



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**NORTHWEST PHYSICIANS MUTUAL INSURANCE COMPANY  
SALEM, OREGON**

**NAIC COMPANY CODE 43583**

AS OF

DECEMBER 31, 2003

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January 10, 2005

Honorable Cory Streisinger, Director  
Department of Consumer and Business Services  
State of Oregon  
350 Winter Street NE, Room 440  
Salem, Oregon 97301-3883

Dear Director:

In accordance with your instructions and pursuant to ORS 731.300, we have examined the business affairs and financial condition of

**NORTHWEST PHYSICIANS MUTUAL INSURANCE COMPANY**  
**2965 Ryan Drive SE**  
**Salem, Oregon 97301**

**NAIC Company Code 43583**

hereinafter referred to as the "Company." The following report is respectfully submitted.

## **SCOPE OF EXAMINATION**

The examination of the Company was conducted as of December 31, 2003, covering the three year period then ended, and included a review of material transactions or events which occurred subsequent to the examination cut-off date and were noted during the examination.

The examination was conducted pursuant to ORS 731.300 and in accordance with procedures and guidelines prescribed by the National Association of Insurance Commissioners (NAIC) for the purpose of determining the Company's financial condition and ability to fulfill its obligations, the nature of its operations, and compliance with the insurance code. Accounting methods, internal control procedures, records and other supporting evidence were examined or tested by appropriate methods to the extent deemed necessary and appropriate for the type, volume and complexity of the accounting system and operations utilized by the Company. A review was also made of the corrective actions taken by the Company with respect to comments and/or recommendations in the previous financial report of examination as of December 31, 2000, by the Oregon Insurance Division.

In addition to the above, work papers were reviewed that were prepared by PricewaterhouseCoopers, the Company's independent auditors, in their audit of the Company's accounts for the year ended December 31, 2003. A portion of the auditors' work papers has been incorporated into our work papers and has been utilized in determining the scope and areas of emphasis in conducting the examination. Shawna Ackerman FCAS, MAAA, consulting Actuary for Pinnacle Actuarial Resources, Inc., represented the State of Oregon in this examination by evaluating reserves for losses and loss adjustment expenses.

A letter of representation attesting to the Company's compliance with Oregon laws relating to location of accounts and records, conducting the Company affairs in a nonhazardous

manner, and exercise of managerial control by a duly qualified and constituted Board of Directors was signed by and received from the chief executive officer.

### **COMPANY HISTORY**

The Company was incorporated on December 30, 1982, and received its Certificate of Authority to write property and casualty business (excluding workers' compensation) as a mutual insurer on November 23, 1983. On September 20, 1996, the Company received an amended Certificate of Authority, authorizing the Company to write property, casualty (including workers' compensation) and health coverages.

The initial surplus of the Company was provided through the sale of subordinated surplus notes to the original organizing physicians. As of the date of this examination, all of the original capital contributions have been paid back to the contributors in accordance with the requirements specified by DCBS.

During 2003, Company policyholders approved a surplus contribution plan requiring permanent surplus contributions from policyholders. All physician member policyholders of record on December 14, 2002, were required to make a surplus contribution ranging from \$3,600 to \$6,000 per policyholder depending on class of coverage and primary practice location. Physician member policyholders added after December 14, 2002 through December 31, 2005 are required to make a surplus contribution of \$3,600. The surplus contributions are due in 12-quarterly installments.

As of December 31, 2003, the Company had collected \$5,421,371 in surplus contributions. In addition, the Company recognized a surplus contribution receivable of \$822,663 in accordance with SSAP No. 72, which allows recognition of surplus contributions received in cash or readily marketable securities up to the filing of the statutory financial statements.

