<u>REPORT ON EXAMINATION</u>

<u>OF THE</u>

<u>HOSPITALS INSURANCE COMPANY, INC.</u>

<u>AS OF</u>

<u>DECEMBER 31, 2009</u>

<u>DATE OF REPORT</u>	<u>NOVEMBER 22, 2010</u>
<u>EXAMINER</u>	<u>KAREN GARD</u>

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

November 22, 2010

Honorable James J. Wrynn
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 30453, dated December 14, 2009 and attached hereto, I have made an examination into the condition and affairs of Hospitals Insurance Company, Inc. as of December 31, 2009, and submit the following report thereon.

Wherever the designation the "Company" appears herein without qualification, it should be understood to indicate Hospitals Insurance Company, Inc.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

The examination was conducted at the Company's home office located at 50 Main Street, White Plains, New York 10606.

1. SCOPE OF EXAMINATION

The Department has performed a single-state examination of Hospitals Insurance Company, Inc. This examination covered the five-year period from January 1, 2005 through December 31, 2009. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners ("NAIC") Financial Condition Examiners Handbook ("Handbook"), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. The examiners also relied upon audit work performed by the Company's independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Financial Condition Examiners Handbook of the NAIC:

Significant subsequent events
Company history
Corporate records
Management and control
Fidelity bonds and other insurance
Pensions, stock ownership and insurance plans
Territory and plan of operation
Growth of Company
Loss experience
Reinsurance
Accounts and records
Statutory deposits
Financial statements
Summary of recommendations

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

2. DESCRIPTION OF COMPANY

Hospitals Insurance Company, Inc. was incorporated under the laws of the State of New York on January 14, 1987, under the name HANYS Insurance Company, Inc. The Company became licensed on July 31, 1987 and commenced business on August 1, 1987.

Pursuant to its original charter, the Company was authorized to issue 375,000 shares of voting "Class A" common stock, and 375,000 shares of voting "Class B" common stock, each at a par value of $1 per share. Class A and Class B common shares were identical with the exception that Class A shareholders could elect seven members of the board of directors, and Class B shareholders could elect eight members. On December 18, 1987, the Company's board of directors passed a resolution to amend the Company's charter to authorize the issuance of 100,000 new, non-voting "Class C" common stock, with a par value of $3 per share. The charter amendment was approved by the Department on March 12, 1991.

On December 16, 1994, the Company's board of directors passed a resolution to amend the Company's charter to authorize the issuance of up to 100,000 shares of non-voting, preferred stock, at a par value of $0.10 per share, for a price of $400 per share. The board of directors further approved, and the Company issued, 75,000 shares of this preferred stock, in 1995, to HANYS Member Hospitals Self Insurance Trust ("HANYS SIT"), for $30,000,000. In 2005, the Company redeemed the 75,000 shares of outstanding preferred stock for $30,000,000. The Department approved the redemption transaction on July 1, 2005.

Prior to September 15, 2005, FFH Hospitals Trust ("FFHHT") owned 100% of the Company's Class A and Class C common stock, and 60% of the Class B common stock. HANYS Hospitals Trust ("HANYS") owned 40% of the Class B common stock. On September 15, 2005, FFHHT became the sole owner of the Company by purchasing the minority interest from HANYS. Due to this restructuring, the Company brought management of its affairs in-house, and continued to utilize the services of FOJP Service Corporation ("FOJP"), pursuant to a service agreement. The Department did not object to the acquisition of control of the Company by FFHHT. The name Hospitals Insurance Company, Inc. was adopted on January 18, 2006.

At December 31, 2009 capital paid in was $1,050,000, consisting of 375,000 shares of $1 par value Class A common stock, 375,000 shares of $1 par value Class B common stock, and 100,000 shares of $3 par value Class C non-voting common stock. Gross paid in and contributed surplus was $19,950,000. Capital paid in decreased by $7,500 during the examination period, as follows:

Year	Description		Amount
2005	Beginning capital paid in		$1,057,500
2005	Redemption of Class A non-voting preferred stock	$ (7,500)	
	Total capital paid in		(7,500)
2009	Ending paid in capital		$1,050,000

Gross paid in and contributed surplus decreased by $30,000,000 during the examination period, as follows:

Year	Description		Amount
2005	Beginning gross paid in and contributed surplus		$ 49,942,500
2005	Redemption of preferred stock	$(30,000,000)	
	Total surplus contributions		(30,000,000)
2009	Ending gross paid in and contributed surplus		$ 19,950,000

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than twelve nor more than twenty-one members. The board meets at least three times during each calendar year. At December 31, 2009, the board of directors was comprised of the following twelve members:

Name and Residence	Principal Business Affiliation
Donald Ashkenase Great Neck, NY	Executive Vice President, Corporate, Montefiore Medical Center
Michael Bruno Katonah, NY	Senior Vice President, Finance, Continuum Health Partners, Inc.
John Collura Suffern, NY	Executive Vice President and Chief Financial Officer, Continuum Health Partners, Inc.

