net income decreased substantially in 2008 due to the loss of a large account in that year. As a result, premiums earned decreased from \$9.7 million in 2007 to \$6.0 million in 2008. In addition, the Corporation accrued a federal tax liability of \$1.9 million at the end of 2008, arising from the loss of its tax exempt status in calendar years 2006 and 2007.

CLAIM EXPERIENCE

The ratio of benefits and expenses to premium earned shown in the following schedule were derived from amounts reported in the Company's Annual statements:

<u>Year</u>	<u>Premiums Earned</u>	<u>Benefits Incurred</u>	<u>Other Expenses Incurred</u>	<u>Ratio of Benefits and Expenses to Premiums Earned</u>
2006*	\$7,840,168	\$5,050,155	\$601,154	72.1%
2007	\$9,719,025	\$6,070,497	\$838,463	71.1%
2008	\$6,070,497	\$4,418,690	\$530,963	81.5%
2009	\$6,084,967	\$4,653,029	\$549,374	85.5%
2010*	\$6,017,265	\$4,583,717	\$591,935	86.0%

*As determined by Examination.

Loss of members of a large client in 2008 decreased premiums earned in 2008 substantially. Loss ratio increased in recent years due to higher utilization of benefits.

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 Corporation. Underlying data was also tested during the limited scope Market Conduct Examination.

Policy Forms and Underwriting Practices

The Corporation provided a single service benefit of vision care to those covered under its policy and addenda, which were approved for use by the Department of Insurance on February 11, 1994.

The policy and addenda were referred to as the Group Vision Care Plan, and were offered on either a risk or on a self-insured basis. Coverages under the Group Vision Care Plan were marketed under several different plans, with the primary differences being the intervals when services were available and the co-payment amounts. The group plans were offered to employer groups and health plans of two or more members and were not marketed to individuals. However, the Corporation anticipates seeking Department approval for an individual plan in the future.

Treatment of Policyholders

Claims:

A sample of closed claims incurred during the examination period was reviewed. The review indicated that, in general, the claims were being settled in a timely manner and in accordance with policy terms.

Complaints:

The Corporation maintained a complaint register, which was reviewed during the examination. The complaint register contained complaints, which the Corporation received in 2007 through 2010. It was determined that the complaint register contained a complete record of all complaints which had been received by the Corporation during the period under examination, as required by Section 41-1330, Idaho Code.

The Corporation had established an anti-fraud and abuse policy and procedures which indicated compliance with Section 41-290, Idaho Code. The Corporation did not identify any fraudulent claims for the examination period of January 1, 2007 through December 31, 2010.

Advertising and Sales Materials

Advertising and sales materials provided for review indicated that VSP advertised in nationally circulated trade publications. All of the print advertisements reviewed were in the name of VSP and did not specifically identify the Corporation.

General information about VSP and access to marketing representatives can be obtained from VSP's web site on the Internet.

Under terms of the Administration and Marketing Agreement, the Corporation was licensed to use VSP's federal registered service marks within the business activities of providing vision care through its panel of doctors.

ACCOUNTS AND RECORDS

General Accounting

The accounts and records of the Corporation were maintained by VSP under provisions of the Administration and Marketing Agreement.

VSP's information system has an IBM z196-603 mainframe computer to process information utilizing the z/OS 1.11 operating system.

Global Software, Inc. developed the general ledger software utilized by VSP. The software generated the financial statements, trial balances, and general ledger entries. The general ledger was maintained on a GAAP basis. However, the account balances were adjusted to statutory accounting through worksheet and adjusting journal entries for annual and quarterly statement reporting. VSP is in the process of migrating to SAP which will include enterprise resource planning (ERP) system to process a majority of VSP's accounting tasks.

The Complete Package (Booke) Annual Statement software was utilized to produce the Corporation's Annual Statements.

