

Statutory Financial Examination of
ALASKA TIMBER INSURANCE EXCHANGE

FE 08-02

as of December 31, 2007

Issued by
STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY, AND
ECONOMIC DEVELOPMENT
DIVISION OF INSURANCE

NAIC Company Code: 38687
NAIC Group Code: 000

FINAL REPORT:
May 1, 2009

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21
22
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CERTIFIED MAIL
RETURN RECEIPT REQUESTED

STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY AND
ECONOMIC DEVELOPMENT
DIVISION OF INSURANCE
550 WEST 7TH AVENUE, SUITE 1560
ANCHORAGE, AK 99501-3567

Order FE 08-02)
In the Matter of Examination of)
Alaska Timber Insurance Exchange)

FINDINGS OF FACT

1. A report of examination of Alaska Timber Insurance Exchange, domiciled in the State of Alaska, has been issued by the State of Alaska, Division of Insurance to Alaska Timber Insurance Exchange.
2. The Report of Examination of Alaska Timber Insurance Exchange (FE 08-02) has been transmitted to Ms. Linda Lewis, President, Alaska Timber Exchange Management Corporation and Mr. Martin Pihl, Chairman of the Board of Governors of Alaska Timber Insurance Exchange (Examinee), and Examinee has been accorded at least 30 days opportunity to review and comment on this Report of Examination. A response from the examinee was received on July 6, 2009.
3. The Director of the Division of Insurance has fully considered and reviewed the report, the examinee response and any relevant portions of the examiner's work papers to the extent she considered necessary.

CONCLUSIONS OF LAW

1. The written Report of Examination referred to in Finding of Fact No. 1 was issued in accordance with Alaska Statute (AS) 21.06.150(b).
2. The actions set forth in finding of Fact No. 2 were conducted in accordance with AS 21.06.150(b).
3. The Director of the Division of Insurance has reviewed the Report of Examination, the examinee response and any other relevant work papers as set forth in Finding of Fact No. 3 to the extent she considered necessary in accordance with AS 21.06.150(b).

STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY, AND ECONOMIC DEVELOPMENT
DIVISION OF INSURANCE
550 WEST SEVENTH AVENUE, SUITE 1560
ANCHORAGE, ALASKA 99501-3567
PHONE: (907) 269-7900
FAX: (907) 269-7910
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ORDER

IT IS ORDERED

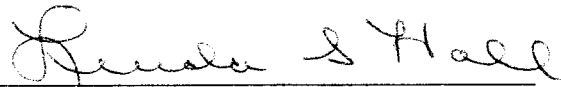
1. Pursuant to AS 21.06.150(b)(1), the Report of Examination of Alaska Timber Insurance Exchange (FE 08-02) is approved as filed.

2. Pursuant to AS 21.06.060, the Report of Examination shall be kept in the Office of the Director of the Division of Insurance and be open to public inspection.

3. The Examinee will implement all recommendations within a reasonable amount of time but no later than one year from the issue date of this examination report, unless otherwise recommended in the Report of Examination. Failure to implement compliance recommendations may result in action against the Examinee for violation of this order.

This order is effective July 13, 2009.

Dated this 13th day of July, 2009 at Anchorage, Alaska.


Linda S. Hall, Director
State of Alaska
Division of Insurance

STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY, AND ECONOMIC DEVELOPMENT
DIVISION OF INSURANCE
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17
18
19
20
21
22
23
24
25
26

TABLE OF CONTENTS

Salutation 1
Scope of Examination 1
Summary of Examination Findings 2
 Significant Findings 2
 Subsequent Events 2
Description of Company 2
 Company History 2
 Corporate Records 2
 Management and Control 3
 Fidelity Bond and Other Insurance 3
 Employees' and Agents' Pensions Stock Ownership, and Other Insurance 3
 Territory and Plan of Operation 3
 Growth of Company 4
 Loss Experience 4
 Reinsurance 4
 Accounts and Records 4
 Statutory Deposits 4
Summary of Actuarial Review 5
Financial Statements 5
 Statement of Assets, Liabilities and Surplus 6
 Statement of Underwriting and Investments 7
 Statement of Capital and Surplus Account 8
Analysis of Changes in Financial Statements Resulting from Examination 9
Compliance with Recommendations in Prior Report of Examination 9
Current Examination Findings and Recommendations 9-11
Closing 12
Affidavit 13



