

REPORT ON EXAMINATION
OF
PHYSICIANS PREFERRED INSURANCE
RECIPROCAL
JACKSONVILLE, FLORIDA

AS OF
DECEMBER 31, 2006

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

November 9, 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 629, 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, 2006, 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 January 1, 2006 through December 31, 2006. The Reciprocal was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2005. This examination commenced, with planning at the Office, on August 23, 2007, to August 24, 2007. The fieldwork commenced on August 27, 2007, and was concluded as of November 9, 2007.

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 of assets and the determination of liabilities, as those balances affect the financial solvency of the Reciprocal as of December 31, 2006. Transactions subsequent to year-end 2006 were reviewed where relevant and deemed significant to the Reciprocal's financial condition.

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 reports, the Reciprocal's independent audit reports and certain work papers prepared by the Reciprocal's independent certified public accountant (CPA) and other reports as considered necessary 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, 2006. Transactions subsequent to year-end 2006 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.

Status of Adverse Findings from Prior Examination

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2005, along with resulting action taken by the Reciprocal in connection therewith.

Corporate Records

There was no documentation in the minutes that the Reciprocal's board of directors (Subscribers Advisory Committee) approved transactions including the authorization of investments as required by Section 625.304, Florida Statutes. **Resolution:** All transactions including the authorization of investments were approved by the Subscribers Advisory Committee (SAC) members during 2006.

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 SAC, which is similar to a Board of Directors. The SAC 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, D. O. (12%), 2 trusts (13%) and the remaining 20% by private investors none of which owned more than 10%. EMTZ 2, LLC is 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.

The Reciprocal was party to Consent Order 77469-04-CO filed August 27, 2004 with the Office regarding the application for the issuance of a certificate of authority. At December 31, 2006, the Reciprocal was in compliance with all of the provisions of this consent order.

The Reciprocal was authorized to transact medical malpractice insurance coverage in Florida on December 31, 2006.

The SAC charter was not amended during the period covered by this examination.

Profitability of Reciprocal

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

| | 2006 | 2005 | 2004 |
|----------------------------------|-------------|-------------|-------------|
| Premiums Earned | 10,876,572 | 4,872,989 | 146,715 |
| Net Underwriting Gain/(Loss) | (197,658) | (657,447) | (912,944) |
| Net Income | (96,559) | (785,148) | (902,556) |
| Total Assets | 25,227,370 | 13,418,484 | 6,858,524 |
| Total Liabilities | 16,061,401 | 7,934,542 | 1,485,328 |
| Surplus As Regards Policyholders | 9,165,969 | 5,483,944 | 5,373,196 |

Distribution of Subscribers Savings

The Reciprocal did not distribute from subscribers saving account balances in 2006.

Management

The annual SAC meeting was held in accordance with Section 629.201, Florida Statutes.

Subscribers serving as of December 31, 2006, were:

Subscribers Advisory Committee Members

Name and Location

Timothy R. Bone
Jacksonville, Florida

Anthony L. Capasso, M.D.
Jacksonville, Florida

Principal Occupation

President, Physicians Preferred
Insurance Reciprocal

Physician

| | |
|--|---|
| Jeffrey S. Grove, D.O. Largo, Florida | Physician |
| Elliott S. Horovitz Jacksonville, Florida | CEO, Physicians Preferred Insurance Reciprocal |
| Kenneth M. Sekine, M.D. Jacksonville, Florida | Physician |
| Michael J. Cohen, M.D. Orlando, Florida | Physician |

The SAC, in accordance with its charter, appointed the following senior officers:

Senior Officers

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

*Resigned as of October 2007 and was replaced by Zachory R. Bushong.

The Reciprocal's SAC members appointed an audit committee in accordance with Section 624.424(8), Florida Statutes. The following were the members of the audit committee as of December 31, 2006:

Audit Committee

Kenneth M. Sekine, M.D.
Anthony L. Capasso, M.D.
Jeffrey S. Grove, D.O.