VSP's in-house developed software includes the following:

1. Policyholder benefits and claims adjudication software.
2. Software that processes plans and group information.

The VSP data center is located on its main campus in Rancho Cordova, CA. The data center is staffed 24 hours a day, seven days a week and 365 days a year with real-time availability monitoring in place for system outages, as well as excessive humidity, heat and water. A co-location recovery site is in place approximately 20 miles from VSP at an environmentally and security hardened facility. The co-location allows VSP to recover critical systems within 1-hour after an event is declared with a maximum data loss of 15 minutes. As a further recovery precaution, and to meet regulatory retention standards, VSP backs-up critical data on a daily basis, storing the encrypted media 25 miles offsite in a

secure location. The back up media can be requested and delivered back to VSP or shipped to a recovery location within 2-hours.

Independent Accountants

The Corporation's annual independent audit for the period under examination (2007-2010) was performed by:

PriceWaterhouseCoopers, L.L.P.
400 Capital Mall
Suite 600
Sacramento, California 95814

The 2007 through 2010 independent audits were reported in accordance with statutory accounting principles. The December 31 audited financial statements for the aforementioned years were provided to the Idaho Department of Insurance in compliance with IDAPA 18.01.62.

The CPA's workpapers were relied upon in some instances and noted accordingly in the respective workpapers.

Actuarial Opinion

The unpaid claims reserves and related actuarial items were calculated by the Corporation and reviewed by Frederick W. Kilbourne, FSA, MAAA, of the Kilbourne Company. The December 31, 2010 statement of opinion states that the amounts carried in the balance sheet:

- (a) are in accordance with accepted actuarial standards consistently applied and are fairly stated in accordance with sound actuarial principles,
- (b) are based on actuarial assumptions relevant to contract provisions and appropriate to the purpose for which the statement was prepared,
- (c) meet the requirements of the laws of the State of Idaho, and are at least as great as the minimum aggregate amounts required by the state in which this statement is filed,
- (d) make a good and sufficient provision for all unpaid claims and other actuarial liabilities of the company under the terms of its contracts and agreements,
- (e) are computed on the basis of assumptions consistent with those used in computing the corresponding items in the annual statement of the preceding year-end, and include provision for all actuarial items that ought to be established, and
- (f) include appropriate provision for all actuarial items that ought to be established.

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

Claims unpaid	\$247,647
Unpaid claims adjustment expenses	\$ 2,560
Aggregate health policy reserves	\$ 26,788
Premiums received in advance	\$ 13,433

Access to Corporation Records

Examiners had difficulty gaining access to certain records of the Corporation. The Idaho examiner made numerous requests to VSP's (parent) management regarding access to VSP/Corporation's internal audit reports and work papers relating to the Model Audit Rule (MAR). Over a period of approximately two (2) months, VSP management failed to provide the detail requested. Instead, only limited information was provided to the examiner in a summary form of key activities/areas tested and the number of exceptions noted in each key activity/area. Furthermore, the examiner was only allowed access to the MAR report and the related work papers a few days before the last on-site day of this examination. This caused unnecessary delay to the completion of this examination; also, the Corporation's limitation on access to its records is in direct violation of Idaho Code Sections 41-223(3) and 41-247, which state (underline emphasis added):

§ 41-223(3): Every person being examined, its officers, attorneys, employees, agents, representatives or others having custody or control thereof, shall make freely available to the director or his examiners the accounts, records, document, files information, assets and matters in his possession or control relating to the subject of the examination, and shall facilitate the examination.

§ 41-247: Inquiry powers of director. The director shall have power to direct an inquiry in writing to any person subject to his jurisdiction with respect to any insurance transaction or matter relative to a subject of insurance resident, located, or to be performed in this state. The person to whom such an inquiry is addressed shall upon receipt thereof promptly furnish to the director all requested information which is in his possession or subject to his control.