## MANAGEMENT AND CONTROL

### Board of Directors

Article 4.2 of the Company's Articles of Incorporation designates that the Board shall be comprised of not less than nine or more than fifteen members. The Company's Board met all of the requirements of ORS 732.305. As of December 31, 2003, a nine member Board of Directors governed the Company as follows:

<u>Name and Address</u>	<u>Principal Occupation</u>	<u>First Appointed</u>
William J. Gallagher, MD PO Box 13400 Salem, OR 97309	President & Chairman Orthopedic Surgery	1982
Robert F. Granatir, MD PO Box 2659 Salem, OR 97308	Treasurer Internal Medicine/Oncology	1985
Michael G. VanRonzelen, MD 875 Oak Street SE, #4010 Salem, OR 97301	Secretary General Surgery	1982
Raymond N. Englander, MD 1200 Hilyard Street, #S420 Eugene, OR 97401	Director Neurology	1985
Marc M. Iseri, MD PO Box L Ontario, OR 97914	Director Urology	1991
Ruth E. Medak, MD 4803 SW Humphrey Ct. Portland, OR 97221	Director Internal Medicine	1991
Eric S. Overland, MD 555 Black Oak Drive, #300 Medford, OR 97504	Director Pulmonary Diseases	1993
Eugene J. Uphoff, MD 541 NE 20 <sup>th</sup> Avenue, #210 Portland, OR 97232	Director Family Practice	1990
Lindsey W. Horenblas, MD 9205 SW Barnes Road Portland OR 97225	Director Emergency Medicine	1999

Elaine M. DiFederico, MD, resigned as a director on December 31, 2003. Dr. DiFederico ceased to be eligible to serve as director because she was no longer insured by the Company.

### Officers

Officers of the Company serving at December 31, 2003 were as follows:

<u>Officer</u>	<u>Office</u>
William Joseph Gallagher, MD	President
Michael George Vanronzelen, MD	Secretary
Robert Francis Granatir, MD	Treasurer
James Thomas Dorigan, Jr.	Chief Executive Officer
Robert Walter Sopke	Vice President - Finance
Douglas Murray Foley	Vice President - Marketing
Doris Elaine Perry*	Vice President - Underwriting
H. Dieter Zimmer	Vice President - Risk Management
Sandra Lynn Tunnell	Vice President - Claims

\* Doris Elaine Perry resigned as vice president of underwriting in February 2004.

### Parent, Subsidiaries and Affiliates

The Company is a member of an insurance holding company system. It has two wholly owned subsidiaries, NPMIC Insurance Agency Inc., and Quality Focus, Inc. Both are accounted for using the equity method. The Company registered one of the subsidiaries, NPMIC Insurance Agency, Inc., with the NAIC's Securities Valuation Office and elected to account for the investment on the audited GAAP equity method. At year-end the common stock of this company was carried at \$528,719. The principal business of NPMIC Insurance Agency, Inc., is selling general lines, life and health insurance. The investment in Quality Focus, Inc., is insignificant and is reflected as a nonadmitted asset for financial statement purposes.

### Intercompany Agreements

As of December 31, 2003, the Company operated under the following agreement with its affiliates as follows:

### **Consolidated Tax Agreement**

The Company files a consolidated income tax return with its subsidiaries. Under this agreement, the Company's income tax provision is calculated on a consolidated basis and its respective share of the liability is allocated on a separate return basis. The allocation method and terms of this agreement appear fair and reasonable. No exceptions were noted.

### **CONFLICT OF INTEREST**

The Company has an established policy that is stated in its Bylaws under Section 3.15 for disclosure of any material interest on the part of any director or officer which is in, or is likely to, conflict with official duties. All officers and directors annually completed a Conflict of Interest Statement. No exceptions were noted.

### **CORPORATE RECORDS**

#### **Board of Director Minutes**

In general, the review of 2000, 2001, 2002 and 2003 Board minutes indicated that the minutes support the transactions of the Company and the actions taken by its officers. In addition, the minutes indicated that the Board approves investments in accordance with the provisions of ORS 733.730 and ORS 733.740.

The Company's Bylaws define a quorum as a majority of the Board. A quorum was achieved at all of the meetings held from 2000 to 2003.

#### **Articles of Incorporation**

Since the last examination, the Articles of Incorporation were amended on December 12, 2002 with the following sentence being deleted from Section 3.4:

The policies of insurance issued by the Corporation shall not be assessable. Following the deletion, Section 3.4 of the Restated Articles of Incorporation read as follows: A member shall not be personally liable for the acts or debts of the Corporation.