STATE OF ALASKA
DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT

Division of Insurance

Sarah Palin, Governor
Emil Notti, Commissioner
Linda S. Hall, Director

May 1, 2009

Ms. Linda S. Hall, Director
Division of Insurance
Department of Commerce, Community
and Economic Development
State of Alaska
550 West 7th Avenue, Suite 1560
Anchorage, AK 99501-3567

Dear Director Hall:

In accordance with your instructions and authorizations, and in accordance with statutory requirements, an examination has been made of the financial condition and business affairs of:

Alaska Timber Insurance Exchange
2417 Tongass Avenue, Suite 214
Ketchikan, Alaska 99901

(NAIC CoCode 38687; Group Code 000)

SCOPE OF EXAMINATION

The examination of Alaska Timber Insurance Exchange covers a three year period from January 1, 2005 to December 31, 2007. The last financial examination of the Exchange was completed as of December 31, 2004. Transactions subsequent to this period were reviewed where deemed appropriate.

Procedures of the examination followed standards established by the NAIC Financial Condition Examiners Handbook and the rules, regulations and directives of the State of Alaska, Division of Insurance. The examination was planned and performed to evaluate the financial condition and identify prospective risks of the Exchange by obtaining information about the Exchange including corporate governance, identifying and assessing inherent risks within the company and evaluating system controls and procedures used to mitigate those risks. The 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 (SSAPs) and annual statement instructions when applicable to domestic insurers.

All accounts and activities of the Exchange were considered in accordance with the risk-focused examination process. The initial phase of the examination focused on evaluating the Exchange's governance and control environment in addition to work performed by the external audit function. The workpapers of independent certified public accountants, Presnell Gage PLLC were reviewed and relied upon where appropriate.

SUMMARY OF EXAMINATION FINDINGS

Significant Findings

This report is recommending the development and implementation of an Ethics/Whistleblower Policy and a Contingency Plan for ATIE's employees and management. ATIE has not adopted a comprehensive ethics policy to define ethical behavior for ATIE personnel. In addition, ATIE has not adopted a whistleblower policy to encourage employees to report suspected violations of the adopted policies. Completed policies in these areas allows for a proactive management of risks and is a good business practice that will reduce the risk of behavior that may be detrimental to the financial status or reputation of ATIE. The adoption of a contingency plan by the Board of Governors will assure data, systems and operations can be successfully recovered and continuity established in the event of a catastrophe.

Subsequent Events

The examiners performed a review of the Exchange's transactions, activities, and events subsequent to December 31, 2007 through May 1, 2009 to ensure all events which require adjustments of or disclosure in the financial statements or notes thereto were identified.

At December 31, 2007, the Exchange reported a pension termination liability to the Pension Benefit Guaranty Corporation (PBGC) of \$300,000. The Exchange terminated its participation in the Alaska Loggers Association Retirement Trust's multi-employer defined benefit pension plan in January 2005 and its final liability to PBGC was estimated at \$478,139. During the first quarter of 2008, the Exchange's pension termination liability was extinguished by payment of \$300,000.

DESCRIPTION OF COMPANY

Company History

Alaska Timber Insurance Exchange (ATIE) is organized as a reciprocal insurance exchange pursuant to Title 21, Chapter 75, of the Alaska Statutes. On March 28, 1980, it received a Certificate of Authority from the State of Alaska, as an unincorporated association authorized to offer property and casualty insurance (excluding vehicle) pursuant to AS 21.12.060 and AS 21.12.070. It issues non-assessable worker's compensation policies to its subscribers. On September 3, 1998, the Exchange's Board broadened reciprocal membership from timber related companies to companies outside the timber industry.

Corporate Records

All records specified by AS 21.69.390(d) such as general ledgers, financial statements, filings, board minutes, contracts, policy and claim files are kept at the Exchange's office at 2417 Tongass Avenue, Suite 214, Ketchikan, Alaska. Documentation maintained substantiates the information provided on business activities conducted in the state.

Management and Control

Subscribers own the Exchange. Alaska Timber Exchange Management Corporation serves as the Exchange's attorney-in-fact and is wholly-owned by the Exchange. The Management Corporation manages the daily operations of the reciprocal. The Exchange has no other subsidiaries or affiliates.

