

REPORT ON EXAMINATION
OF
PHYSICIANS PREFERRED INSURANCE
RECIPROCAL
JACKSONVILLE, FLORIDA

AS OF
DECEMBER 31, 2005

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

March 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 PREFERRED INSURANCE RECIPROCAL
9310 OLD KINGS ROAD, SUITE 702
JACKSONVILLE, FLORIDA 32257**

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

SCOPE OF EXAMINATION

This examination covered the period of August 27, 2004 through December 31, 2005. This is the first examination of the Reciprocal by representatives of the Florida Office of Insurance Regulation (Office). This examination commenced, with planning at the Office, on December 27, 2006, to December 29, 2006. The fieldwork commenced on January 8, 2007, and was concluded as of March 2, 2007. 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 Reciprocal.

The examination included a review of the corporate records and other selected records deemed pertinent to the Reciprocal's operations and practices. In addition, the NAIC IRIS ratio report, the Reciprocal's independent audit reports and certain work papers prepared by the Reciprocal'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 Reciprocal's assets and liabilities as reported by the Reciprocal in its annual statement as of December 31, 2005. Transactions subsequent to year-end 2005 were reviewed where relevant and deemed significant to the Reciprocal'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.

Based on the review of the Reciprocal's control environment and the materiality level set for this examination, reliance was placed on work performed by the Reciprocal's CPAs, after verifying the statutory requirements, for the following accounts

- Taxes, Licenses and Fees
- Net Deferred Tax Assets
- Current Federal and Foreign Income Tax Recoverable

HISTORY

General

The Reciprocal was organized in Florida on April 21, 2004 as a reciprocal insurer and commenced business on August 27, 2004 as Physicians Preferred Insurance Reciprocal. The Reciprocal is a non-assessable, unincorporated aggregation of subscribers governed by a Subscribers Advisory Committee (SAC), which is similar to a Board of Directors, and was comprised of at least two-thirds physician subscribers who were insured by the Reciprocal.

The Reciprocal was managed by its Attorney-in-Fact (AIF), Physicians Preferred Insurance Management, LLC. The AIF managed all of the operations of the Reciprocal and was owned by EMTZ 2, LLC (55%), James H. Barker, DO (12%), 2 Trusts (13%) and the remaining 20% by private investors none of which owned more than 10%. EMTZ 2, LLC was owned by Elliott Horovitz, Timothy R. Bone, Zachory R. Bushong, and Michael J. Wallace. EMTZ 2, LLC members were also officers of its AIF.

The Reciprocal was initially capitalized with a \$5 Million surplus note and was owned by the physicians and surgeons it insured. The Reciprocal collected a one time surplus contribution from new subscribers. The contribution may be paid over a three-year period, if requested by the subscriber. No distributions from subscribers savings account balances were made during the period covered by this examination.

The Reciprocal was party to Consent Order No. 77469-04-CO filed August 27, 2004 with the Office regarding the application for the issuance of a certificate of authority. One of the provisions of the consent order was that the Reciprocal was required to obtain written approval from the Office prior to making a payment on the surplus debenture note. This provision was in paragraph 10 of the consent order.

The Reciprocal did not obtain written approval from the Office before making the first payment on the surplus debenture note in January 2005. The Reciprocal requested approval on January 3, 2005, made payment on January 12, 2005, but did not receive written approval from the Office until January 18, 2005. All future payments were made after first receiving written approval from the Office.

In accordance with Section 624.401(1), Florida Statutes, the Reciprocal was authorized to transact medical malpractice insurance coverage in Florida on December 31, 2005.

Profitability of Reciprocal

The following table shows the profitability trend (in dollars) of the Reciprocal for the period of examination.

	2005	2004
Premiums Earned	4,872,989	146,715
Net Underwriting Gain/(Loss)	(657,447)	(912,944)
Net Income/(Loss)	(785,148)	(902,556)
Total Assets	13,418,484	6,858,524
Total Liabilities	7,934,542	1,485,328
Surplus As Regards Policyholders	5,483,944	5,373,196

Distribution of Savings

In accordance with Section 629.271, Florida Statutes, the Reciprocal did not declare or pay dividends to its subscribers in 2004 or 2005.

