Report of the Examination of

Preferred Insurance Affiliates, Inc.

Evanston, Illinois

As of December 31, 2019

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July 31, 2020

Honorable Mark V. Afable
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53703

Commissioner:

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

PREFERRED INSURANCE AFFILIATES, INC.
Evanston, Illinois

and this report is respectfully submitted.

I. INTRODUCTION

The examination of Preferred Insurance Affiliates, Inc. (the company or PIA) was conducted in 2020 as of December 31, 2019. The current examination covered the start of the company's operations since its inception on June 4, 2014, through the period ending December 31, 2019, and included a review of such 2020 transactions as deemed necessary to complete the examination.

The examination of the company was conducted concurrently with the examination of the Preferred Insurance Group. The Illinois Department of Insurance acted in the capacity as the lead state for the coordinated examination. Work performed by the Illinois Department of Insurance was reviewed and relied on where deemed appropriate.

The examination was conducted using a risk-focused approach in accordance with the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook*. This approach sets forth guidance for planning and performing the examination of an insurer to evaluate the financial condition, assess corporate governance, identify current and prospective risks (including those that might materially affect the financial condition, either currently or prospectively), and evaluate system controls and procedures used to mitigate those risks.

All accounts and activities of the company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with statutory accounting principles, annual statement instructions, and Wisconsin laws and regulations. The examination does not attest to the fair presentation of the financial statements included herein. If during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately at the end of the "Financial Data" section in the area captioned "Reconciliation of Surplus per Examination."

Emphasis was placed on those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination.

II. HISTORY AND PLAN OF OPERATION

Preferred Insurance Affiliates, Inc. is described as a for-profit limited service health organization (LSHO) insurer that underwrites and markets dental insurance. An LSHO insurer is defined by s. 609.01 (3), Wis. Stat., as ". . . a health care plan offered by an organization established under ch. 185, 611, 613, or 614 or issued a certificate of authority under ch. 618 that makes available to its enrolled participants, in consideration for predetermined fixed payments, a limited range of health care services performed by providers selected by the organization." Under the network model, the company provides care through contracts with dental clinics and otherwise independent dentists operating out of their separate offices.

The company was incorporated June 4, 2014, and commenced business August 1, 2015. The company is owned by Dr. Frank Karkazis with 75% ownership and Dr. Peter Contos with 25% ownership.

PIA's sole focus is dental insurance, providing both general (preventative, diagnostic, basic-restorative, and major restorative) and specialty dental care. PIA issues dental insurance policies to residents of nursing homes and long-term care facilities. The company's current providers are concentrated in Southeastern Wisconsin.

PIA contracts for services through Preferred Dentistry Associates, LLC, an affiliate, Dental Associates, a non-affiliate, and the Careington Network, a non-affiliate. The contracted dental providers render both general and specialty dental services to policyholders. Covered services in this agreement include preventative and diagnostic procedures, basic/minor-restorative, major-restorative procedures, and services such as implants and orthodontic procedures. Dental services provided to policyholders are reimbursed based on the plan benefits and limited by fee schedules set by PIA and agreed upon by the provider(s). Under the terms of the hold harmless provisions, the dentist agrees that an eligible patient is not liable for any amount payable by PIA under the terms of applicable dental care contracts. Providers may not charge members for any difference between their fee and the contracted fee schedule for covered services. The contract has a one-year term and may be terminated upon not less than 30 days' prior written notice to the other party, or at any time for cause as outlined in the agreement.

The company currently markets to individuals. The company uses its co-owner, Dr. Contos, as an agent and pays a 5% commission on new and renewal business. Subsequent to this exam, the company entered into an agreement with an agent to market policies in Wisconsin with a 5% commission on assisted living and nursing home policies, and 10% on commercial policies.

The company uses an actuarially determined base as a beginning point in premium determination. The company charges the same premium for the same policy regardless of any other factors. The company has not adjusted premium rates since its inception.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of four members. All directors are elected annually to serve a one-year term. Officers of the company are elected at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the holding company group. The board members currently receive no compensation for serving on the board.