Alaska Statute and the Exchange's Subscriber's Agreement limit the control of any single subscriber regarding matters critical to the Exchange. The Subscriber's Agreement limits each subscriber to one vote on the questions of terminating the attorney-in-fact; merging with another reciprocal insurer; converting to a stock or mutual insurer; or calling a special meeting of the Board of Governors. Subscribers have proportional voting on other matters based on the amount of surplus contributed to the Exchange. Proportional voting rights are determined on April 30 of each year.

The nine-member Board of Governors supervises the business of the Exchange. Subscribers elect board members at the annual member's meeting pursuant to the Restated Rules of the Exchange. Three board members are elected to three-year terms annually. The Investment Committee is the only committee designated by the board.

Fidelity Bonds and Other Insurance

Fidelity bond coverage for the Exchange is a \$300,000 single loss limit liability with a deductible of \$10,000. Fidelity coverage meets the NAIC minimum recommended amount and is deemed adequate. Employees of the Management Corporation are also covered by a \$100,000 attorney-in-fact bond.

Employees' and Agents' Pensions, Stock Ownership, and Other Insurance

The Exchange does not have employees. Personnel costs incurred by the attorney-in-fact are allocated to the Exchange. Employees may participate in a 401(k) plan. The Board of Governors authorizes contributions to the 401(k) profit sharing plan based on employee earnings.

Territory and Plan of Operation

The Exchange specializes in worker's compensation policies. It issues policies only in the State of Alaska. The Exchange's marketing strategy utilizes appointed agents to increase the number of its subscribers.

Growth of Company

Results of the Exchange’s operation for the period of 2005 to 2007 are shown in the following exhibit. Figures presented below are from the Exchange’s Annual Statements for the years 2005, 2006 and 2007. The 2004 data is from the division’s Report of Examination for the year 2004.

Year	Admitted Assets	Liabilities	Surplus	Dividends to Policyholders
2004	\$ 18,149,482	\$ 13,069,830	\$ 5,079,652	\$ 241,322
2005	20,795,710	13,746,917	7,048,793	243,383
2006	20,925,220	13,493,216	7,432,005	2,199,987
2007	22,428,633	13,556,083	8,872,550	1,800,000

Admitted assets increased 23.6% and surplus increased 74.6% since 2004.

Loss Experience

Year	Premiums Earned	Losses Incurred		Loss Expense Incurred	
2005	\$ 5,969,070	\$ 2,335,620	39.13%	\$ 967,518	16.21%
2006	5,165,130	1,974,249	38.22%	752,306	14.56%
2007	5,147,198	1,453,122	28.23%	605,269	11.76%

Reinsurance

The Exchange’s retention is \$500,000 each occurrence. Reinsurance coverage is outlined below:

First Workers’ Compensation Excess of Loss - \$1,500,000 excess of \$500,000
 Second Worker’ Compensation Excess of Loss - \$5,000,000 excess of \$2,000,000
 Third Workers’ Compensation Excess of Loss - \$13,000,000 excess of \$7,000,000
 Reinsurance has a maximum \$7,000,000 coverage for any one life.

Accounts and Records

Accounts and records are maintained electronically using various software programs. The Exchange uses software programs to adjust claims, manage data, compile reports, and accounts. Virus and firewall protection programs are also used to assure the security of the Exchange’s data.

Statutory Deposits

A \$300,000 statutory deposit is maintained at First Bank in Ketchikan, Alaska.

SUMMARY OF ACTUARIAL REVIEW

As of December 31, 2007, ATIE carried \$11,346,000 in net loss and expense reserves and \$13,694,000 in gross loss and expense reserves.

For the actuarial review, ATIE provided medical, indemnity and loss adjustment expense data by accident year. Using this information, along with information obtained by interviewing company staff, the division actuary reviewed the reserves held by ATIE as well as the Milliman, Inc. actuarial report in support of the 2007 Statement of Actuarial Opinion. Based on this review, ATIE's overall reserve position is determined to be within a reasonable range of reserve estimates and is accepted as stated.

FINANCIAL STATEMENTS

The following pages contain statutory financial statements for the Exchange as of December 31, 2007 as reported to the division and as determined by the examiners.

