

REPORT ON EXAMINATION
OF
MEDMAL DIRECT INSURANCE
COMPANY
JACKSONVILLE FLORIDA

AS OF
DECEMBER 31, 2011

BY THE
FLORIDA OFFICE OF INSURANCE REGULATION

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October 5, 2012

Kevin M. McCarty
Commissioner
Office of Insurance Regulation
State of Florida
Tallahassee, Florida 32399-0326

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, Rule 690-138.005, Florida Administrative Code, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2011, of the financial condition and corporate affairs of:

**MEDMAL DIRECT INSURANCE COMPANY
245 RIVERSIDE AVENUE
JACKSONVILLE, FLORIDA 32202-4924**

Hereinafter referred to as, the "Company". Such report of examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period of June 17, 2010, through December 31, 2011. This examination commenced with planning at the Office on March 26, 2012, to March 30, 2012. The fieldwork commenced on June 18, 2012, and concluded as of October 05, 2012.

This financial examination was a statutory financial examination conducted in accordance with the Financial Condition Examiners Handbook, Accounting Practices and Procedures Manual and annual statement instructions promulgated by the NAIC as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code, with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

The Financial Condition Examiners Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, 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 and management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

This report of examination is confined to significant adverse findings, a material change in the financial statements or other information of regulatory significance or requiring regulatory action. The report comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

SUMMARY OF SIGNIFICANT FINDINGS

Current Exam Findings

This was a first year (1st) examination of the Company. The findings noted during this examination, were resolved by the Company subsequent to the examination date. However, the resolved findings or exceptions are discussed in detail in the body of the examination report.

HISTORY

General

The Company was incorporated in Florida on June 14, 2010 and commenced business on June 17, 2010, as MedMal Direct Insurance Company.

The Company was party to Consent Order 110831-10-CO filed June 10, 2010, regarding the application for the issuance of a Certificate of Authority. The Company failed to comply with the following provisions of this consent order:

- There was no custodian agreement between the Company and Merrill Lynch & Company, Inc. (Merrill Lynch) as required by Rule 69O-143.042, Florida Administrative Code. **Subsequent Event:** The Company executed a custodian agreement with Merrill Lynch during the examination and the executed copy met the requirements of Rule 69O-143.042, Florida Administrative Code.

- The Company was not in compliance with Executive order 13224. **Subsequent Event:** On July 20, 2012, the Company provided completed Terrorism Sanctions questionnaires and certified compliance with executive order 13224.

The Company was authorized to transact Medical Malpractice insurance coverage in Florida on June 17, 2010 and continues to be authorized as of December 31, 2011.

The Articles of Incorporation and the Bylaws were not amended during the period covered by this examination.

Dividends to Stockholders

The Company did not declare or pay any dividends during the period of this examination.

Capital Stock and Capital Contributions

As of December 31, 2011, the Company’s capitalization was as follows:

Number of authorized common capital shares	10,000,000
Number of shares issued and outstanding	7,000,000
Total common capital stock	\$7,000,000
Par value per share	\$1.00

Control of the Company was maintained by its parent, MedMal Direct Insurance Group, LLC (“parent”), who owned 100% of the stock issued by the Company, who in turn was 100% owned by Physicians Trust, LLC, a Florida corporation. The parent contributed a total of \$7,000,000 in cash & cash equivalent(s) to the Company through December 31, 2011.

Surplus Notes

The Company did not have any surplus notes during the period of this examination.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales through Reinsurance

The Company had no acquisitions, mergers, disposals, and purchase or sales through reinsurance during the period of this examination.

CORPORATE RECORDS

The recorded minutes of the Shareholder(s), Board of Directors (Board) were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events, in compliance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code including the authorization of investments as required by Section 625.304, Florida Statutes.

Conflict of Interest

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code.

MANAGEMENT AND CONTROL

Management

The annual shareholder meeting for the election of directors was held in accordance with Section 628.231, Florida Statutes. Directors serving as of December 31, 2011, were:

Directors

Name and Location	Principal Occupation
Carter B. Bryan Jacksonville, Florida	Director MedMal Direct Insurance Company
Timothy R. Bone Jacksonville, Florida	President MedMal Direct Insurance Company
Philip B. Ball Jacksonville, Florida	Chief Executive Officer MedMal Direct Insurance Company
Michael J. Wallace Saint Johns, Florida	CFO & Vice President MedMal Direct Insurance Company
Sheldon C. Bryan (a) Atlantic Beach, Florida	Director Self Employed - Wingard Creative

(a) Resigned and was replaced by Christopher M. Ball as director per notice to the Office received on April 18, 2012.