Currently, the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Frank L. Karkazis Deerfield, Illinois	Dentist	2020
Peter Contos Northbrook, Illinois	Dentist	2020
Elizabeth Karkazis Evanston, Illinois	Optometrist	2020
Larry Shanley Long Grove, Illinois	Business Owner	2020
Georgene Shanley Long Grove, Illinois	Homemaker	2020
Maria Contos Northbrook, Illinois	Dentist	2020
Anthony Karkazis Deerfield, Illinois	President – Landscaping Company	2020

Officers of the Company

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

Name	Office	2019 Compensation
Frank L. Karkazis	President	$0
Elizabeth M. Karkazis	Secretary	$0
Peter A. Contos	Treasurer	$0

Committees of the Board

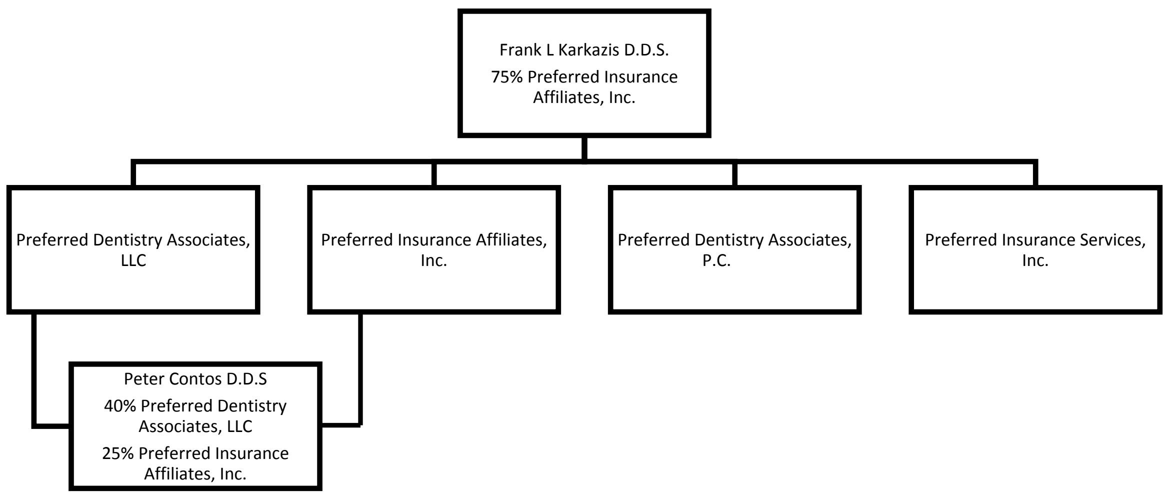
The company's bylaws allow for the formation of certain committees by the board of directors. There were no committees at the time of the examination.

The company has no employees. Necessary staff is provided through a management agreement with Preferred Dentistry Associates, LLC. Under the agreement, effective September 11, 2014, Preferred Dentistry Associates, LLC agrees to negotiate employer, provider, subscriber, and other contracts; advises the board; maintains the accounting and financial records; recruits marketing, utilization review, and claims processing personnel; provides or contracts for claims processing, and management information systems. Preferred Dentistry Associates, LLC receives reimbursement for actual expenses for services rendered. The agreement continues in perpetuity until terminated by either party with not less than 60 days’ prior notice. The company may terminate the agreement upon 30 days' written notice in the event of a material breach of the agreement.

IV. AFFILIATED COMPANIES

Preferred Insurance Affiliates, Inc. is a member of a holding company system. Its ultimate controlling person is Frank L. Karkazis D.D.S. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of Preferred Insurance Affiliates, Inc. follows the organizational chart.

Holding Company Chart
As of December 31, 2019



Preferred Dentistry Associates, P.C.

Preferred Dentistry Associates, P.C. provides professional dental services. As of December 31, 2019, the company's unaudited financial statement reported assets of $18,865, liabilities of $7,790, and equity of $11,075. Operations for 2019 produced net income of $24,087 on revenues of $1,439,307.