Also, a new section 3.5 was added to the restated Articles of Incorporation that required insured physicians to pay surplus contributions over a three-year period to enable the Company to increase its surplus as regards to policyholders.

The Articles of Incorporation conformed with Oregon statutes.

### **Bylaws**

In 2003 the Company's Board unanimously passed two amendments to the Bylaws, which are stated below:

On April 16, 2003 the Board authorized the Company to amend the Bylaws to create an audit committee and to eliminate the finance committee.

On August 20, 2003 the Board voted to amend its Bylaws to permit directors to serve until age 65.

The Bylaws were not actually amended to reflect these changes as authorized by the Board.

As a result, **I recommend the Company amend its Bylaws to comply with the changes authorized by the Board. This recommendation is made in accordance with the NAIC Examiners Handbook and the provisions of ORS 731.302.**

### **Holding Company Registration Statement**

Insurance holding company registration statements were filed on behalf of the Company in accordance with the provisions of ORS 732.552, ORS 732.554, and Oregon Administrative Rule (OAR) 836-027-0020(1).

### **Statutory Deposit**

The Company maintains a deposit for workers' compensation with the Department of Consumer and Business Services in Oregon in the amount of \$550,000. The 2003 Oregon Special Schedule P reflects a required deposit of \$333,562.

### **TERRITORY AND PLAN OF OPERATION**

As of December 31, 2003, the Company was authorized to write property and casualty business in Alaska, California, Idaho, Hawaii, Montana, Nevada, Oregon, and Washington. The Company predominantly sells medical malpractice insurance to qualified physicians in Oregon, California and Idaho. The annual statement Schedule T shows the Company's direct premiums written distributed among these states as follows:

<b><u>State</u></b>	<b><u>Direct Premium Written</u></b>	<b><u>Percentage of Total Premium Written</u></b>
Oregon	\$27,758,928	74.2%
California	6,716,256	18.0%
Idaho	2,506,539	6.7%
Alaska	242,018	0.6%
Washington	<u>198,026</u>	<u>0.5%</u>
Total	<u>\$37,421,767</u>	<u>100.0%</u>

The Company did not write any business in Hawaii, Montana, or Nevada. The Company primarily markets its Oregon business on a direct basis. The majority of policies are sold through the Company's marketing department. It uses independent agents to market its products in other states. In 2003, approximately 95% of the medical malpractice insurance was written on a *Claims Made* basis. The Company was licensed to write workers' compensation policies in Oregon although it ceased writing workers' compensation policies in Oregon effective August 1, 2002.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company is covered for up to \$700,000 per occurrence against losses from acts of dishonesty and fraud by its employees. This fidelity bond coverage was found to meet the minimum coverage recommended by the NAIC. In addition, the Company is insured for directors' and officers' liability for losses up to \$7,500,000.

Other insurance coverage's in force at December 31, 2003, included commercial general liability, umbrella, property (including computer equipment), and workers' compensation. All coverage's appeared adequate as of December 31, 2003.

### **RETIREMENT PLANS AND OTHER POST RETIREMENT BENEFITS**

The Company offers the following benefits to its employees.

#### **Retirement Plan**

The Company has a defined contribution pension plan available to all employees after six months of service. The retirement plan is qualified under section 401(k) of the Internal Revenue Code. The plan provides for the Company to match 50% of employee contributions up to 3% of each participating employee's salary. In addition, the Company may make voluntary contributions to the plan. No exceptions were noted in the examination of the Company's retirement plan.

#### **Postretirement Benefits**

The Company does not offer postretirement benefits other than pensions.

#### **Deferred Compensation**

The Company sponsors a deferred compensation plan covering its chief executive officer (CEO). Under the plan provisions, deferred compensation is deposited into a trust account maintained in the name of the employee. Benefits from the trust are payable when the CEO reaches age 60 or upon the termination of employment. The right to receive a distribution is an unsecured claim against the general assets of the Company. Both parties signed the deferred compensation agreement on April 19, 1995.

## GROWTH OF THE COMPANY

The growth of the Company since the last financial examination is reflected in the following schedule. The stated amounts were derived from Company's filed annual statements, except in those years where a triennial report of examination has been prepared by the Oregon Insurance Division.