Name and Residence	Principal Business Affiliation
Eugene Daly Franklin Lakes, NJ	Vice President, Underwriting, Hospitals Insurance Company, Inc. Senior Vice President, Underwriting and Data Quality Control, FOJP Service Corporation
Burton Drayer, MD New York, NY	Executive Vice President for Risk, Mount Sinai Medical Center
Dorothy Feldman Oceanside, NY	Vice President, Chief Risk Officer, North Shore – Long Island Jewish Health System
David Ingber Armonk, NY	Vice President, Montefiore Medical Center
Lisa Kramer Bedford, NY	President and Chief Executive Officer, Hospitals Insurance Company, Inc. President and Chief Executive Officer, FOJP Service Corporation
Mark McDougle New York, NY	Executive Vice President and Chief Operating Officer, Maimonides Medical Center
Robert Naldi Centerport, NY	Executive Vice President and Chief Financial Officer, Maimonides Medical Center
Donald Scanlon Commack, NY	Executive Vice President and Chief Financial Officer, Mount Sinai Medical Center
Robert Shapiro Old Bethpage, NY	Senior Vice President and Chief Financial Officer, North Shore – Long Island Jewish Health System

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member has an acceptable record of attendance.

As of December 31, 2009, the principal officers of the Company were as follows:

Name	Title
Lisa Kramer	Chief Executive Officer and President
Loreto Ruzzo	Vice President, General Counsel and Secretary
Eugene Daly	Vice President, Underwriting and Treasurer

B. Territory and Plan of Operation

As of December 31, 2009, the Company was licensed to write business in New York only. As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

Paragraph	Line of Business
3	Accident & health
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity
29	Legal services

In addition, the Company is licensed to do within this State the business of special risk insurance pursuant to Article 63 of the New York Insurance Law.

Based on the lines of business for which the Company is licensed and the Company’s current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of $4,400,000.

The following schedule shows the direct premiums written by the Company for the period under examination:

Calendar Year	New York State	Total Premiums	Premiums Written in New York State as a Percentage of Total Premium
2005	$ 60,504,628	$ 60,504,628	100.00%
2006	$ 68,860,720	$ 68,860,720	100.00%
2007	$121,798,995	$121,798,995	100.00%
2008	$136,922,582	$136,922,582	100.00%
2009	$153,124,259	$153,124,259	100.00%

As of December 31, 2009, the Company provided primary and excess medical malpractice insurance to the following medical centers and to their affiliated physicians: Mt. Sinai Medical Center Group, Beth Israel Medical Center Group, Maimonides Medical Center Group, and Montefiore Medical Center Group. The Company also writes primary and excess professional liability insurance to Bronx Lebanon Hospital Center Group and to its employed physicians. Additionally, the Company provides primary professional liability insurance to the seven hospitals and related entities of each hospital, and the voluntary attending physicians, affiliated with the CCC Program, namely: Brookdale Hospital Medical Center, Jamaica Hospital Medical Center, NYU Hospitals Center, St Luke's-Roosevelt Hospital Center, Long Island College Hospital, New York Methodist Hospital, and St. John's Episcopal Health Services (collectively known as the "CCC hospitals"). The Company also provides excess professional liability insurance to the Albert Einstein College of Medicine of Yeshiva University. On a limited basis, the Company writes general liability insurance, employee benefits liability insurance and directors and officers' liability insurance.

As of December 31, 2009, the Company provided primary medical malpractice insurance to approximately 1,600 voluntary attending physicians, and provided excess medical malpractice insurance to approximately 2,800 physicians and dentists. Of the $153 million of direct written premium in 2009, approximately $103 million, or 67.3%, is premiums attributable to the four owner-hospitals and affiliated physicians; approximately $20 million, or 13.1%, is attributable to the CCC hospitals, and approximately $14 million, or 8.9% is attributable to Bronx Lebanon Hospital Center.

