

REPORT ON EXAMINATION
OF
PHYSICIANS INSURANCE COMPANY
POMPANO BEACH, FLORIDA

AS OF
DECEMBER 31, 2005

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

February 2, 2007

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, 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, 2005, of the financial condition and corporate affairs of:

PHYSICIANS INSURANCE COMPANY
3200 NE 14th Street
Pompano Beach, Florida 32605

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

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2005 through December 31, 2005. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2004, as a first complete year of business exam. This examination commenced with planning at the Office, on December 4, 2006, to December 8, 2006. The fieldwork commenced on December 11, 2006, and was concluded as of February 2, 2006. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

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.

In this examination, emphasis was directed to the quality, value and integrity of the statement assets and the determination of liabilities, as those balances affect the financial solvency of the Company.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio report, the A.M. Best Report, the Company's independent audit reports and certain work papers prepared by the Company's independent certified public accountant (CPA) were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the amounts of the Company's assets and liabilities as reported by the Company in its annual statement as of December 31, 2005. Transactions subsequent to year-end 2005 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which are deemed to require special explanation or description.

Status of Adverse Findings from Prior Examination

The following is a summary of adverse findings contained in the Office's prior examination report as of December 31, 2004, along with the resulting action taken by the Company.

Conflicts of Interest Statement

As of December 31, 2004, the Company did not adopt a policy statement of conflicts of interest requiring annual disclosure under Section 607.0832, Florida Statutes. **Resolution:** During the December 31, 2004 examination, the Company provided signed copies of the conflicts of interest statement by all of the Board of Directors listed on the Jurat page of the annual statement.

Audit Committee

The Board did not appoint an audit committee as required under Section 624.424(8)(c), Florida Statutes. **Resolution:** During the December 31, 2004 examination, the Board established an audit committee in accordance with Section 624.424(8)(c), Florida Statutes.

Fidelity Bond

The Company did not maintain the minimum suggested fidelity bond as required by the NAIC.

Resolution: The fidelity bond at December 31, 2005 was in compliance with the minimum requirements prescribed by the NAIC.

Accounts & Records

The scope paragraph of the actuarial opinion did not disclose the reserve for Ceded Unearned Premiums, the reserve for Direct Unearned Premiums and the reserve for Net Unearned Premiums as required by SSAP No. 65, paragraph 32. **Resolution:** All disclosures as required by SSAP No. 65, paragraph 32 were included in the 2005 actuarial opinion.

HISTORY

General

The Company was incorporated in Florida on January 31, 2003, under the laws of the State of Florida, as a stock property and casualty insurer and commenced business on March 7, 2003.

The Company issued approximately 51% (205,000 shares) of its outstanding common shares to Daniel R. O'Neal, an individual resident of the State of Florida. The remaining 49% (195,000 shares) of the Company's issued and outstanding common shares were issued to American Physicians Assurance Corporation (APA), a Florida-licensed property and casualty insurer domiciled in the State of Michigan.

On December 31, 2004, Mr. O'Neal acquired all of APA's 195,000 common shares in the Company for the purchase price of \$3,000,000 pursuant to a promissory note executed in favor of APA. Mr. O'Neal paid for these shares in monthly installments. Payment for these shares was secured under the note by Mr. O'Neal's shares of Company's stock pursuant to a stock pledge agreement.

The Office granted approval to Mr. O'Neal's Form "A" filing, with plans to acquire APA's common shares in the Consent Order No. 80862-05-CO, dated April 22, 2005.

The Company was authorized to transact Medical Malpractice business, in the State of Florida, and received a certificate of authority on February 26, 2003. As of August 31, 2005, the Company was issued a certificate of authority to write liability other than automobile in the State of Texas.

The Company's articles of incorporation and bylaws were amended on April 11, 2005 by revising the par value of the common stock from \$1.00 per share to \$2.50 per share.

Capital Stock

As of December 31, 2005, the Company's capitalization was as follows:

Number of authorized common capital shares	500,000
Number of shares issued and outstanding	400,000
Total common capital stock	\$1,000,000
Par value per share	\$2.50

Control of the Company was maintained by its owner, Daniel R. O'Neal, an individual and resident of Florida, who owned 100% of the stock issued by the Company.

Profitability of Company

The following table shows the probability trend (in dollars) of the Company for the period of examination, as reported in the filed annual statement of the Company.

	2005	2004	2003
Premiums Earned	3,462,161	2,305,664	610,563
Net Underwriting Gain/(Loss)	579,850	177,469	(742,412)

Net Income	476,227	235,379	(698,024)
Total Assets	11,680,849	9,599,529	6,600,632
Total Liabilities	6,614,419	4,996,678	2,185,307
Surplus As Regards Policyholders	5,066,430	4,602,851	4,415,325

Dividends to Stockholders

There were no dividends to stockholders declared by the board of directors during the period of examination.