<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Surplus and Other Funds</u>	<u>Net Income (Loss)</u>
2000*	\$62,793,845	\$43,273,842	\$19,520,003	\$(2,820,063)
2001	61,688,652	49,813,715	11,874,937	(12,464,936)
2002	62,452,208	55,196,826	7,255,382	(5,941,743)
2003*	75,697,728	71,034,105	4,663,623	(9,312,505)

\*Per examination

The negative earnings reduced surplus by more than 76% over the period under examination.

The decrease in surplus is primarily attributable to the Company adverse claims experience.

Please see the following section on loss experience.

## LOSS EXPERIENCE

The following exhibit reflects the annual underwriting results of the Company since 2000.

The stated amounts were compiled from copies of the Company's filed annual statements and, where indicated, from the current and previous examination reports.

<u>Year</u>	(1) <u>Premium Earned</u>	(2) <u>Losses Incurred and LAE Incurred</u>	(3) <u>Other Underwriting Expenses Incurred</u>	(2)+(3)/(1) <u>Ratio</u>
2000*	\$12,406,612	\$19,327,880	\$3,081,334	181%
2001	13,074,831	25,407,638	3,353,810	221
2002	18,804,607	21,882,224	3,266,692	134
2003*	22,191,677	30,847,446	3,239,110	154

\*Per examination

The Company's combined losses incurred and LAE exceeded 100% of premiums earned for the last four years covered by this examination. The Company has instituted a surplus contribution requirement from policyholders, substantial premium rate increases, a surcharge on certain policyholders, and implemented stricter underwriting guidelines on new and renewal business during this period in order to reverse this trend.

### **REINSURANCE**

The Company's reinsurance coverages are obtained through General Reinsurance Corporation. The Company's reinsurance program is comprised of excess of loss, quota share, clash, and facultative coverage.

#### **Casualty Business**

The Company's casualty business, primarily medical malpractice, is reinsured through two layers of excess of loss agreement through General Reinsurance Corporation. The agreement provide the following limits and retention's:

<b><u>Coverage Line</u></b>	<b><u>Company Retention</u></b>	<b><u>First Excess Cover</u></b>	<b><u>Second Excess Cover</u></b>
Medical Professional Liability	\$400,000 each occurrence	\$600,000 per occurrence	\$4,000,000 per occurrence
Personal Umbrella Liability	\$400,000 each occurrence	\$600,000 per occurrence	\$4,000,000 per occurrence

Reinsurance contracts for the first excess casualty layer provide for subsequent annual adjustment of ceding premiums based on the Company's loss experience. Management adjusts ceded premium quarterly based on its best estimate of loss experience development.

In addition, the reinsurer provides additional reinsurance to the Company for 80% of loss in excess of policy limits and/or extra contractual obligations in excess subject to an annual aggregate limit of \$2,000,000 effective during the annual period. Also, the Company is party

to a *Medefense* quota share reinsurance agreement whereby it cedes 80% of its premiums and losses for its physicians billing errors and omissions defense coverage. The policy is limited to \$25,000 per claim with a \$1,000 deductible.

### **Workers' Compensation and Employers Liability**

General Reinsurance Corporation reinsures the Company's workers' compensation and employers' liability business. The excess of loss reinsurance covers losses for \$5,000,000 (\$10,000,000 aggregate) per occurrence in excess of \$250,000.

### **Facultative Reinsurance**

In addition to treaty coverage, the Company has entered into facultative arrangements to cede certain risks in excess of \$5,000,000 for its medical malpractice business.

### **Risk Retention**

The highest risk the Company retains on any one insured is \$400,000. As such, the Company does not retain risk on any one subject in excess of 10% of its surplus as regards policyholders and therefore complies with the provisions of ORS 731.504.

### **Insolvency Clauses**

All reinsurance agreements contained an insolvency clause that specified payments would be made to a statutory successor without diminution in the event of insolvency.