Management

The SAC meeting was held in accordance with the document entitled Powers of the Subscribers Advisory Committee. Subscribers' serving as of December 31, 2005, were:

Subscribers Advisory Committee Members

Name and Location	Principal Occupation
Timothy R. Bone Jacksonville, Florida	President, Physicians Preferred Insurance Reciprocal
Anthony L. Capasso, MD Jacksonville, Florida	Physician
Jeffrey S. Grove, DO Largo, Florida	Physician
Elliott S. Horovitz Jacksonville, Florida	CEO, Physicians Preferred Insurance Reciprocal
Kenneth M. Sekine, MD Jacksonville, Florida	Physician
Mark A. Wilstrup, MD Winter Park, Florida	Physician

The Reciprocal was managed by its AIF. The following were senior officers of the AIF:

Senior Officers

Name	Title
Timothy R. Bone	President
Elliott S. Horovitz	CEO
Howard B. Horovitz	Executive Vice President
Michael J. Wallace	CFO

The SAC appointed only two members, Anthony L. Capasso, MD and Kenneth M. Sekine, MD to serve on the audit committee. Section 624.424(8), Florida Statutes, requires at least three members to serve on the audit committee.

Subsequent Event

The SAC appointed Jeffrey S. Grove, DO, as the third member of the audit committee effective May 17, 2006.

Conflict of Interest Procedure

The Reciprocal adopted a policy statement requiring annual disclosure of conflicts of interest. No exceptions were noted during this examination period.

Corporate Records

The SAC did not maintain recorded minutes of their meetings on advice of counsel. As such, there was no documentation that the SAC approved Reciprocal transactions including the authorization of investments as required by Section 625.304, Florida Statutes.

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

As of December 31, 2005, there were no acquisitions, mergers, disposals, dissolutions, and purchase or sales through reinsurance.

Surplus Debentures

On August 24, 2004, the Reciprocal issued a surplus debenture in the amount of \$5 Million to the AIF in return for cash used to capitalize the Reciprocal. Terms of the note included interest rate of prime plus 1% per annum commencing January 1, 2005. The note indicated that repayments shall be made in minimum increments of \$250,000 with prior approval of the Office. During 2005, the Reciprocal paid \$2,150,000 in principal and \$327,138 in interest to the AIF. There was no documentation that the Reciprocal obtained approval from the Office prior to making the first payment on January 12, 2005 as required by paragraph 10 of Consent Order No. 77469-04-CO filed August 27, 2004.

As mentioned previously in the report, the surplus debenture note payment made in 2005 was made prior to written Office approval; however, all future payments were made after first receiving written approval from the Office.

Subsequent Event

The Reciprocal repaid \$1 Million in principle and \$0 interest payments during 2006.

AFFILIATED COMPANIES

This reciprocal insurer was owned by its subscribers. As such, there were no affiliated parties as defined by Rule 69O-143.045(1), Florida Administrative Code.

Subscribers Agreement

The Reciprocal maintained an agreement with each subscriber during the period covered by this examination. The subscriber or policyholder agreed to pay their premiums, compensate the AIF for its services and make a one time surplus contribution to the Reciprocal.

FIDELITY BOND AND OTHER INSURANCE

The Reciprocal maintained an AIF bond in the amount of \$100,000 in accordance with Section 629.121, Florida Statutes. The Reciprocal also maintained Directors and Officers (D&O), and Errors & Omissions (E&O) coverage with limits of \$1,000,000 and deductibles ranging from \$50,000 to \$150,000.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Reciprocal had no employees and therefore no pension, stock ownership or insurance plans.

STATUTORY DEPOSITS

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

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

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

At December 31, 2005, the Reciprocal was authorized to transact insurance only in the state of Florida.

Treatment of Policyholders

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

REINSURANCE

The Reciprocal did not maintain reinsurance for the period covered by this examination.

ACCOUNTS AND RECORDS

An independent CPA audited the Reciprocal'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 Reciprocal's accounting records were maintained on a computerized system. The Reciprocal's balance sheet accounts were verified with the line items of the annual statement submitted to the Office.

The Reciprocal maintained its principal operational offices in Jacksonville, Florida, where this examination was conducted.

The Reciprocal and non-affiliates had the following agreements:

Custodial Agreement

The Reciprocal maintained a custodial agreement with Mercantile Bank Trust Division effective March 22, 2005.

Attorney In Fact Agreement

The Reciprocal maintained an agreement appointing Physicians Preferred Insurance Management LLC, as AIF. The AIF provided administrative, claims underwriting and management of the day to day insurance business for remuneration.

Independent Auditor Agreement

The Reciprocal engaged Johnson Lambert & Co. for the purpose of annually auditing and reporting on the statutory basis financial statements at year-end.