Management

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, Florida Statutes. Directors serving as of December 31, 2005, were:

Directors

Name and Location

Principal Occupation

Daniel R. O'Neal, Chairman
Pompano Beach, FL

CEO of Physicians Insurance Company

Pamela N. Browning
Pompano Beach, FL

COO of Physicians Insurance Company

Rebecca M. Brocard-Santiago
Pompano Beach, FL

CFO of Physicians Insurance Company

Dennis M. Faulkner
Pompano Beach, FL

Chief Claims Officer of Physicians Insurance Company

Christopher J. Waterson
East Lansing, MI

VP of American Physicians Assurance Corp.

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

Senior Officers

Name	Title
Daniel R. O'Neal	CEO
Pamela N. Browning	COO
Rebecca M. Brocard-Santiago	CFO

The Company's board appointed an audit committee in accordance with Section 607.0825, Florida Statutes, as follows:

Audit Committee

Daniel R. O'Neal, Chairman

Christopher J. Waterson

Rebecca M. Brocard-Santiago

Conflict of Interest Procedure

The Company adopted a policy statement requiring annual disclosure of conflicts of interest, in accordance with the NAIC Financial Condition Examiners Handbook.

Corporate Records

The recorded minutes of the shareholders, Board of Directors and audit committee meeting were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, Florida Statutes.

The minutes of the board of directors recorded that the board established an audit committee as provided by Section 624.424(8) (c), Florida Statutes, and approved the Company's investments as required by Section 625.304, Florida Statutes.

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

There were no mergers, disposals, dissolutions, and purchase or sales through reinsurance during the period under examination. There was an acquisition of 195,000 common shares in the Company by Daniel R. O'Neal from APA on December 31, 2004.

Surplus Debentures

As of December 31, 2005, there were no outstanding surplus debentures of the Company.

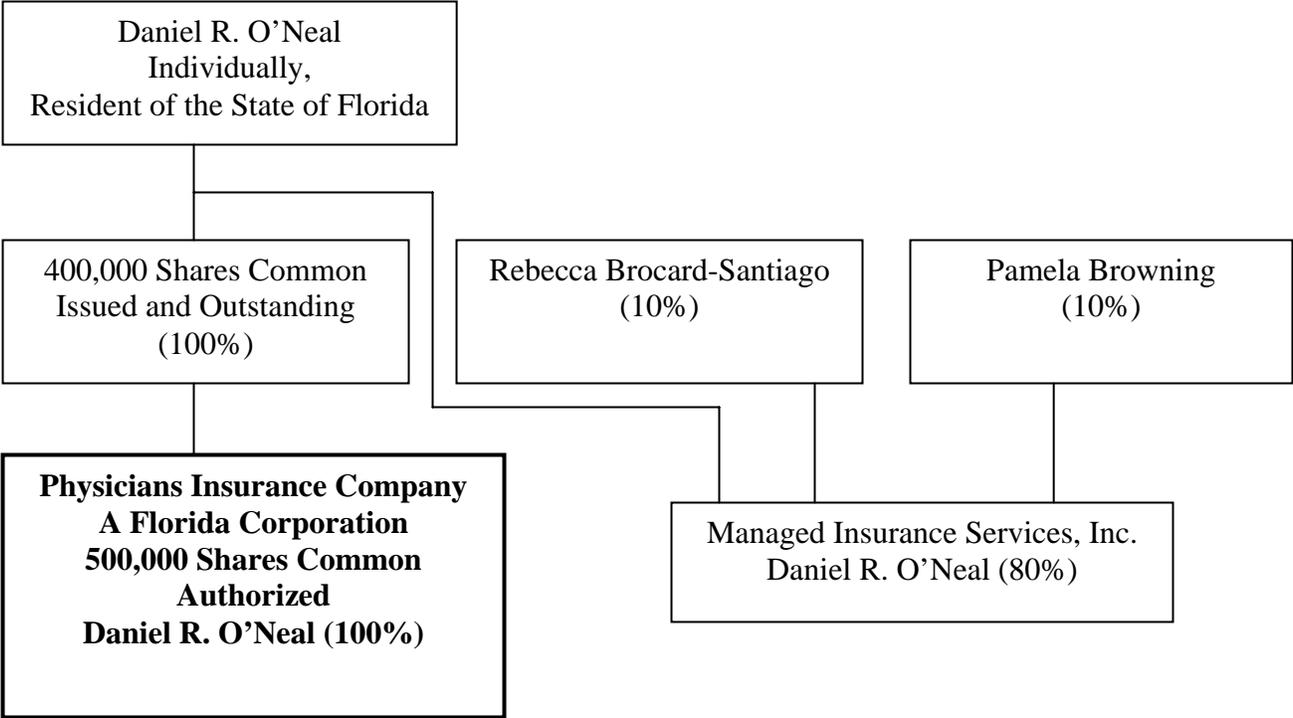
AFFILIATED COMPANIES

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 May 27, 2005. The Company disclosed 100% acquisition of common shares of American Physicians Insurance Company by Daniel O'Neal as required by Section 628.801, Florida Statutes and Rule 69O-143.046, Florida Administrative Code.