## **ACCOUNTS AND RECORDS**

In general, the Company's records and source documentation supported the amounts presented in the December 31, 2003, annual statement and were maintained in a manner by which the financial condition was readily verifiable as required by ORS 733.170. All disbursements in excess of \$100 were supported by signed vouchers or related documents as required by ORS 732.320. However, attention is directed to the following issues:

### *Uncashed Checks*

The Company reported stale dated checks as an offset to cash as well as a liability under amounts withheld for accounts of others. Per the NAIC Annual Statement Instructions (page 67) “Aggregate write-ins for liabilities shall include uncashed drafts and checks that are pending escheatment to a state.” As a result, **I recommend the Company classify outstanding checks which have been outstanding over one year as an aggregate write-in for other liabilities, rather than as an offset against cash. This recommendation is made pursuant to ORS 731.574. It was also noted that most of these checks were unclaimed for more than three years and reportable to the Oregon Division of State Lands. As a result, I recommend the Company comply with the provisions of ORS 98.342 and OAR 141-045-0021.**

### **COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS**

The Company has taken corrective action with all recommendations made in the 2000 report of examination.

1. I recommend key personnel sign conflict of interest statements at least annually. This recommendation is made in accordance with the NAIC Examiners Handbook and the provisions of ORS 731.302.

The Company’s key personnel signed conflict interest statements annually during the three-year period without exception.

2. I recommend the Company complete annual statement Schedule E in accordance with the NAIC Annual Statement Instructions for Property and Casualty. The provisions of ORS 731.574 support this recommendation.

The Company complied with the recommendation and properly reported cash and cash equivalents in annual statement Schedule E.

3. I recommend the liability for losses be increased by \$4,037,000. This amount consists of a \$2,491,000 increase in the estimate for losses and allocated loss adjustment expense and \$1,646,000 for the swing rating adjustment. The liability for loss adjustment expenses should be decreased by \$110,000.

The Company complied with this recommendation by recording increase in losses and loss adjustment expense in the third quarter 2001.

4. I recommend that DCBS conduct a target examination of the Company as of December 31, 2001.

A target examination as of June 30, 2002, was conducted that included a review of reserves, premiums and deferred taxes. An additional upward loss and loss adjustment expense reserve adjustment of \$707,000 was booked by the Company as a result of the target examination.

**NORTHWEST PHYSICIANS MUTUAL INSURANCE COMPANY**  
**BALANCE SHEET**  
**As of December 31, 2003**

<b><u>ASSETS</u></b>	<b><u>Per Company</u></b>	<b><u>Examination Adjustments</u></b>	<b><u>Per Examination</u></b>
Bonds (Note 1)	\$46,378,428	\$	\$46,378,428
Common stock	4,254,283		4,254,283
Real estate	1,268,063		1,268,063
Cash & short-term investments (Note 3)	5,446,708	7,635	5,454,343
Premiums & agents balances in course or collection	2,140,661		2,140,661
Investment income due and accrued	576,716		576,716
Premiums, agents' balances and installments booked but deferred	12,553,082		12,553,082
Reinsurance recoverables	1,062,456		1,062,456
Net deferred tax asset	818,069		818,069
Guaranty funds receivable or on deposit	116,992		116,992
Electronic data processing equipment	61,175		61,175
Aggregate write-ins	<u>1,013,460</u>	<u>0</u>	<u>1,013,460</u>
Total Assets	<u>\$75,690,093</u>	<u>\$ 7,635</u>	<u>\$75,697,728</u>
 <b><u>LIABILITIES</u></b>			
Losses (Note 2)	\$33,723,561	\$488,628	\$34,212,189
Loss adjustment expenses (Note 2)	13,672,053	268,296	13,940,349
Commissions payable, contingent commissions and other similar charges	267,845		267,845
Other expenses	110,698		110,698
Taxes, licenses and fees	3,841		3,841
Unearned premium	14,578,476		14,578,476
Advance premiums	325,371		325,371
Ceded reinsurance premiums payable	7,373,211		7,373,211
Amounts withheld or retained by company for account of others (Note 3)	7,621	(7,621)	
Provision for reinsurance	16,072		16,072
Aggregate write-ins liabilities (Note 3)	<u>190,797</u>	<u>15,256</u>	<u>206,053</u>
Total Liabilities	<u>70,269,546</u>	<u>764,559</u>	<u>71,034,105</u>
 <b><u>SURPLUS AND OTHER FUNDS</u></b>			
Aggregate write-ins for other than special surplus funds	6,963,617		6,963,617
Unassigned funds	<u>(1,543,070)</u>	<u>(756,924)</u>	<u>(2,299,994)</u>
Total Surplus and Other Funds	<u>5,420,547</u>	<u>(756,924)</u>	<u>4,663,623</u>
Total Liabilities, Surplus and Other Funds	<u>\$75,690,093</u>	<u>\$ 7,635</u>	<u>\$75,697,728</u>