Preferred Dentistry Associates, LLC

Preferred Dentistry Associates, LLC provides professional dental services. As of December 31, 2019, the company's audited financial statement reported assets of $29,678, liabilities of $65,043, and equity of $(35,365). Operations for 2019 produced net income of $207,640 on revenues of $860,264.

Preferred Insurance Services, Inc.

Preferred Insurance Services, Inc. provides dental insurance to nursing home residents in Illinois. As of December 31, 2019, the company's audited financial statement reported assets of $703,341, liabilities of $430,381, and capital and surplus of $272,960. Operations for 2019 produced net income of $30,425 on revenues of $1,046,871.

Agreements with Affiliates

Administrative Services Agreement

Preferred Insurance Affiliates, Inc. entered into an Administrative Services Agreement with Preferred Dentistry Associates, LLC as of September 11, 2014. As a fee for its services, Preferred Insurance Affiliates, Inc. reimburses Preferred Dentistry Associates, LLC for actual expenses allocated to them. The agreement continues in perpetuity until terminated by either party with not less than 60 days' prior notice. The company may terminate the agreement upon 30 days' written notice in the event of a material breach of the agreement. During the examination period Preferred Insurance Affiliates, Inc. did not pay Preferred Dentistry Associates, LLC for services rendered.

Provider Agreement

Preferred Insurance Affiliates, Inc. entered into a Provider Agreement with Preferred Dentistry Associates, LLC as of September 11, 2014. Pursuant to the terms of the agreement, Preferred Dentistry Associates, LLC agrees to provide dental services to individuals insured under a dental insurance policy issued by Preferred Insurance Affiliates, Inc. The agreement was originally effective for an initial term of 12 months and currently renews automatically for successive one-year terms. Preferred Insurance Affiliates, Inc. compensates Preferred Dentistry Associates, LLC for its services according to an exhibit of covered services. During the examination period the following amounts were paid by Preferred Insurance Affiliates, Inc. for services provided by Preferred Dentistry Associates, LLC: **2019**- $103,117; **2018**- $59,148; **2017**- $112,221; **2016**- $116,056; **2015**- $6,011.

Commission Agreement

Preferred Insurance Affiliates, Inc. entered into a Commission Agreement with its co-owner, Dr. Peter Contos, effective October 15, 2015. The agreement retains Dr. Contos as an agent to sell dental insurance to residents of nursing homes and long-term care facilities at a rate of 5% of the premiums collected by Preferred Insurance Affiliates, Inc., net of refunds and overpayments. Dr. Contos has no authority to bind the company to any agreement/contract without written consent from the president of the company. The term of the agreement is one year and renews for additional terms of one year each until 30 days' prior written notice.

V. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2019, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Capital and Surplus per Examination." Also included in this section are schedules that reflect the growth of the company for the period under examination.

Preferred Insurance Affiliates, Inc.
Assets
As of December 31, 2019

	Assets	Nonadmitted Assets	Net Admitted Assets
Cash, cash equivalents and short-term investments	$292,223	$ 0	$292,223
Investment income due and accrued	784	0	784
Uncollected premiums and agents' balances in the course of collection	16,263	13,432	2,831
Total Assets	$309,270	$13,432	$295,838

Preferred Insurance Affiliates, Inc.
Liabilities and Net Worth
As of December 31, 2019

Claims unpaid		$ 58,525
Aggregate health claim reserves		24,735
Premiums received in advance		688
General expenses due or accrued		15,186
Total Liabilities		99,134
Common capital stock	$ 1,000	
Gross paid in and contributed surplus	124,000	
Surplus notes	200,000	
Aggregate write-ins for other than special surplus funds		
Unassigned funds (surplus)	(128,296)	
Total Capital and Surplus		196,704
Total Liabilities, Capital and Surplus		$295,838

Preferred Insurance Affiliates, Inc.
Statement of Revenue and Expenses
For the Year 2019

Net premium income		$123,838
Medical and Hospital:		
Hospital/medical benefits	$ 99,070	
General administrative expenses	104,121	
Total underwriting deductions		203,191
Net underwriting gain or (loss)		(79,353)
Net investment income earned		1,757
Net Income (Loss)		$ (77,596)