C. Reinsurance

Assumed reinsurance accounted for 4.5% of the Company's gross premium written at December 31, 2009. During the period covered by this examination, the Company's assumed reinsurance business has remained stable. The Company's assumed reinsurance program consists solely of its participation in the Medical Malpractice Insurance Pool ("MMIP"). The MMIP is an involuntary pool that was created by all authorized insurers writing medical malpractice insurance in New York, as an alternative to receiving direct assignments of eligible health care providers through the MMIP. In the MMIP, each participating insurer is liable for each risk in an amount equal to the premiums it writes in the medical malpractice insurance market. As of December 31, 2009, the Company is responsible for approximately $41 million, or 9%, of MMIP's net current deficit.

The Company has an assumed reinsurance agreement in place for a block of business written in 1998 by National Union Fire Insurance Company of Pittsburg ("NUFIC"). As security for the obligations assumed, the Company is required to establish and maintain a letter of credit for the benefit of the reinsured in a form, substance and amount acceptable to the reinsured in its sole discretion. As of the examination date, the Company maintained letter of credit collateral in the amount of $30,000,000 for known case losses and LAE reserves of $3,825,000.

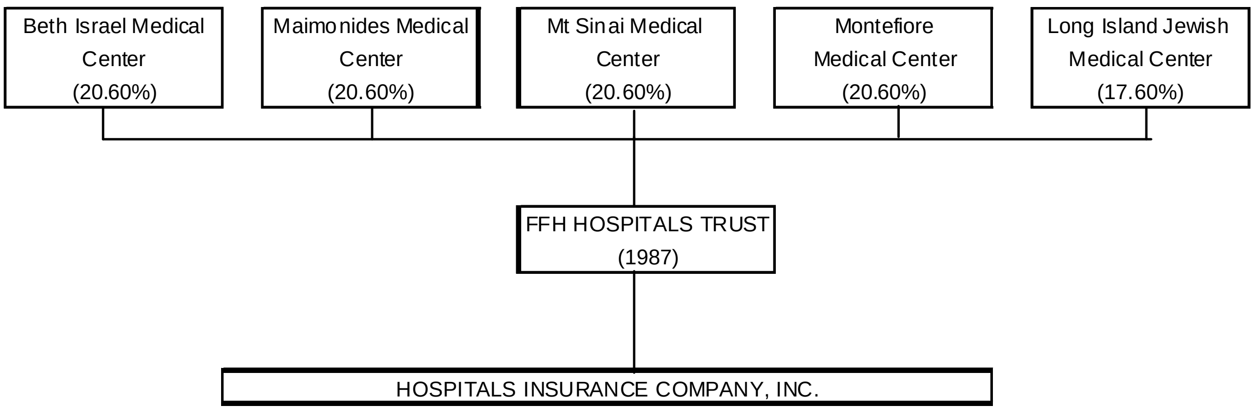
The Company utilizes reinsurance accounting as defined in NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles ("SSAP") No. 62 for all of its assumed reinsurance business.

The Company does not have an active ceded reinsurance program in place. Effective 2009, the Company entered into a fronting arrangement with Oasis Reciprocal Risk Retention Group ("OASIS"), a Vermont risk retention group. The Company provides primary professional liability insurance on a claims-made basis to ENT and Allergy, LLP, and to its affiliated New York State-licensed physicians; and excess professional liability insurance to these physicians. The Company cedes 100% of the primary professional liability insurance risk to OASIS. The reinsurer maintains a trust agreement in accordance with Department Regulation No. 114.

During the period covered by this examination, the Company commuted a reinsurance agreement where it is was a ceding insurer. The commutation resulted in a net gain to the Company's surplus position of $17.8 million.

D. Holding Company System

The Company is a wholly-owned subsidiary of FFH Hospitals Trust, a trust domiciled in New York, whose five grantors are also the beneficiaries of the trust. The following is a chart of the holding company system at December 31, 2009:



A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

To increase its surplus position, the Company issued to the four insured owner-hospitals, loan agreements pursuant to Section 1307 of the New York Insurance Law. In March 2009, HIC issued a series of surplus notes totaling $12 million, and in June 2009, a second series of notes was issued totaling $5 million. The holders of these surplus notes are insured owner-hospitals, and all notes were approved by the Department. The notes bear interest at 7%, and have an open maturity date.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2009, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	95%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	116%*
Premiums in course of collection to surplus as regards policyholders	9%

The above ratios denoted with an asterisk fall outside the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The Company failed IRIS Ratio 9 adjusted liabilities to liquid assets because total liabilities of $726,682,466 were greater than liquid assets of $625,014,206. Liquid assets consisted of bonds, preferred stocks, common stocks, cash and short term investments and securities receivables.