**NORTHWEST PHYSICIANS MUTUAL INSURANCE COMPANY**  
**UNDERWRITING AND INVESTMENT EXHIBIT**  
**STATEMENT OF INCOME**  
**For the Year Ended December 31, 2003**

<b><u>UNDERWRITING INCOME</u></b>	<b><u>Per Company</u></b>	<b><u>Examination Adjustments</u></b>	<b><u>Per Examination</u></b>
Premiums earned	\$22,191,677	\$ 0	\$22,191,677
Deductions:			
Losses incurred	16,290,738	488,628	16,779,366
Loss expense incurred	13,799,785	268,296	14,068,081
Other underwriting expenses incurred	3,239,110	0	3,239,110
Total Underwriting Deductions	<u>33,329,633</u>	<u>756,924</u>	<u>34,086,557</u>
Net Underwriting Gain or Loss	<u>(11,137,956)</u>	<u>(756,924)</u>	<u>(11,894,880)</u>
 <b><u>INVESTMENT INCOME</u></b>			
Net investment income earned	1,757,728		1,757,728
Net realized capital gains or (loss)	<u>781,486</u>	<u>0</u>	<u>781,486</u>
Net Investment Gain or Loss	<u>2,539,214</u>	<u>0</u>	<u>2,539,214</u>
 <b><u>OTHER INCOME</u></b>			
Aggregate write-ins for miscellaneous income	<u>6,261</u>	<u>0</u>	<u>6,261</u>
Net income before Federal taxes	(8,592,481)	(756,924)	(9,349,405)
Federal income taxes incurred	<u>(36,900)</u>	<u>0</u>	<u>(36,900)</u>
Net Income	<u>\$(8,555,581)</u>	<u>\$(756,924)</u>	<u>\$(9,312,505)</u>
 <b><u>SURPLUS ACCOUNT</u></b>			
Surplus as regards policyholders, prior year	<u>\$ 7,255,382</u>	<u>\$ 0</u>	<u>\$7,255,382</u>
Net income	(8,555,581)	(756,924)	(9,312,505)
Net unrealized capital gains or (losses)	514,420		514,420
Change in net deferred income tax	372,216		372,216
Change in nonadmitted assets	(393,852)		(393,852)
Change in provision for reinsurance	(16,072)		(16,072)
Aggregate Write-ins for and losses in surplus	<u>6,244,034</u>	<u>0</u>	<u>6,244,034</u>
Change in surplus as regards policyholders for the year	<u>(1,834,835)</u>	<u>(756,924)</u>	<u>(2,591,759)</u>
Surplus as regards policyholders, current year	<u>\$ 5,420,547</u>	<u>\$(756,924)</u>	<u>\$4,663,623</u>

## NOTES TO FINANCIAL STATEMENTS

### Note 1 - Bonds

Investments in bonds represented approximately 61% of the total admitted assets of the Company at December 31, 2003. The Company's bond portfolio was primarily comprised of high quality investments in industrial and government bonds with maturities distributed between 1 to 20 years. The Company did not have any investments in low-grade bonds. A quality distribution of the Company's bonds is presented below:

<u>Year</u>	<u>(1)</u> <u>Book/Adjusted</u> <u>Carrying Value</u>	<u>(2)</u> <u>Fair Value</u> <u>Securities</u>	<u>(3)</u> <u>Medium and Low</u> <u>Grade Securities*</u>	<u>(3/1)</u> <u>Percent of</u> <u>Portfolio</u>
2000	\$37,866,670	\$38,599,456	0	0.00%
2001	36,694,376	38,091,424	0	0.00%
2002	32,686,147	34,225,150	0	0.00%
2003	46,378,428	47,128,658	0	0.00%

\*Medium grade is defined by the NAIC as those securities with a NAIC Securities Valuation Office rating of "3." SVO designations of "4" to "6" are considered low investment grade.