Preferred Insurance Affiliates, Inc.
Capital and Surplus Account
For the Five-Year Period Ending December 31, 2019

	2019	2018	2017	2016	2015
Capital and surplus, beginning of year	$137,732	$153,297	$148,078	$137,339	$ 0
Net income (loss)	(77,596)	(15,565)	5,219	10,739	(37,661)
Change in non-admitted assets	(13,432)				
Change in surplus notes	150,000				50,000
Paid in capital					1,000
Paid in surplus					124,000
Capital and Surplus, End of Year	$196,704	$137,732	$153,297	$148,078	$137,339

Preferred Insurance Affiliates, Inc.
Statement of Cash Flows
As of December 31, 2019

Premiums collected net of reinsurance		$111,134
Net investment income		1,558
Total		112,692
Less:		
Benefit- and loss-related payments	$103,118	
Commissions, expenses paid and aggregate write-ins for deductions	101,661	
Total		204,779
Net cash from operations		(92,087)
Cash Provided/Applied:		
Surplus notes, capital notes		150,000
Net Change in Cash, Cash Equivalents, and Short-Term Investments		57,913
Cash, cash equivalents, and short-term investments:		
Beginning of year		234,310
End of Year		$292,223

Growth of the Company

The following schedules reflect the growth of the company during the examination period:

Year	Assets	Liabilities	Capital and Surplus	Premium Earned	Medical Expenses Incurred	Net Income
2019	$295,838	$99,134	$196,704	$123,838	$99,070	$(77,596)
2018	237,766	100,033	137,732	202,190	102,456	(17,116)
2017	238,430	85,133	153,297	207,321	124,393	5,219
2016	191,956	43,877	148,079	170,490	119,343	10,327
2015	146,524	9,185	137,339	5,307	9,011	(37,802)

Year	Profit Margin	Medical Expense Ratio	Administrative Expense Ratio	Enrollment	Change in Enrollment
2019	-61.8%	80.0%	84.1%	66	-63.7%
2018	-7.6	50.7	57.8	182	-3.7
2017	2.5	60.0	37.5	189	-11.7
2016	6.3	70.0	23.9	214	1,646.2
2015	NR	NR	NR	13	100.0

Per Member Per Month Information

	2019	2018	Percentage Change
Total Premiums and Risk Revenue	$ 91.26	$101.04	-25.8%
Expenses:			
Hospital/medical benefits	73.00	51.20	42.6
General administrative expenses	76.73	58.40	31.3
Total underwriting deductions	$149.73	$109.60	36.6%

The company experienced a significant decline in membership from 2018 to 2019 due to the loss of a group of nursing homes. Membership has been declining since 2016. The company posted a net loss in three of the four years of operation with two of those being the most recent years of operation. The company has had increasing administrative expenses every year while claim expenses have fluctuated. Due to additional surplus notes issued in 2019, the company has sufficient capital and surplus to support operations.

Financial Requirements

The financial requirements for an LSHO under s. Ins 9.04, Wis. Adm. Code, are as follows:

		Amount Required
1.	Minimum capital or permanent surplus	Not less than $75,000

2.	Security deposit	Each LSHO is required to maintain a deposit of securities with the state treasurer or an acceptable letter of credit on file with the Commissioner's office. The amount of the deposit or letter of credit shall not be less than $75,000. The letter of credit must be payable to the Commissioner whenever liquidation or rehabilitation proceedings are initiated against the company.
3.	Compulsory surplus	Not less than the greater of: 3% of the premiums earned by the company in the previous 12 months or $75,000 The Commissioner may accept the deposit or letter of credit under par. 2 to satisfy the compulsory surplus requirement if the company demonstrates to the satisfaction of the Commissioner that all risk for loss has been transferred to the providers.
4.	Security surplus	The company should maintain a security surplus to provide an ample margin of safety and clearly assure a sound operation. The security surplus should not be less than 110% of the compulsory surplus.