FINANCIAL STATEMENTS
STATEMENT OF ASSETS, LIABILITIES AND SURPLUS
As of December 31, 2007

	<u>As Reported</u>	<u>Adjustments</u>	<u>Finding No.</u>	<u>As Adjusted</u>
<u>Assets</u>				
Bonds	\$16,907,873			\$16,907,873
Common stock	1,000			1,000
Cash & short term investments	4,021,057			4,021,057
Other invested assets	499			499
Receivable s for securities	17,351			17,351
Investment income due & accrued	223,284			223,284
Uncollected premiums and agents' balances in course of collection	249,182			249,182
Deferred premiums, agents' balances & installments booked but deferred	310,235	32,850	6	343,085
Reinsurance amounts recoverable	(14,359)			(14,359)
Net deferred tax asset	176,638			176,638
Guaranty funds receivable	157,149			157,149
Electronic data processing equipment' and software	9,071			9,071
Annuities held	369,653			369,653
 Total Admitted Assets	 <u>\$22,428,633</u>	 <u>32,850</u>	 6	 <u>\$22,461,483</u>
<u>Liabilities, Surplus and Other Funds</u>				
<u>Liabilities</u>				
Losses	\$ 9,546,640			\$ 9,546,640
Loss adjustment expenses	1,799,478			1,799,478
Commissions Payable	40,095			40,095
Other expenses	97,268			97,268
Taxes, licenses and fees	186,701			186,701
Policyholders' dividends declared	1,000,000			1,000,000
Ceded reinsurance premiums payable	585,900			585,900
Pension fund termination liability payable	300,000			300,000
 Total Liabilities	 <u>\$13,556,082</u>	 <u></u>	 	 <u>\$13,556,082</u>
<u>Surplus</u>				
Gross paid-in and contributed surplus	\$ 3,299,353			\$ 3,299,353
Unassigned funds (surplus)	3,893,717	32,850	6	3,926,567
Other than special surplus funds	1,679,480			1,679,480
Surplus as regards policyholders	<u>\$ 8,872,550</u>	<u>32,850</u>	6	<u>\$ 8,905,400</u>
Total Liabilities and Surplus	<u>\$22,428,633</u>	<u>32,850</u>		<u>\$22,461,483</u>

FINANCIAL STATEMENTS
STATEMENT OF UNDERWRITING AND INVESTMENT
as of December 31, 2007

	As Reported	Examination Adjustments	Finding Number	As Adjusted
<u>Underwriting Income</u>				
<u>Revenue</u>				
Premiums earned	\$ 5,147,198	32,850	6	\$ 5,180,048
Total Revenue	<u>\$ 5,147,198</u>	<u>32,850</u>		<u>\$ 5,180,048</u>
<u>Deductions</u>				
Losses incurred	\$ 1,453,122			\$ 1,453,122
Loss expenses incurred	605,269			605,269
Other underwriting expenses	853,595			853,595
Total underwriting deductions	<u>\$ 2,911,986</u>			<u>\$ 2,911,986</u>
Net underwriting gain or loss	<u>\$ 2,235,212</u>	<u>32,850</u>	6	<u>\$ 2,268,062</u>
<u>Investment Income</u>				
Net investment income earned	\$ 881,177			881,177
Net realized capital gains or (losses)	1,453			1,453
Net investment gain or (loss)	<u>\$ 882,630</u>			<u>\$ 882,630</u>
<u>Other Income</u>				
	<u>\$ 217,500</u>			<u>\$ 217,500</u>
Net income before dividends	\$ 3,335,341			3,335,341
Dividends to policyholders	1,800,000			1,800,000
Net Income (Loss)	<u>1,535,341</u>	<u>32,850</u>	6	<u>1,568,191</u>
<u>Capital and Surplus Account</u>				
Surplus, December 31, prior year	<u>\$ 7,432,005</u>			<u>\$ 7,432,005</u>
<u>Gains and (Losses) in Surplus</u>				
Net income (loss)	\$ 1,535,341	32,850	6	\$ 1,568,191
Change in deferred income tax	(530,421)			(530,421)
Change in non-admitted assets	527,503			527,503
Surplus adjustments: Paid in	(114,925)			(114,925)
Aggregate write-ins for gains in surplus	23,046			23,046
Change in surplus as regards policyholders	<u>\$ 1,440,545</u>	<u>32,850</u>	6	<u>\$ 1,473,395</u>
Surplus for the period ended December 31, 2007	<u>\$ 8,872,550</u>	<u>32,850</u>	6	<u>\$ 8,905,400</u>