The Board in accordance with the Company's bylaws appointed the following senior officers:

Senior Officers

Name	Title
Timothy R. Bone	President
Philip B. Ball	Chief Executive Officer
Michael J. Wallace	Vice President & Chief Financial Officer

The Company's Board appointed several internal committees. Following were the principal internal board committees and their members as of December 31, 2011:

Audit Committee

Michael J. Wallace¹
Philip B. Ball

Investment Committee

Philip B. Ball ¹
Michael J. Wallace

¹ Chairman

The audit committee was comprised of two senior officers of the Company; therefore, the Company was not in compliance with Section 624.424(8) (c), Florida Statutes, which states that "The board shall establish an audit committee of three or more directors. The audit committee shall be comprised solely of members who are free from any relationship that, in the opinion of its board of directors, would interfere with the exercise of independent judgment as a committee member."

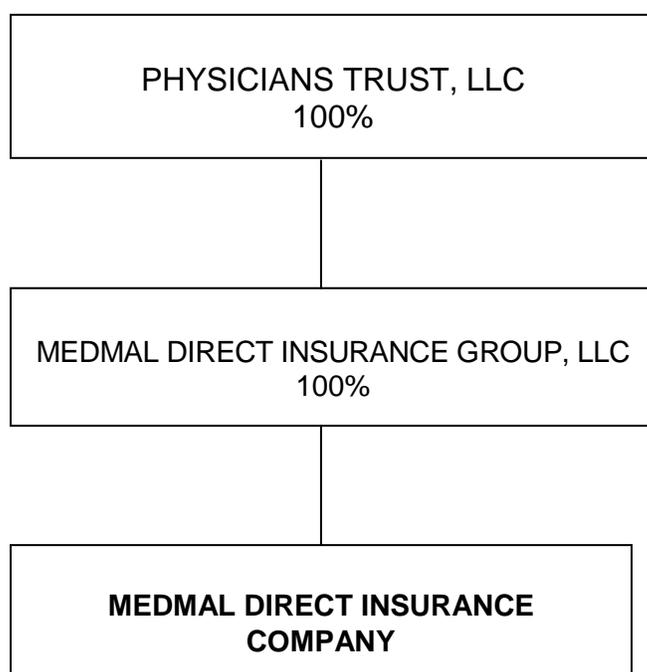
Affiliated Companies

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The latest holding company registration statement was filed with the State of Florida on February 28, 2012, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2011, reflecting the holding company system, is shown below. Schedule Y of the Company's 2011 annual statement provided a list of all related companies of the holding company group.

**MEDMAL DIRECT INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2011



The following agreement was in effect between the Company and its affiliate (parent):

Cost Sharing Agreement

The Company entered into a Service Agreement in June 2010 with MedMal Direct Insurance Group, LLC (parent) whereby the parent provided personnel to perform certain services for the benefit of the Company, including but not limited to, sales and marketing, accounting and financial reporting, operations and regulatory. The Company paid the parent a fee equal to one hundred and fifteen (115%) percent of the actual compensation & related personnel costs incurred by the parent as a result of providing these services to the Company.

FIDELITY BOND

The Company maintained fidelity bond coverage up to \$500,000 with a deductible of \$5,000 which reached the suggested minimum as recommended by the NAIC. The coverage was effective for the period December 1, 2011 through December 1, 2012.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company had no employees and therefore no pension, stock ownership or insurance plans in place at the Company during the period of this examination.

TERRITORY AND PLAN OF OPERATIONS

The Company was authorized to transact medical malpractice insurance only in the State of Florida.

Treatment of Policyholders

The Company established procedures for handling written complaints in accordance with Section 626.9541(1) (j), Florida Statutes.

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim in accordance with Section 626.9541(1) (i) 3a, Florida Statutes.

COMPANY GROWTH

The Company is relatively new as it began writing business in June of 2010. The Company experienced net losses in 2010 and 2011 primarily attributable to start up costs. However, the Company shows favorable underwriting with 700 insureds which are diverse geographically and by specialty. The Company markets directly to prospects through the internet, mailing, referrals, seminars, conventions, meetings and other means of direct market. The Company anticipates having significant growth in written premiums over the next several years as they gain market share in the Florida medical malpractice market.