In Addition, VSP management refused to allow the examiner to make copies of work papers relating to the MAR. After objections from the examiner, the examiner was allowed to make copies of a few pages of the work papers. This is in violation of Idaho Code Section 41-223(5) which states as follows (underline emphasis added):

Neither the director nor any examiner shall remove any record, account, document, file or other property of the person being examined from the offices of such person except with the written consent of such person being given in advance of such removal, or pursuant to an order of court duly obtained. This provision shall not be deemed to affect the making and removal of copies or abstracts of any such record, account, document, or file.

It is therefore recommended that VSP management comply with Idaho Code Sections 41-223(3), 41-223(5) and 41-247 in future examinations and make "freely available" and "promptly furnish" access to Company records.

SUBSEQUENT EVENT

Subsequent to the examination “as of” date of December 31, 2010, a Form D was filed with the Department on or about April, 27, 2011 regarding the Tax Sharing Agreement. There were no objections raised by the Department.

FINANCIAL STATEMENTS

The financial section of this report contains the following statements:

Balance Sheet as of December 31, 2010

State of Revenue and Expenses for the Year Ending December 31, 2010

Capital and Surplus Account for the Year Ending December 31, 2010

Reconciliation of Capital and Surplus, December 31, 2006 through December 31, 2010

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BALANCE SHEET
As of December 31, 2010

	<u>ASSETS</u>	Nonadmitted <u>Assets</u>	Net Admitted <u>Assets</u>
	<u>Assets</u>		
Bonds	\$ 6,678,512	\$ 0	\$ 6,678,512
Common stocks	1,873,097	0	1,873,097
Cash, cash equivalents and short-term investments	3,211,674	0	3,211,674
Investment income due and accrued	50,878	0	50,878
Uncollected premiums	200,381	1,729	198,652
Amounts receivable relating to uninsured plans	<u>639,334</u>	<u>0</u>	<u>639,334</u>
Totals	<u>\$12,653,876</u>	<u>\$ 1,729</u>	<u>\$12,652,147</u>

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LIABILITIES, CAPITAL AND SURPLUS

	<u>Covered</u>	<u>Uncovered</u>	<u>Total</u>
Claims unpaid	\$ 247,647	\$	\$ 247,647
Unpaid claims adjustment expenses	2,560		2,560
Aggregate health policy reserves	26,788		26,788
Premiums received in advance	13,433		13,433
General expenses due or accrued	58,882		58,882
Federal tax payable and interest thereon (see Note)	2,273,957		2,273,957
Net deferred tax liability	110,104		110,104
Amounts due to parent, subsidiaries and affiliates	224,187		224,187
Liability for amounts held under uninsured plans	40,807		40,807
Premium taxes, license and miscellaneous fees	<u>21,524</u>	<u>\$ 0</u>	<u>21,524</u>
Total liabilities	<u>\$ 3,019,889</u>	<u>\$ 0</u>	<u>\$ 3,019,889</u>
Statutory reserve	\$ 100,000		\$ 100,000
Unassigned funds (surplus)	<u>9,532,258</u>		<u>9,532,258</u>
Total capital and surplus	<u>\$ 9,632,258</u>		<u>\$ 9,632,258</u>
Totals	<u>\$12,652,147</u>	<u>\$ 0</u>	<u>\$12,652,147</u>

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STATEMENT OF REVENUES AND EXPENSES

For the Year Ending December 31, 2010

	<u>Uncovered</u>	<u>Total</u>
Net premium income		\$5,794,263
Fee-for-service		222,879
Risk revenue		123
Total revenues		<u>\$6,017,265</u>
Medical and Hospital:		
Other professional services		<u>\$4,583,717</u>
Total Medical and Hospital		<u>\$4,583,717</u>
Claims adjustment expense		45,724
General administrative expense		546,211
Increase in reserves for accident and health contracts		26,788
Total underwriting deductions	<u>\$ 0</u>	<u>\$5,202,440</u>
Net underwriting gain		<u>\$ 814,825</u>
Net investment income earned		\$ 119,317
Net realized capital gains		11,058
Net investment gains or (losses)	<u>\$ 0</u>	<u>\$ 130,375</u>
Net gain or (loss) from agents' or premium balances charged off	<u>0</u>	<u>(2,348)</u>
Net income after capital gains tax and before federal income taxes	<u>\$ 0</u>	<u>\$ 942,852</u>
Federal income taxes incurred		399,481
Net income	<u>\$ 0</u>	<u>\$ 543,371</u>