FINANCIAL STATEMENTS
STATEMENT OF CAPITAL AND SURPLUS ACCOUNT
As of December 31, 2007

	Reserve for Policy Deposit	SURPLUS		TOTAL
		Paid-In	Unassigned	
Balance at December 31, 2004	\$ 1,467,471	\$ 3,104,485	\$ 507,696	\$ 5,079,652
Surplus Contributed, Net		34,870		34,870
Reserve for Policy Deposit	212,888			212,888
Net income – 2005			1,533,434	1,533,434
Change in nonadmitted assets			700,593	700,593
Change in net deferred tax asset			(518,444)	(518,444)
Change in provision for reinsurance			5,799	5,799
Balance at December 31, 2005	\$ 1,680,359	\$ 3,139,355	\$2,229,079	\$ 7,048,793
Surplus Contributed, Net		274,923		274,923
Reserve for Policy Deposit	(23,925)			(23,925)
Net income – 2006			134,225	134,225
Change in nonadmitted assets			56,342	56,342
Change in net deferred tax asset			(58,353)	(58,353)
Change in provision for reinsurance			0	0
Balance at December 31, 2006	\$ 1,656,434	\$ 3,414,278	\$2,361,292	\$ 7,432,005
Surplus Contributed, Net		(114,925)		(114,925)
Reserve for Policy Deposit	23,046			23,046
Net income – 2007			1,568,191	1,568,191
Change in nonadmitted assets			527,503	527,503
Change in net deferred tax asset			(530,421)	(530,421)
Change in provision for reinsurance			0	0
Balance at December 31, 2007 (As adjusted)	\$ 1,679,480	\$ 3,299,353	\$3,893,717	\$ 8,905,400

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS RESULTING FROM THE EXAMINATION

One change was made to the financial statements as a result of this examination. Current Finding 6 regarding the reporting of earned but unbilled premium, resulted in an increase in premium revenue of \$32,850.

COMPLIANCE WITH RECOMMENDATIONS IN PRIOR REPORT OF EXAMINATION

During the examination the following recommendation in the prior report of examination was found to have been implemented or the issue was no longer present:

Prior Finding 1 – Investment Guidelines

The following prior finding was not found to be resolved during the current examination:

Prior Finding 2 – Good Business Practices – Contingency Plan

ATIE has not developed a written contingency plan. The Exchange's general manager, statutory accountant and claims manager all commute to the Exchange from various locations outside Alaska. Therefore, it is especially critical that everyone understand their responsibilities in the event of a disaster. Officers and staff should be provided with a board approved contingency plan that will assure data, systems and operations can be successfully recovered and continuity established in the event of a disaster. This is a repeat finding of the last examination.

Prior Recommendation: It is recommended that a written contingency plan be developed and communicated to all personnel. The plan should be approved by the Board of Governors.

Current Status: The Exchange continues to operate without a contingency plan. See current Finding 2.

CURRENT EXAMINATION FINDINGS AND RECOMMENDATIONS

Finding 1 - Lack of Ethics and Whistleblower Policy

The Exchange lacks a comprehensive ethics and whistleblower policy for its employees and management. The Exchange requires conflict of interest statements to be filed annually by senior management and board members. These statements ask about knowledge of violations of rules, regulations or policies of ATIE and knowledge of conflicts of interest. This practice is one step in addressing ethics issues. However, ATIE has not determined and put in writing a comprehensive ethics policy to define ethical behavior for the personnel involved with ATIE and a whistleblower policy to encourage employees to report suspected violations of policy.

Having a complete policy in this area allows for a proactive management of risks to avoid surprises, and is a good business practice that will reduce the risk of behavior that may be detrimental to the financial standing or reputation of ATIE.

Recommendation: It is recommended that a comprehensive ethics and whistleblower policy be developed and adopted by management and the Board of Governors. The policies should be included in the company's employee manual.

Finding 2 - Contingency Plan

ATIE has not developed a written contingency plan in the event of a catastrophe. The Exchange's general manager, statutory accountant and claims manager all commute to the Exchange from various locations outside Alaska and work onsite at ATIE's offices in Ketchikan less than 50% of the time. Other work is conducted via remote connections and by telephone. Therefore, it is especially critical that everyone understand their responsibilities in the event of a disaster. Officers and staff should be provided with a board approved contingency plan that will assure data, systems and operations can be successfully recovered and continuity established. The adopted plan should be tested periodically to confirm that it will operate as expected. This is a repeat finding of the last examination.

Recommendation: It is recommended that a written contingency plan be developed and communicated to all personnel. The plan should be approved by the Board of Governors.