Profitability of Company

The following table shows the profitability trend (in dollars) of the Company for the period of operations as reported in the filed annual statements.

	2011	2010
Premiums Earned	2,368,062	231,681
Net Underwriting Gain/(Loss)	(1,216,562)	(661,673)
Net Income	(1,067,195)	(609,200)
Total Assets	9,114,314	6,134,267
Total Liabilities	3,380,787	1,133,062
Surplus As Regards Policyholders	5,733,527	5,001,205

LOSS EXPERIENCE

The Company had no significant one or two-year net loss development over the past two years. The Company was licensed in June 2010 and began writing business during the third quarter of 2010.

REINSURANCE

The reinsurance agreements reviewed complied with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines.

Assumed

The Company did not assume any reinsurance during the period of this examination.

Ceded

During 2011, the Company ceded risk on an excess of loss basis to various Lloyd's Syndicates in order to limit its financial exposure to large claims by using Locton Re as their reinsurance intermediary. The treaty period covered claims made from March 1, 2011 through March 1, 2014. Under the per risk coverage, the reinsurers paid up to \$750,000 per loss insured, in excess of \$250,000. Under the clash coverage, the reinsurers paid up to \$500,000 per loss occurrence, in excess of \$500,000. Each loss occurrence under the clash coverage provision comprised at least three insureds. The reinsurance agreement provided for adjustable premiums based on ceded incurred losses. There were no ceded incurred losses during the year ended December 31, 2011.

The Company also utilized three unauthorized reinsurers during the period of this exam. There were no letters of credit established for these un-authorized reinsurers. However, the amounts recoverable(s) from these reinsurers were insignificant.

The reinsurance contracts were reviewed by the Company's appointed actuary and were utilized in determining the ultimate loss opinion.

ACCOUNTS AND RECORDS

The Company maintained its principal operational offices in Jacksonville, Florida.

An independent CPA audited the Company's statutory basis financial statements annually for the years 2010 and 2011, in accordance with Section 624.424(8), Florida Statutes. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, Florida Administrative Code.

The Company's accounting records were prepared using Intuit QuickBooks to support general ledger activity, cash collections and payables. Microsoft Dynamics CRM was used for processing claims and underwriting. Microsoft Excel is used primarily for rating, but also to support general ledger entries, accounting calculations, fixed assets details, and other accounting functions.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company utilized Merrill Lynch as its custodian during the period covered by this examination. There was no custodian agreement executed with Merrill Lynch during the period covered by this examination. **Subsequent Event:** During the examination, the Company provided a custodian agreement which was executed with Merrill Lynch. The Custodian Agreement met all of the requirements of Rule 69O-143.042, Florida Administrative Code.

Lease Agreement

The Company entered into an operating lease for its office space effective July 1, 2010 with One Independent Square, LLC. Rent expense was \$126,621 and \$67,166 for the year ended December 31, 2011 and for the period from June 17, 2010 through December 31, 2010, respectively.

The Company subleased a portion of its office space to an unaffiliated party effective August 1, 2010. Rental income related to the sublease agreement was \$31,226 and \$13,011 for the year ended December 31, 2011 and for the period from June 17, 2010 through December 31, 2010, respectively.

Subsequent Event: The Company relocated to 245 Riverside Avenue, Suite 550, Jacksonville, Florida 32202, during this examination.

Reinsurance Intermediary Agreement

The reinsurance intermediary agreement with Lockton Re did not meet the requirements of Section 626.7492 (4) (5), Florida Statutes. **Subsequent Event:** The Company provided an amended contract with Lockton, Re during the examination. The amended contract met all of the requirements of Section 626.7492 (4) (5), Florida Statutes.

Independent Auditor Agreement

The Company contracted with an external independent CPA firm to perform the annual audit of its financial statements as required by Rule 69O-137.002 (7) (c), Florida Administrative Code.

INFORMATION TECHNOLOGY REPORT

Claude B. Granese, CPA of INS Services, Inc., performed an evaluation of the information technology and computer systems of the Company. Results of the evaluation were noted in the Information Technology Report provided to the Company.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, Florida Statutes.

STATE	Description	Par Value	Market Value
FL	Cash	\$ 250,000	\$ 250,000
TOTAL SPECIAL DEPOSITS		<u>\$ 250,000</u>	<u>\$ 250,000</u>

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2011, and the results of its operations for the year then ended as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."