The company's calculation as of December 31, 2019, as modified for examination adjustments, is as follows:

Assets	$295,838	
Amount available to satisfy surplus requirements	295,838	
Less:		
Liabilities	99,134	
Examination adjustments	21,593	
Net amount available to satisfy surplus requirements		$175,111
Net premium earned	123,838	
Compulsory factor	3%	
Compulsory surplus – greater of 3% of premium or $75,000		75,000
Compulsory Excess (Deficit)		$100,111
Net amount available to satisfy surplus requirements		$175,111
Compulsory surplus		75,000
Security surplus factor		140%
Security surplus		105,000
Security Excess (Deficit)		$70,111

Reconciliation of Capital and Surplus per Examination

The following schedule is a reconciliation of capital and surplus between that reported by the company and as determined by this examination. Changes shown on this page are discussed in the "Summary of Examination Results" section of this report.

	Increase	Decrease	
Capital and surplus December 31, 2019, per annual statement			$196,704
Cash, cash equivalents, and short-term investments		$21,593	(21,593)
Capital and surplus December 31, 2019, per examination			$175,111

Examination Reclassifications

	Debit	Credit
General expenses due or accrued	$10,425	
Amounts due to parent, subsidiaries and affiliates		$10,425

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

This is the company's first examination. There are no prior recommendations.

Summary of Current Examination Results

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

Compliance with Bylaws

PIA's bylaws [Article II, Section 2.01] state that "*the annual meeting of the shareholders shall be held in December every year for the purpose of electing directors*…" Based on the examiner's review of the shareholder meeting minutes provided, there were no annual meetings of PIA's shareholders for the election of directors in 2018 and 2019. It is recommended the company follow its bylaws by holding an annual meeting. It is further recommended that the shareholders elect directors and officers at the annual meeting.

Jurat Page

The elected officers and directors are not properly reflected on the annual statement jurat pages in 2015, 2016, 2018 and 2019 as the jurat pages instead improperly identified unelected individuals and positions indicated as held were incorrect. It is recommended that the company accurately complete the jurat page to include the current officers and directors of the company.

Reporting of Amounts due to Parent, Subsidiaries, and Affiliates

The company is misclassifying unpaid amounts due to affiliates as general expenses due or accrued. Amounts owed through intercompany transactions should be reported on Line 15, Amounts Due to Parent, Subsidiaries and Affiliates. The company reported General Expenses Due and Accrued of $15,187 at year-end December 31, 2019, of which $10,425 is for amounts due to parent Dr. Contos for 2017 accrued commission expenses. It is recommended that the company properly classify amounts due to Parent, Subsidiaries, and Affiliates on the liabilities page.

Completion of General Interrogatories

The company's General Interrogatories #1.1, #1.2 and #1.3 were not accurately answered or were left blank. The company indicated that they are not part of an insurance holding company system, have not filed registration statements and do not identify the states regulating them. It is recommended that the company properly and accurately complete the General Interrogatories section of the Health Annual Statement.

Non-compliance with SSAP 70

Shared expenses between all entities under the holding company system (including non-insurance entities) were not appropriately allocated amongst all entities utilizing shared services. The company did not pay any salaries, administrative fees or rental expenses for the personnel and facilities that they shared with their affiliates. If shared costs are not paid as allocated, they should be accounted for as additional paid in capital. It is recommended that the company determine a method for properly allocating shared costs between affiliated parties.

Conflict of Interest Statements

Review of the Annual Conflict of Interest Statements showed that the company does not have all directors complete a Conflict of Interest Statement as required by a directive of the commissioner. It is recommended that that company have all officers and directors fill out a Conflict of Interest Statement on an annual basis.

Information Technology

During the examination there were certain information technology issues discussed with the company. The items discussed were based on the existence and application of the company's policies and procedures in key areas related to information technology. It is recommended that the company review its information technology processes and procedures and correct them if necessary to mitigate any deficiencies communicated to the company.