The underwriting ratios presented below are on an earned/incurred basis and encompass the five year period covered by this examination:

	Amounts	Ratios
Losses and loss adjustment expenses incurred	$626,131,937	112.48%
Other underwriting expenses incurred	42,591,090	7.65
Net underwriting loss	(112,078,739)	(20.13)
Premiums earned	$556,644,288	100.00%

F. Accounts and Records

i. Premium Accounting

A review of a sample of policies revealed that some of the policies issued by the Company provide professional liability, general liability and employee benefits liability coverages. The Company did not calculate separate premium for these coverages. The entire premium was reported as professional liability in the 2009 filed annual statement. Also, some of these policies have claims-made, occurrence, and modified occurrence coverages, but the entire premium was reported as medical malpractice occurrence premiums.

It is recommended that the Company properly report its premium by line of business.

ii. Claims and Administrative Service Agreement

The Company has in place an amended and restated claims and administrative service agreement with FOJP Service Corporation, effective January 1, 2005, and subsequently amended. Pursuant to the terms of this agreement, FOJP provides claims handling services for claims related to the four insured owner-hospitals on behalf of the Company, and provides administrative services, including legal, finance, human resources and technology.

An opinion issued by the Office of the General Counsel dated January 4, 2005 states in part that a consulting agreement between a domestic property/casualty insurance company and an unaffiliated entity is required to be approved by the Department in a situation where the president of the insurer is also the president of the unaffiliated entity. The Company's circumstances are similar in that the President and chief executive officer, Ms. Lisa Kramer, is also the president and chief executive officer for FOJP.

The Company submitted the amended and restated claims and administrative service agreement, including amendments 1 and 2, to the Department in January 2007. The agreement covered the period from January 1, 2005 until December 31, 2009.

It is recommended that the Company submit to the Department for approval the new service agreement upon its completion, or amend the existing agreement to extend the termination date. Any amendments to the agreement should be submitted to the Department as well.

iii. Custodial Agreement

The Company maintains a custodial agreement dated March 16, 1995 with Bank of America (Fleet Trust Company) and amended March 1, 2006. The custodial agreement does not contain the protective covenants and provisions required to satisfy the necessary safeguards and controls established by the NAIC and the Department.

Additionally, the Company maintains a custodial agreement with Comerica Bank, dated August 25, 2000, and amended May 9, 2006. The custodial agreement does not contain the protective covenant required to satisfy the necessary safeguards and controls established by the NAIC and the Department.

When the examiner apprised the Company of the deficient contract language, the Company began the process of amending the custodial agreements with Bank of America and Comerica to include the requisite provisions.

It is recommended that the Company amend its custodial agreements with Bank of America and Comerica to include the requisite protective provisions.

iv. Schedules BA and D Reporting

A review of the Company's 2009 filed annual statement revealed that Schedule BA and Schedule D were not properly completed. For Schedule BA, the following information was missing from the Schedule: Name of General Partner; Type and Strategy; and, Percentage of Ownership. Additionally, the Company completed Column 7 "NAIC Designations" of Schedule BA. However, as stated in the NAIC Annual Statement Instructions, Column 7 should only be completed by Life Companies and Fraternal Benefit Societies. When the examiner apprised the Company, the Company provided a revised Schedule BA.

For Schedule D, the Company failed to identify its assets that are pledged as collateral. Although the Company correctly completed the General Interrogatories of the 2009 Annual Statement, regarding assets pledged by collateral, it failed to adhere to the Annual Statement Instructions requiring bonds that are not under the exclusive control of the company are to be identified by the letter "C."

It is recommended that the Company report its investments in Schedules BA and D in accordance with the NAIC Annual Statement Instructions.