An organizational chart as of December 31, 2005, reflecting the holding company system, is shown below. Schedule Y of the Company's 2005 annual statement provided a list of all related companies of the holding company group.

**PHYSICIANS INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2005



FIDELITY BOND

The Company maintained fidelity bond coverage of \$500,000 per occurrence with a \$5,000 deductible per occurrence. The Company was a named insured on the fidelity bond. This policy adequately covered the \$175,000 suggested minimum amount of coverage for the Company recommended by the NAIC.

PENSION PLANS

Eligible employees were covered by a qualified defined contribution pension plan sponsored by the Company. The Company contributed up to 1% each year into this plan.

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	<u>\$ 280,365</u>	<u>\$ 280,365</u>
TOTAL FLORIDA DEPOSITS		<u>\$ 280,365</u>	<u>\$ 280,365</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory

The Company was licensed in the States of Florida and Texas. There was only a small volume of premium produced in Texas with over 99% coming from Florida.

Treatment of Policyholders

The Company had 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 626.954(1)(i) 3,a, Florida Statutes.

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 risk during the period covered by this examination.

Ceded

During 2005, the Company ceded \$5,101,828 in written premiums to the various reinsurers on an excess of loss basis through a reinsurance intermediary. The Company utilized three unauthorized reinsurers as listed on Schedule F-Part 5 of the annual statement. Letters of credit were adequately established for these reinsurers. Two of the reinsurers listed as authorized were not authorized to underwrite medical malpractice insurance of reinsurance in the State of Florida.

Subsequent Event:

Prior to the end of this examination, the Company received a copy of an amendment to the 2005 - 2006 reinsurance treaty changing the assuming company to the appropriate authorized reinsurer in the ACE group of insurance companies; and received a copy of the letter of credit from the unauthorized reinsurer for \$350,000 with an effective date of December 31, 2006.

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

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory basis financial statements annually for the years, 2004 and 2005, 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 maintained on a computerized system. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Office with one exception described below.

During 2005, the Company moved to its current address located in Pompano Beach, Florida. The Company maintained its principal operational offices in Pompano Beach, Florida, where this examination was conducted.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company had a custodial agreement with Northern Trust Bank dated March 25, 2003 which was amended on July 16, 2004 and then again on September 5, 2006. The agreement was in accordance with Rule 69O-143.042, Florida Administrative Code.

Office Lease Agreement

The office lease agreement was with DWV Real Property Inc., dated February 12, 2004. The agreement included the use of prescribed office space, parking facilities and the maintenance of said property.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2005, 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."

PHYSICIANS INSURANCE COMPANY
Assets

DECEMBER 31, 2005

	Per Company	Examination Adjustments	Per Examination
Bonds	\$5,481,656		\$5,481,656
Cash & Short-term investments	3,170,890		3,170,890
Investment income due and accrued	78,869		78,869
Agents' balances in the course of collection	2,734,373		2,734,373
Reinsurance recoverable	9,297		9,297
Net deferred tax asset	121,962		121,962
Electronic data processing equipment and software	83,802		83,802
Totals	<u>\$ 11,680,849</u>	<u>0</u>	<u>\$ 11,680,849</u>

PHYSICIANS INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2005

	Per Company	Examination Adjustments	Per Examination
Losses	\$ 1,679,805		\$ 1,679,805
Loss adjustment expenses	714,875		714,875
Commissions payable, contingent comms and other similar charges	283,998		283,998
Other expenses	37,953		37,953
Current federal and foreign income taxes	84,169		84,169
Unearned premiums	2,130,909		2,130,909
Advance premiums	75,623		75,623
Ceded reinsurance premiums payable	1,607,087		1,607,087
Provision for reinsurance	0		0
Total liabilities	\$ 6,614,419		\$ 6,614,419
Common capital stock	\$ 1,000,000		\$ 1,000,000
Gross paid in and contributed surplus	4,000,000		4,000,000
Unassigned surplus	66,430		66,430
Surplus as regards policyholders	5,066,430		5,066,430
Total liabilities, capital and surplus	<u>\$ 11,680,849</u>	<u>0</u>	<u>\$ 11,680,849</u>