CAPITAL AND SURPLUS ACCOUNT

For the Year Ending December 31, 2010

	<u>Per</u> <u>Corporation</u>	<u>Examination</u> <u>Changes</u>	<u>Per</u> <u>Examination</u>
Capital and surplus prior reporting year	<u>\$8,909,109</u>	<u>\$ 0</u>	<u>\$8,909,109</u>
<u>GAINS AND LOSSES TO</u>			
<u>CAPITAL AND SURPLUS</u>			
Net income or (loss)	\$ 543,371	\$ 0	\$ 543,371
Change in net unrealized capital gains	186,733		186,733
Change in net deferred income tax	(6,496)		(6,496)
Change in nonadmitted assets	<u>(459)</u>	<u> </u>	<u>(459)</u>
Capital and surplus end of reporting year	<u>\$9,632,258</u>	<u>\$ 0</u>	<u>\$9,632,258</u>

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RECONCILIATION OF CAPITAL AND SURPLUS

December 31, 2006 through December 31, 2010

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
Capital and surplus prior reporting year	<u>\$6,368,046*</u>	<u>\$9,540,909</u>	<u>\$8,235,694</u>	<u>\$8,909,109</u>
Net income	\$3,213,834	\$(1,536,479)	\$ 726,152	\$ 543,371
Change in net unrealized gains or losses	38,186	(25,239)	81,337	186,733
Change in net deferred income tax	0	186,949	(146,211)	(6,496)
Change in nonadmitted assets	<u>(79,157)</u>	<u>69,554</u>	<u>12,137</u>	<u>(459)</u>
Net change in capital and surplus	<u>\$3,172,863</u>	<u>\$(1,305,215)</u>	<u>\$ 673,415</u>	<u>\$ 723,149</u>
Capital and surplus end of reporting year	<u>\$9,540,909</u>	<u>\$ 8,235,694</u>	<u>\$8,909,109</u>	<u>\$9,632,258*</u>

* = Per examination

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NOTE TO THE FINANCIAL STATEMENTS

Federal Tax Payable and Interest Thereon

\$2,273,957

The captioned amount is composed of \$1,927,081 of federal tax payable and \$346,876 of interest payable for tax years 2006 and 2007. As stated under “History and Description (Corporate Records)”, in 2009 the Corporation’s tax-exempt status was revoked effective periods beginning in 2006. A liability has been accrued for the 2006 and 2007 tax returns and taxes have been filed and paid since 2008.

SUMMARY, COMMENTS AND RECOMMENDATIONS

Summary

The results of this examination disclosed that as of December 31, 2010, the Corporation had admitted assets of \$12,652,147, liabilities of \$3,019,889, a statutory reserve of \$100,000, and unassigned funds of \$9,532,258.

The unassigned funds amount met the minimum requirements per Section 41-3422, Idaho Code.

Comments and Recommendations

Page

3	In 2009, the Corporation’s tax-exempt status was revoked effective periods beginning in 2006. A liability has been accrued for the 2006 and 2007 tax returns and taxes have been filed and paid since 2008. The Corporation is pursuing prospective treatment for its tax liability consistent with the treatment of affiliates that had their tax exemption revoked.
8	It was noted that the intercompany tax sharing agreement had not been approved by the board. It is recommended that both the VSP and the Corporation’s board approve this agreement. Corporation management informed the examiner that this agreement was later approved by the board on April 10, 2012.
14	The Corporation was not in compliance with Idaho Code Sections 41-223(3), 41-223(5) and 41-247; this caused unnecessary delay to the completion of this examination. It is recommended that VSP management comply with aforementioned Idaho Code Sections in future examinations and make “freely available” and “promptly furnish” access to Company records.