G. Risk Management and Internal Controls

During the examination period, the Company did not maintain an internal audit department. In 2010, the Company initiated and formalized plans with KPMG, LLP ("KPMG") to perform the Company's enterprise risk assessment. KPMG finalized the risk assessment and proposed internal audit plan in September 2010. The Company is in the process of out-sourcing the function of internal audit, which is expected to be completed by June 2011.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2009 as determined by this examination and as reported by the Company:

Assets	Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$427,819,044	$ 0	$427,819,044
Preferred stocks	1,765,766	0	1,765,766
Common stocks	140,363,387	0	140,363,387
Cash, cash equivalents and short-term investments	40,955,464	0	40,955,464
Other invested assets	214,669,337	0	214,669,337
Receivable for securities	10,269,151	0	10,269,151
MMIP Asset	15,575,942	0	15,575,942
Investment income due and accrued	3,841,394	0	3,841,394
Uncollected premiums and agents' balances in the course of collection	15,062,764	0	15,062,764
Current federal and foreign income tax recoverable and interest thereon	20,674,766	0	20,674,766
Net deferred tax asset	21,331,385	18,905,502	2,425,883
MMIP accrued income	123,676	0	123,676
Prepaid Expenses	177,552	177,552	0
ARCA - Escrow	25,000	0	25,000
Lease - security deposit	15,000	0	15,000
Total assets	$912,669,628	$19,083,054	$893,586,574

Liabilities, Surplus and Other Funds			Surplus
Liabilities	Examination	Company	Increase (Decrease)
Losses and loss adjustment expenses	$723,749,713	$680,749,713	$(43,000,000)
Reinsurance payable on paid losses and loss adjustment expenses	0	0	
Other expenses (excluding taxes, licenses and fees)	2,573,777	2,573,777	
Unearned premiums	19,833,545	19,833,545	
Advance premium	10,613,403	10,613,403	
Ceded reinsurance premiums payable (net of ceding commissions)	1,024,968	1,024,968	
Payable for securities	10,796,665	10,796,665	
MMIP Premium Deficiency Reserve	861,576	861,576	
MMIP Accrued Expenses	3,544	3,544	
MMIP Accrued Investment Payable	225,275	225,275	0
Total liabilities	$769,682,466	$726,682,466	$(43,000,000)
Surplus and Other Funds			
Common capital stock	$ 1,050,000	$ 1,050,000	
Surplus notes	17,000,000	17,000,000	
Gross paid in and contributed surplus	19,950,000	19,950,000	
Unassigned funds (surplus)	85,904,108	128,904,108	$(43,000,000)
Surplus as regards policyholders	$123,904,108	$166,904,108	$(43,000,000)
Total liabilities, surplus and other funds	$893,586,574	$893,586,574	

NOTE: The Internal Revenue Service has not audited the tax returns covering tax years 2005 through 2009. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $723,749,713 is $43,000,000 more than the $680,749,713 reported by the Company as of December 31, 2009. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and in its filed annual statements.

It is noted that the Company in effect has already recognized this deficiency as of December 31, 2010, as it represents its one-year loss and LAE run-off. It is further noted that this $43 million run-off deficiency is overstated as approximately one third of this development is attributable to the manner in which the "Modified Occurrence Policies" are booked, not actual development.

5. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	Accounts and Records	
i.	It is recommended that the Company properly report its premium by line of business.	10
ii.	It is recommended that the Company submit to the Department for approval the new service agreement upon its completion, or amend the existing agreement to extend the termination date. Any amendments to the agreement should be submitted to the Department as well.	11
iii.	It is recommended that the Company amend its custodial agreements with Bank of America and Comerica to include the requisite protective provisions.	11
iv.	It is recommended that the Company report its investments in Schedules BA and D in accordance with the NAIC Annual Statement Instructions.	12

Respectfully submitted,

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Karen Gard
Senior Insurance Examiner

STATE OF NEW YORK)
)ss:
COUNTY OF NEW YORK)

KAREN GARD, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

____
Karen Gard

Subscribed and sworn to before me

this__________ day of ___________________, 2010.

Appointment No. 30453

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, James J. Wrynn *Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:*

Karen Gard

as proper person to examine into the affairs of the

HOSPITALS INSURANCE COMPANY, INC.

and to make a report to me in writing of the condition of the said

Company

with such other information as she shall deem requisite.

In Witness Whereof, I have hereunto subscribed by the name and affixed the official Seal of this Department, at the City of New York,

this 14th *day of* December, *2009*

STATE OF NEW YORK ★ SUPERINTENDENT OF INSURANCE ★
EXCELSIOR

JAMES J. WRYNN
Superintendent of Insurance