PHYSICIANS INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2005

Underwriting Income	
Premiums earned	\$3,462,161
DEDUCTIONS:	
Losses incurred	847,001
Loss expenses incurred	819,046
Other underwriting expenses incurred	1,216,264
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$2,882,311</u>
Net underwriting gain or (loss)	\$579,850
Investment Income	
Net investment income earned	\$175,470
Net realized capital gains or (losses)	(1,682)
Net investment gain or (loss)	<u>\$173,788</u>
Other Income	
Net gain or (loss) from agents' or premium balances charged off	\$0
Finance and service charges not included in premiums	\$43,742
Aggregate write-ins for miscellaneous income	0
Total other income	<u>\$43,742</u>
Net income before dividends to policyholders and before federal & foreign income taxes	\$797,380
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	<u>\$797,380</u>
Federal & foreign income taxes	<u>321,153</u>
Net Income	\$476,227
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	\$4,602,851
Gains and (Losses) in Surplus	
Net Income	\$476,227
Change in net deferred income tax	46,847
Change in non-admitted assets	(59,495)
Change in provision for reinsurance	0
Capital changes: Paid in	600,000
Surplus adjustments: Paid in	(600,000)
Surplus adjustments: Transferred from capital	0
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>\$463,579</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$5,066,430</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Assets

Electronic data processing equipment and software \$83,802

The electronic data processing equipment and software purchased from 2003 through December 31, 2005 did not meet the criteria of an asset in accordance with Section 625.012(11), Florida Statutes, as all purchases individually were less than the \$25,000 minimum requirement. However, no adjustment was made by this examination to non-admit the \$83,802 which did not qualify as an admitted asset; because the \$83,802 was not material.

Liabilities

Losses and Loss Adjustment Expenses \$2,394,680

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, 2005, make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office actuary reviewed work papers provided by the Company and was in concurrence with this opinion.

Provision for Reinsurance \$0

The Company reported one reinsurer, XL Reinsurance America (XL Re), as authorized which had no approval to underwrite medical malpractice in Florida. XL Re did not provide collateral as required in Rule 69O-144.005 (4), Florida Administrative Code, for unauthorized reinsurers and as required by XL

Re's contract with the Company. On April 26, 2007, the Company entered into a Novation and Termination Addendum effective March 1, 2005, replacing XL Re with XL Insurance Company of New York; this eliminating the need for a \$715,000 provision for reinsurance.

A comparative analysis of changes in surplus is shown below.

**PHYSICIANS INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

DECEMBER 31, 2005

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 per December 31, 2005, Annual Statement	\$5,066,430
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
LIABILITIES:			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2005, Per Examination			\$5,066,430

SUMMARY OF FINDINGS

Current examination comments and corrective action

The following is a brief summary of items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2005.

Assets

The electronic data processing equipment and software purchased from 2003 through December 31, 2005 did not meet the criteria of an asset in accordance with Section 625.012(11), Florida Statutes, as all purchases individually were less than the \$25,000 minimum requirement. **We recommend that in all future filings, the Company record the asset for electronic data processing equipment in accordance with Section 625.012(11), Florida Statutes.**

Reinsurance

The Company reported one reinsurer, XL Re, as authorized which had no approval to underwrite medical malpractice in Florida. Also, XL Re did not provide collateral as required in Rule 69O-144.005(4), Florida Administrative Code, for unauthorized reinsurers and as required by XL Re's contract with the Company. Prior to the end of this examination, the Company's 2005-2006 reinsurance treaty with ACE was amended to change the assuming company to the appropriate authorized reinsurer in the ACE group of insurance companies; and a letter of credit effective December 31, 2006 was received from an unauthorized reinsurer. **We recommend that the Company ensure compliance in the future with Rule 69O-144.005 (4), Florida Administrative Code.**

SUBSEQUENT EVENTS

During 2006, the CFO position changed as Rebecca M. Brocard-Santiago resigned and Walter Brysh was hired as the new CFO.

Commutations were received for the various reinsurers to which the Company ceded business in 2005.

The Company entered into a managing general agency agreement on April 19, 2006 with an affiliate, Managed Insurance Services, Inc.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Physicians Insurance Company, Inc.** as of December 31, 2005, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's adjusted Surplus as regards policyholders was \$5,066,430, which was in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Richard Schaaf, Financial Specialist; Kethessa Carpenter, CPA, Financial Examiner/Analyst Supervisor; and Joseph Boor, FCAS, Actuary, participated in the examination.

Respectfully submitted,

Richard A. Shaffer
Financial Specialist
Florida Office of Insurance Regulation