Conflict of Interest Procedure

The Reciprocal 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 SAC meetings were reviewed for the period under examination. The recorded minutes of the SAC adequately documented its meetings and approval of Reciprocal transactions and events in accordance with Section 607.1601, Florida Statutes, 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, 2006, 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 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 2006, the Reciprocal paid \$1,500,000 in principal and \$247,520 in interest to AIF with approval of the Office.

Subsequent event: During the six months ended June 30, 2007, the Reciprocal paid the remaining principal balance of \$1,350,000 and interest of \$70,921 to the AIF with approval from the Office.

AFFILIATED COMPANIES

The Reciprocal was owned by its subscribers. As such, there were no affiliated parties as defined by 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.

ATTORNEY'S BOND, 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 along with the AIF maintained fidelity bond coverage with an aggregate limit of \$250,000 with a deductible of \$25,000, which adequately covered the suggested minimum amount of coverage as recommended by the NAIC.

The Reciprocal also maintained Directors and Officers, and Errors & Omissions coverage with limits of \$1,000,000.

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:

| STATE | Description | Par Value | Market Value |
|------------------------|-------------|-------------------|-------------------|
| 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

At December 31, 2006, the Reciprocal was authorized to transact insurance only in the state of Florida.

Treatment of Policyholders

The Reciprocal had not established procedures for handling written complaints in accordance with Section 626.9541(1)(j), Florida Statutes. **Subsequent event:** During the examination, the Reciprocal provided written procedures for handling written complaints in accordance with Section 626.9541(1)(j), Florida Statutes.

REINSURANCE

Assumed

The Reciprocal did not assume risk for the period covered by this examination.

Ceded

During 2006, the Reciprocal ceded risk in the amount of \$165,000, on an excess of loss basis to the various Lloyd's syndicates. The ceded reinsurance contract was reviewed by the Reciprocal's appointed actuary but was not utilized in determining the ultimate loss opinion.

ACCOUNTS AND RECORDS

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

An independent CPA audited the Reciprocal's statutory basis financial statements annually for the years 2004, 2005 and 2006, 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 and non-affiliates had the following agreements:

Custodial Agreement

The Reciprocal maintained a custodial agreement with Mercantile Bank Trust Division effective March 22, 2005. The agreement was in compliance with the requirements of Rule 69O-143.042, Florida Administrative Code.

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.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Reciprocal's financial position as of December 31, 2006, 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, 2006

| | Per Company | Examination Adjustments | Per Examination |
|--|---------------------|----------------------------|---------------------|
| Bonds | \$10,263,172 | | \$10,263,172 |
| Cash: | 13,780,486 | | 13,780,486 |
| Uncollected premium | 356,866 | | 356,866 |
| Interest and dividend income due & accrued | 161,011 | | 161,011 |
| Current federal & foreign income tax and affiliates | 665,835 | | 665,835 |
| | <hr/> | | |
| Totals | <u>\$25,227,370</u> | <u>\$0</u> | <u>\$25,227,370</u> |

PHYSICIANS PREFERRED INSURANCE RECIPROCAL
Liabilities, Surplus and Other Funds

DECEMBER 31, 2006

| | Per Company | Examination Adjustments | Per Examination |
|--|-------------------------|----------------------------|-------------------------|
| Losses | \$5,726,403 | | \$5,726,403 |
| Loss adjustment expenses | 2,577,648 | | 2,577,648 |
| Other expenses | 39,022 | | 39,022 |
| Taxes, licenses and fees | 109,583 | | 109,583 |
| Current federal & foreign income taxes | 301,526 | | 301,526 |
| Unearned premium | 6,498,676 | | 6,498,676 |
| Advance premium | <u>808,543</u> | | <u>808,543</u> |
| Total Liabilities | \$16,061,401 | | \$16,061,401 |
| Aggregate write-ins for other than special surplus funds | \$8,953,097 | | \$8,953,097 |
| Surplus notes | 1,350,000 | | 1,350,000 |
| Unassigned funds (surplus) | <u>(1,137,128)</u> | | <u>(1,137,128)</u> |
| Surplus as regards policyholders | <u>\$9,165,969</u> | | <u>\$9,165,969</u> |
| Total liabilities, surplus and other funds | <u>\$25,227,370</u> | \$0 | <u>\$25,227,370</u> |