### Note 2 - Losses and Loss Adjustment Expenses (LAE)

Pinnacle Actuarial Resources, Inc., was retained by the Oregon Department of Consumer Business Services Insurance Division (DCBS) to review the gross and net loss and loss adjustment expense reserves of Northwest Physicians Mutual Insurance Company as of December 31, 2003. As required by the Statement of Work, they provided a point estimate of the loss reserves to compare to the reserves recorded by the Company to conclude whether the recorded reserves are reasonable. Pinnacle's actuarial report included the following recommendation:

On a net basis Northwest Physicians Mutual Insurance Company's carried reserve is approximately 1.5% less than our estimate. We believe this is within a reasonable range of acceptable estimates. In other words, a reasonable range based on differences in assumption would create a range that contains the NPMIC's carried reserves. Nevertheless, the Statement of Work requires a point estimate, which we have provided. The difference in our point estimate as compared to year ending adjusted capital is 14% which represents a material risk.

The table below shows the actuarial adjustments by loss reserve component:

	<u><b>NPMIC</b></u>	<u><b>Examination</b></u>	<u><b>Difference</b></u>
Total Reviewed Segments	\$45,458,000	\$45,942,628	(\$484,628)
ULAE Reserve	1,845,000	2,113,296	(268,296)
DD&R Reserve	4,604,000	4,608,000	(4,000)
Non-reviewed Segments	<u>93,000</u>	<u>93,000</u>	<u>0</u>
Total	<u>\$52,000,000</u>	<u>\$52,756,924</u>	<u>\$756,924</u>

ULAE = Unallocated Loss Adjustment Expense  
DD&R = Death, Disability & Retirement Reserve

The complete actuarial report is contained in the examination work papers.

**Note 3 – Stale Dated Checks**

As discussed in the accounts records section of this report, cash and amounts withheld for the account of others included stale dated checks that should be reported under aggregate write-ins for other liabilities in accordance with the Annual Statement Instructions Property and Casualty. As a result, aggregate write-ins for the account of others was increased by \$15,256 and cash was increased and amounts withheld for account others was decreased by \$7,635 and \$7,621, respectively.

**SUMMARY OF COMMENTS AND RECOMMENDATIONS**

Page

- 9 I recommend the Company amend its Bylaws to include changes authorized by its Board. This recommendation is supported by ORS 731.302.
  
- 15 I recommend the Company classify outstanding checks which have been outstanding over one year as an aggregate write-in for other liabilities, rather than as an offset against cash. This recommendation is made pursuant to ORS 731.574. I also recommend that checks outstanding for more than three years be escheated to the Oregon Division of State Lands in compliance with the provision of ORS 98.342 and OAR 141-045-0021.
  
- 19 I recommend the liability for losses and loss adjustment expense be increased by \$756,924. This amount consists of a \$488,628 increase in the estimate for losses and \$268,296 in unallocated loss adjustment expenses.

## CONCLUSION

During the three year period covered by this examination, the surplus of the Company has decreased from \$19,520,003 as presented in the December 31, 2000 report of examination to \$4,663,623 as shown in this report of examination. The comparative assets and liabilities are shown below:

	<u>2003</u>	<u>December 31,</u> <u>2000</u>	<u>Change</u>
Assets	\$75,697,728	\$62,793,845	\$12,903,883
Liabilities	<u>71,034,105</u>	<u>43,273,842</u>	<u>27,760,263</u>
Surplus	<u>\$ 4,663,623</u>	<u>\$19,520,003</u>	<u>\$(14,856,380)</u>

The Company has suffered a substantial decrease of its surplus in the last few years due to adverse development on its medical malpractice business. In 2002, the Company became subject to the Company Action requirements under the Oregon Administrative Rules for Risk Based Capital (RBC). The Company filed an original action plan with the Insurance Division which included increasing rates, instituting a moratorium on accepting new policyholders practicing in certain classes and specialties, increasing the cost of reporting endorsements, and implementing a surplus contribution plan whereby physician member policyholders are required to make surplus contributions based on their class of coverage and primary practice.