CONCLUSION

The undersigned acknowledges the assistance and cooperation of the Corporation's officers and employees in conducting the examination.

Respectfully submitted,


A handwritten signature in black ink, appearing to read "Kelvin Ko", with a stylized flourish at the end.

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

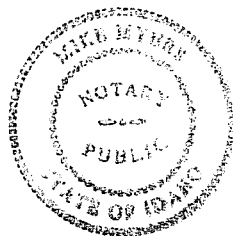
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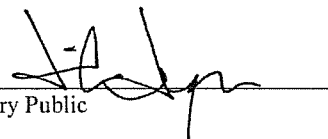
State of Idaho
County of Bannock

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 *Vision Service Plan of Idaho, Inc.* for the period from January 1, 2007 through December 31, 2010, 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.


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

Subscribed and sworn to before me the 4 day of APRIL, 2012, at Pocatello, Idaho.




Notary Public

My Commission Expires: 5-22-12

EXHIBIT B

May 1, 2012



Mr. William R. Michels, MBA, CPA, CFE
Department of Insurance
P.O. Box 83720
Boise ID 83720-0043

Re: Verified Report of Examination as of December 31, 2010
Vision Service Plan of Idaho, Inc.

Dear Mr. Michels:

We have received the above-entitled Report. We respectfully offer this written submission in response.

Recommendation page 3: The fourth paragraph on page 3 states:

In 2009, the Corporation's tax-exempt status was revoked effecting periods beginning in 2006. A liability has been accrued for the 2006 and 2007 tax returns and taxes have been filed and paid since 2008. The Corporation is pursuing prospective treatment for its tax liability consistent with the treatment of affiliates that had their exemption revoked.

The paragraph should be revised to more accurately state the facts. A revision follows:

In 2009, an IRS agent left the Corporation's parent company a voicemail indicating the IRS' intent to revoke the Corporations' tax-exempt status. The IRS is seeking retroactive revocation such that the 2006 and 2007 federal income tax years could be affected. A liability has been accrued for the 2006 and 2007 tax returns and taxes have been filed and paid since 2008. The Corporation is pursuing prospective treatment for its tax liability similar to its affiliates' having obtained prospective treatment.

Recommendation Page 8: A similar revision should be made to the related comment on page 8 and 21.

On pages 8 and 21, the Department recommends that both the VSP parent corporation and the Corporation's board approve the intercompany tax sharing agreement. With respect to the VSP parent corporation, we respectfully submit that on March 20, 2009, at a duly-called and duly-held meeting of the Board of Directors of the parent corporation, the parent company's CEO formally reported to that Board that the affiliated companies had been consolidated into the companies' overall finances, and the Board accepted that report. With respect to the Corporation, approval has been received by the Corporation's Board for the intercompany tax sharing agreement.

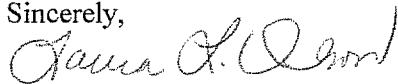
Recommendation Page 14:

The Company understands the importance of the requirements of Idaho Code Sections 41-223(3), 41-427 and 41-223(5) and takes seriously its obligation to comply with the regulatory requirements in every state where it does business. It also understands that the provisions of law relate to the "subject of the examination." The subject of the examination was Vision Service Plan of Idaho, Inc. Our Company has a longstanding record of cooperation during the examination process. While the Company understands that there are instances when records need to be provided to the Department when processes or policies have been adopted by multiple insurers, there were instances during this examination when requests were made for information that in the Company's view were outside of the scope of the examination.

Mr. William R. Michels, MBA, CPA, CFE
Page 2 of 2

If you have any questions or comments, please let us know. Thank you for the opportunity to submit comments.

Sincerely,

A handwritten signature in cursive script, appearing to read "Laura L. Olson".

LAURA L. OLSON

Controller

VSP

(916) 858-7440