MEDMAL DIRECT INSURANCE COMPANY

Assets

DECEMBER 31, 2011

	Per Company	Examination Adjustments	Per Examination
Bonds	\$4,200,082		\$4,200,082
Stocks:			
Common	815,888		815,888
Cash and Short-Term Investments	3,281,168		3,281,168
Interest and dividend income due & accrued	16,575		16,575
Agents' Balances:			
Uncollected premium	400,400		400,400
Net deferred tax asset	400,201		400,201
	<hr/>		
Totals	\$9,114,314	\$0	\$9,114,314
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MEDMAL DIRECT INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2011

	Per Company	Examination Adjustments	Per Examination
Losses	\$1,104,647		\$1,104,647
Loss adjustment expenses	293,662		293,662
Other expenses	136,986		136,986
Taxes, licenses and fees	19,304		19,304
Unearned premium	1,959,048		1,959,048
Advanced Premiums	198,390		198,390
Ceded Reinsurance Premiums Payable	(331,250)		(331,250)
<hr/>			
Total Liabilities	\$3,380,787	\$0	\$3,380,787
Common capital stock	\$7,000,000		\$7,000,000
Gross paid in and contributed surplus	0		0
Unassigned funds (surplus)	(1,266,473)		(1,266,473)
<hr/>			
Surplus as regards policyholders	\$5,733,527	\$0	\$5,733,527
<hr/>			
Total liabilities, surplus and other funds	\$9,114,314	\$0	\$9,114,314

MEDMAL DIRECT INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2011

Underwriting Income

Premiums earned		\$2,368,062
	Deductions:	
Losses incurred		\$1,000,391
Loss expenses incurred		444,618
Other underwriting expenses incurred		2,139,615
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		\$3,584,624
Net underwriting gain or (loss)		(\$1,216,562)

Investment Income

Net investment income earned		\$118,140
Net realized capital gains or (losses)		0
Net investment gain or (loss)		\$118,140

Other Income

Net gain or (loss) from agents' or premium balances charged off		\$0
Finance and service charges not included in premiums		0
Aggregate write-ins for miscellaneous income		31,227
Total other income		\$31,227
Net income before dividends to policyholders and before federal & foreign income taxes		(\$1,067,195)
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		(\$1,067,195)
Federal & foreign income taxes		0
Net Income		(\$1,067,195)

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$5,001,205
Net Income		(\$1,067,195)
Net unrealized capital gains or losses		14,948
Change in non-admitted assets		(78,878)
Change in net deferred income tax		363,447
Change in excess statutory over statement reserves		0
Surplus adjustments: Paid in		1,500,000
Aggregate write-ins for gains and losses in surplus		0
Examination Adjustment		0
Change in surplus as regards policyholders for the year		\$732,322
Surplus as regards policyholders, December 31 current year		\$5,733,527

A comparative analysis of changes in surplus is shown below.

MEDMAL DIRECT INSURANCE COMPANY
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2011

The following is a reconciliation of Surplus as regards policyholders between that reported by the Company and as determined by the examination.

Surplus as Regards Policyholders December 31, 2011, per Annual Statement	\$5,733,527
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS: No Adjustment			
LIABILITIES: No Adjustment			
Net Change in Surplus:			<u>0</u>
Surplus as Regards Policyholders December 31, 2011, Per Examination			<u><u>\$5,733,527</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$1,398,309

An outside actuarial firm appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2011, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office's consulting actuary, Robert W. Gardner, FCAS, MAAA of INS Consultants, Inc., reviewed the loss and loss adjustment expense work papers provided by the Company and he was in concurrence with this opinion.

Capital and Surplus

The amount of Capital and surplus reported by the Company of \$5,733,527 exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **MedMal Direct Insurance Company** as of December 31, 2011, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$5,733,527 which exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

In addition to the undersigned, John M. Romano, CPA, CFE, Examination Manager of ParenteBeard, LLC, participated in the examination. In addition, Dave J. Macesic, ACAS, MAAA and Robert W. Gardner FCAS, MAAA, consulting actuaries of INS Consultants, Inc., and Claude B. Granese, CPA, IT Supervisor, Sherese Mack, IT Examiner and Paul Berkebile, CISA, IT Manager, of INS Services, Inc., also participated in the examination.

Respectfully submitted,

Samita K. Lamsal,
Financial Examiner Analyst II
Florida Office of Insurance Regulation