Even with this recent action plan, at December 31, 2003, the Company's total adjusted capital was within the authorized control level based on the risk-based capital calculation required by the Insurance Division. The Company's management met with Insurance Division management to discuss their 2003 results and their plan of action. The Company filed a RBC plan with the Insurance Division on April 9, 2004.

## SUBSEQUENT EVENTS

During 2004, the Company amended its certificate of authority to eliminate its ability to write certain lines of insurance in certain states. This resulted in a lower capital and surplus requirement in these states. The Company currently complies with the minimum surplus requirements of each state in which it is authorized. The Company surrendered its Certificate of Authority in the State of Hawaii.

The Company initiated the following actions in 2004 in response to negative operating results and deteriorating financial condition:

- 1) Instituted a moratorium on new business except physicians joining practices currently insured by the Company.** The Company will reevaluate its business by territory and specialty to determine the types of risks it should insure in the future before adding additional policyholders.
- 2) Implemented rate increases.** The Company requested significant rate increases for 2004 which were approved in Oregon, California, and Idaho.
- 3) Retained a new independent actuary to review pricing and loss results by specialty and geographic area.** The Company contracted with a new actuary to review its pricing by specialty and territory. The Company implemented rate increases, where appropriate.
- 4) Target patient safety initiatives.** The Company held several symposiums during 2004.
- 5) Develop and implement a plan for reducing allocated loss adjustment expenses.** The cost of defending cases, including legal fees, expert witnesses, trial preparation and court costs have increased at a rate far faster than inflation. The Company has developed a plan for controlling these costs.
- 6) Continue ongoing review of operating budget to ensure that operations are efficient.**
- 7) Dispose of common stock portfolio.** On March 29, 2004, the Company sold its nonaffiliated common stock.

**8) Amended its certificates of authority to eliminate certain lines of authority to reduce its minimum capital and surplus requirements.** The Company initiated action in various states to reduce its authority to write certain lines of insurance. In Oregon, the Company amended its Certificate of Authority to eliminate the authority to write workers' compensation, health and property insurance. The Company's statutory minimum capital and surplus was reduced from \$5,000,000 to \$2,500,000. The Company made similar amendments in other states and withdrew from the State of Hawaii in which it had written no business.

In addition to the above actions, the Company contracted with an independent actuary to determine the adequacy of its loss and loss adjustment expense reserves as of June 30, 2004. This actuary found the Company's loss and loss adjustment expense reserves to be deficient. The Company increased its reserves during the third and fourth quarter accordingly. As a result of this reserve strengthening during the third and fourth quarter, no additional reserve adjustment will be necessary as a result of this examination.

As of September 30, 2004, based on the Company's filed statutory financial statements, the Company complies with the minimum capital and surplus requirements of the states in which it is authorized to transact insurance.

## ACKNOWLEDGMENT

The cooperation and assistance extended by the officers and employees of the Company during the examination process are gratefully acknowledged.

In addition to the undersigned, Mark Giffin, CFE, Ray Anderson, insurance examiners for the State of Oregon, Department of Consumer and Business Services, Insurance Division, and Shawna Ackerman, FCAS, MAAA, Property and Casualty Actuary for Pinnacle Actuarial Resources, Inc., participated in the examination.

Respectfully submitted,

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David L. Daulton, CFE  
Supervising Insurance Examiner  
Insurance Division  
Department of Consumer and Business Services  
State of Oregon

**AFFIDAVIT**

STATE OF OREGON            )  
  )  ss  
County of Marion            )

David L. Daulton, CFE, being duly sworn, deposes and says the preceding report of financial examination as of December 31, 2003, of Northwest Physicians Mutual Insurance Company, Salem, Oregon, subscribed by him is true and correct to the best of his knowledge and belief.

\_\_\_\_\_  
David L. Daulton, CFE  
Supervising Insurance Examiner  
Insurance Division  
Department of Consumer and Business Services  
State of Oregon

Subscribed and sworn to before me this \_\_\_\_\_ day of \_\_\_\_\_, 2005.

\_\_\_\_\_  
Notary Public for the State of Oregon