PHYSICIANS PREFERRED INSURANCE RECIPROCAL
Statement of Income

DECEMBER 31, 2006

| Underwriting Income | | |
|--|--------------------|---------------------|
| Premiums earned | | \$10,876,572 |
| | Deductions: | |
| Losses incurred | | 5,155,296 |
| Loss expenses incurred | | 1,876,244 |
| Other underwriting expenses incurred | | 4,042,690 |
| Aggregate write-ins for underwriting deductions | | 0 |
| Total underwriting deductions | | <u>\$11,074,230</u> |
| Net underwriting gain or (loss) | | (\$197,658) |
| Investment Income | | |
| Net investment income earned | | \$532,666 |
| Net realized capital gains or (losses) | | 0 |
| Net investment gain or (loss) | | <u>\$532,666</u> |
| Other Income | | |
| Total other income | | \$0 |
| Net income before dividends to policyholders and before federal & foreign income taxes | | \$335,008 |
| Dividends to policyholders | | 0 |
| Net Income, after dividends to policyholders, but before federal & foreign income taxes | | <u>\$335,008</u> |
| Federal & foreign income taxes | | <u>431,567</u> |
| Net Income | | (\$96,559) |
| Capital and Surplus Account | | |
| Surplus as regards policyholders, December 31 prior year | | \$5,483,944 |
| Net Income | | (\$96,559) |
| Change in net deferred income tax | | 324,511 |
| Change in non-admitted assets | | (95,467) |
| Change in surplus notes | | (1,500,000) |
| Change in surplus notes | | 0 |
| Surplus adjustments: Paid in | | 0 |
| Aggregate write-ins for gains and losses in surplus | | 0 |
| Examination Adjustment | | 5,049,540 |
| Change in surplus as regards policyholders for the year | | <u>\$3,682,025</u> |
| Surplus as regards policyholders, December 31 current year | | <u>\$9,165,969</u> |

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$8,304,051

An outside actuarial firm appointed by the SAC rendered an opinion that the amounts carried in the balance sheet as of December 31, 2006, made a reasonable provision for all unpaid loss and loss expense obligations of the Reciprocal under the terms of its policies and agreements.

L. J. Halliwell, LLC, the actuarial firm contracted by the Office, 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, 2006

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, 2006, per Annual Statement | \$9,165,969 |
|---|-------------|

| | <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, 2006, per Examination | | | \$9,165,969 |

SUMMARY OF FINDINGS

Compliance with previous directives

The Reciprocal has taken the necessary actions to comply with the comments made in the 2005 examination report issued by the Office.

Current examination comments and corrective action

There were no exceptions noted in the current examination as of December 31, 2006.

SUBSEQUENT EVENTS

The following changes have been made to the management of the Reciprocal subsequent to the examination date:

The Company received Office approval on October 16, 2007 to convert from a reciprocal to a stock company. It became a stock company on December 28, 2007. The name was changed to Physicians Preferred Insurance Company on December 21, 2007.

Mike Wallace, CFO resigned during the examination and was replaced by Zachory R. Bushong as CFO.

CONCLUSION

The 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, 2006, consistent with the insurance laws of the State of Florida.

Per examination findings, the Reciprocal's Surplus as regards policyholders was \$9,165,969 in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Michael Hampton, CFE, CPA, DABFA, CFE, CPM Financial Examiner/Analyst Supervisor, participated in the examination. We also recognize the participation of Leigh J. Halliwell, FCAS, MAAA, of L. J. Halliwell, LLC in the examination.

Respectfully submitted,

Samita Lamsal
Financial Examiner/Analyst II
Florida Office of Insurance Regulation