Risk-Based Capital

The Reciprocal reported its risk-based capital at an adequate level.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Reciprocal'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 PREFERRED INSURANCE RECIPROCAL
Assets**

DECEMBER 31, 2005

	Per Company	Examination Adjustments	Per Examination
Bonds	\$6,019,175		\$6,019,175
Cash:			
On deposit	2,031,147		2,031,147
Short-term investments	4,578,242		4,578,242
Agents' Balances:			
Uncollected premium	119,021		119,021
Deferred premium	0		0
Interest and dividend			
income due & accrued	101,426		101,426
Federal income tax recoverable	130,041		130,041
Net deferred tax assets	418,091		418,091
Aggregate write-in for other than invested assets	21,341		21,341
Totals	\$13,418,484	\$0	\$13,418,484

PHYSICIANS PREFERRED INSURANCE RECIPROCAL
Liabilities, Surplus and Other Funds

DECEMBER 31, 2005

	Per Company	Examination Adjustments	Per Examination
Losses	\$2,129,108		\$2,129,108
Loss adjustment expenses	975,142		975,142
Other expenses	18,960		18,960
Taxes, licenses and fees	43,355		43,355
Unearned premium	4,204,528		4,204,528
Advanced premiums	<u>563,449</u>		<u>563,449</u>
Total Liabilities	\$7,934,542		\$7,934,542
Agg write-in for other than special surplus funds	\$3,903,557		\$3,903,557
Surplus notes	2,850,000		2,850,000
Unassigned funds (surplus)	<u>(1,269,613)</u>		<u>(1,269,613)</u>
Surplus as regards policyholders	<u>\$5,483,944</u>		<u>\$5,483,944</u>
Total liabilities, capital and surplus	<u>\$13,418,486</u>	<u>\$0</u>	<u>\$13,418,486</u>

PHYSICIANS PREFERRED INSURANCE RECIPROCAL
Statement of Income

DECEMBER 31, 2005

Underwriting Income	
Premiums earned	\$4,872,989
DEDUCTIONS:	
Losses incurred	2,288,086
Loss expenses incurred	1,016,926
Other underwriting expenses incurred	2,225,424
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$5,530,436</u>
Net underwriting gain or (loss)	(\$657,447)
Investment Income	
Net investment income earned	(\$77,415)
Net realized capital gains or (losses)	0
Net investment gain or (loss)	<u>(\$77,415)</u>
Other Income	
Total other income	\$0
Net income before dividends to policyholders and before federal & foreign income taxes	(\$734,862)
Dividends to policyholders	<u>0</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$734,862)
Federal & foreign income taxes	<u>50,286</u>
Net Income	(\$785,148)
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	\$5,373,196
Gains and (Losses) in Surplus	
Net Income	(\$785,148)
Net unrealized capital gains or losses	0
Change in non-admitted assets	(193,489)
Change in provision for reinsurance	0
Change in net deferred income tax	611,580
Change in surplus note	(2,150,000)
Change in aggregate write-ins for other than special surplus	2,627,805
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>\$110,748</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$5,483,944</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$3,104,250

An outside actuarial firm appointed by the SAC, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2005, made a reasonable provision for all unpaid loss and loss expense obligations of the Reciprocal under the terms of its policies and agreements.

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

**PHYSICIANS PREFERRED INSURANCE RECIPROCAL
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	\$5,483,944
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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:			0
Surplus as Regards Policyholders December 31, 2005, Per Examination			\$5,483,944

SUMMARY OF FINDINGS

Compliance with previous directives

This was a first year examination of the Reciprocal. There were no prior comments or directives issued by the Office.

Current examination comments and corrective action

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

Corporate Records

There was no documentation that the SAC approved transactions including the authorization of investments as required by Section 625.304, Florida Statutes. **We recommend the Reciprocal comply with Section 625.304, Florida Statutes, and fully document the SAC approval of Reciprocal transactions.**

SUBSEQUENT EVENTS

There have been a few changes to the management of the Reciprocal subsequent to the examination date. Mark A. Wilstrup, MD was removed from the SAC effective January 1, 2006. Michael J. Cohen, MD was appointed to the SAC effective October 9, 2006.

CONCLUSION

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

Per examination findings, the Reciprocal's Surplus as regards policyholders was \$5,483,944, which was in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned Carol A. McBrier, Financial Specialist, John C. Berry, Financial Examiner/Analyst Supervisor, and Joseph Boor, FCAS, Office Actuary, participated in the examination.

Respectfully submitted,

Kethessa Carpenter, CPA
Financial Examiner/Analyst Supervisor
Florida Office of Insurance Regulation