Finding 3 - Advisory Committee Voting

The Board of Governors serves as the Exchange's Advisory Committee. During the exam period two directors/officers of the Management Corporation were permitted to vote at joint meetings of the ATIE Board of Governors and the Management Corporation Board of Directors. Neither director of the Management Corporation was an elected member of the Exchange's Board of Governors and voting was not recorded separately for each group.

Recommendation: At joint meetings of the Board of Governors and the Directors of the Management Corporation, it is recommended that votes of each group be recorded separately and noted in the minutes.

Finding 4 – Aging of Reinsurance Recoverable on Paid Losses

The Exchange did not follow the NAIC Annual Statement instructions regarding reporting of aged reinsurance recoverables. ATIE did not prepare an aging schedule and reported all reinsurance recoverables on the 2007 Annual Statement as current. One billed item of \$1,547 was not a current receivable. The inaccurate reporting of the receivable did not affect the calculation of the provision for reinsurance for 2007.

Recommendation: It is recommended that the Exchange prepare Schedule F – Part 4 in accordance with the NAIC Annual Statement Instructions.

Finding 5 – Noncompliance With Approved Investment Guidelines

The Board approved investment guidelines included a weighted average maturity (WAM) of eight years for the investment portfolio. To calculate the WAM number the weight of each security to the total portfolio is multiplied by the time until maturity of each investment and all the values are totaled. This is a common calculation used to determine the maturity of a financial organization's portfolio and at December 31, 2007 the Exchange's investment portfolio had a weighted average maturity of approximately ten years.

According to the Exchange's management, the average maturity of the portfolio was calculated using a weighted average effective maturity. The investment guidelines did not include the effective method.

Recommendation: It is recommended that the Exchange calculate portfolio maturity using the method in the investment guidelines. If additional methods are to be used they should be approved by the Board of Governors and added to the guidelines.

Finding 6 – Earned But Unbilled Premiums

ATIE did not record an amount for earned but unbilled premiums (EBUB) at December 31, 2007. Based on the audit performed during 2008 EBUB at December 31, 2007 was \$32,850. On the Annual Statement page two, line 13.2, the Exchange reported the Booked but Deferred and Not Yet Due Premiums of \$310,235 and incorrectly reported these as EBUB premiums. Pursuant to the Statement of Statutory Accounting Principles (SSAP) No. 53, EBUB premiums are mainly audit premiums which the Company estimates using historical company data or other processes. The recording of EBUB is a recognition of the change in the level of exposure to insurance risk for the reporting period. An adjustment has been made to the financial statements in this examination report.

Recommendation: It is recommended that the Exchange develop a method of estimating EBUB and record these premiums in future financial statements.

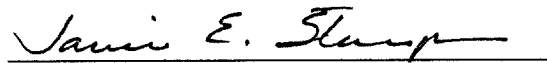
CLOSING

This examination was conducted in accordance with practices and procedures promulgated by the NAIC. This examination also includes a compliance review of applicable Alaska Statutes.


In addition to the undersigned, the following examiners participated in the examination: Actuary Sarah McNair-Grove, FCAS, MCAA and Insurance Financial Examiner Douglas Hartman, AFE, of the Division of Insurance and Patricia Neesham, CFE and Daniel Mitchell, CFE of RMS McGladrey.

We wish to express our appreciation for the courteous cooperation and assistance extended to us by the management and staff of Alaska Timber Insurance Exchange during the course of this examination.

This report is respectfully submitted,



Janice E. Stamper, CFE
Examiner-in-Charge



Gloria G. Glover, CFE
Chief Financial Examiner

AFFIDAVIT

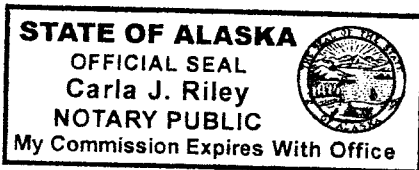
Anchorage, Alaska)
June 9, 2009)
STATE OF ALASKA)
THIRD JUDICIAL DISTRICT)

We, the undersigned, being duly sworn, do verify that the report of examination as of December 31, 2007, of Alaska Timber Insurance Exchange, an Alaska domiciled company holding Certificate of Authority D-1272, is true to the best of our knowledge and belief.

Janice E. Stamper
Janice E. Stamper, CFE
Examiner-in-Charge

Gloria G. Glover
Gloria G. Glover, CFE
Chief Financial Examiner

Subscribed and sworn to before me this 9 day of June, 2009.



Carla J. Riley
Notary Public for the State of Alaska

My commission expires: with office