Internal Controls over Cash Disbursements

The examination disclosed that an affiliated party wrote a check to the incorrect holding company for reimbursement of shared expenses. The company does not have a process in place to review checks written by a second person. It is recommended that the company develop controls to ensure that cash disbursements are accurately and correctly processed and recorded.

Affiliated Agreements

During the examination, the company provided a copy of a Commission Agreement with Dr. Peter Contos who is also an owner of the company. However, this Commission Agreement was not filed with the Office of the Commissioner of Insurance for advance approval as required by s. 617.21 (2), Wis. Stat., and s. Ins 40.04 (2) (d), Wis. Adm. Code. It is recommended that the company file agreements with affiliates and amendments thereof with the commissioner at least 30 days prior to the proposed effective date in accordance with s. 617.21 (2), Wis. Stat., and s. Ins 40.04 (2) (d), Wis. Adm. Code.

Cash Reporting

The examination found that the company did not have ownership rights for the claims account with Chase Bank. Chase Bank did not have any company personnel on file as owners or authorized signers on the account. The total in the account as of December 31, 2019, reported as an asset was $21,593. This adjustment is disclosed in the section of this report captioned “Reconciliation of Capital and Surplus per Examination”. It is recommended that the company only report as assets those cash accounts for which the company has ownership or control.

VII. CONCLUSION

Preferred Insurance Affiliates, Inc. was incorporated on June 4, 2014, and commenced business on August 1, 2015. The company markets dental insurance to nursing home residents. The company operates through contracts with affiliated and nonaffiliated dental providers.

Preferred Insurance Affiliates, Inc.'s financial statements reported assets of $295,838, liabilities of $99,134, and surplus of $196,704. Operations for 2019 produced a net loss of $(77,596). The company had a peak enrollment of 214 in 2016, since then enrollment has decreased by 69.1% to 66 members.

In this, its first examination, the company had an adjustment to surplus of $21,593, and a reclassification to the balance sheet of $10,425. The examination resulted in 10 recommendations. Areas for improvement include proper accounting procedures and controls, completion of conflict of interest disclosures, timely reporting of affiliated agreements to the Office of the Commissioner of Insurance, and ensuring that the financial statement filings are kept up to date to include the Jurat Page and the General Interrogatories.

VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 17 - Bylaws - It is recommended the company follow its bylaws by holding an annual meeting. It is further recommended that the shareholders elect directors and officers at the annual meeting.

2. Page 17 - Jurat Page - It is recommended that the company accurately complete the jurat page to include the current officers and directors of the company.

3. Page 17 - Reporting of Amounts Due to Parents, Subsidiaries, and Affiliates - It is recommended that the company properly classify amounts due to Parent, Subsidiaries, and Affiliates on the liabilities page.

4. Page 17 - Completion of General Interrogatories - It is recommended that the company properly and accurately complete the General Interrogatories section of the Health Annual Statement.

5. Page 18 - Non-compliance with SSAP 70 - It is recommended that the company determine a method for properly allocating shared costs between affiliated parties.

6. Page 18 - Conflict of Interest Statements - It is recommended that that company have all officers and directors fill out a Conflict of Interest Statement on an annual basis.

7. Page 18 - Information Technology - It is recommended that the company review its information technology processes and procedures and correct them if necessary to mitigate any deficiencies communicated to the company.

8. Page 19 - Lack of Internal Controls over Cash Disbursements - It is recommended that the company develop controls to ensure that cash disbursements are accurately and correctly processed and recorded.

9. Page 19 - Affiliated Agreements - It is recommended that the company file agreements with affiliates and amendments thereof with the commissioner at least 30 days prior to the proposed effective date in accordance with s. 617.21 (2), Wis. Stat., and s. Ins 40.04 (2) (d), Wis. Adm. Code.

10. Page 19 - Cash Reporting - It is recommended that the company only report as assets those cash accounts for which the company has ownership or control.

IX. ACKNOWLEDGMENT

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

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

Name	**Title**
Eleanor Lu, CISA	IT Specialist
Nicholas Hartwig	Quality Control Specialist

Respectfully submitted,

Gabriel Gorske
Examiner-in-Charge