

REPORT ON EXAMINATION

OF

PHYSICIANS' RECIPROCAL INSURERS

AS OF

DECEMBER 31, 2014

DATE OF REPORT

JULY 21, 2016

EXAMINER

MOSES EGBON, CFE

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Maria T. Vullo
Superintendent

July 21, 2016

Honorable Maria T. Vullo
Superintendent
New York State Department of Financial Services
Albany, New York 12257

Madam:

Pursuant to the requirements of the New York Insurance Law ("NYIL"), and in compliance with the instructions contained in Appointment Number 31373 dated August 17, 2015, attached hereto, I have made an examination into the condition and affairs of Physicians' Reciprocal Insurers as of December 31, 2014, and submit the following report thereon.

Wherever the designation "the Company" or "Reciprocal" appear herein without qualification, it should be understood to indicate Physicians' Reciprocal Insurers.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Company's administrative office located at 1800 Northern Boulevard, Roslyn, New York 11576.

This examination has determined that as of December 31, 2014, the Company was insolvent in the amount of \$295,705,493, and its capital of \$650,000 was impaired in the amount of \$296,355,493. Additionally, the Company's minimum required to be maintained surplus of \$650,000 was impaired in the amount of \$296,355,493.

1. SCOPE OF EXAMINATION

The Department has performed an individual examination of the Company, a single state insurer. This examination covered the five-year period from January 1, 2010 through December 31, 2014. 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 New York State regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company’s own control environment assessment. 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 Handbook:

- Significant subsequent events
- Company history
- Corporate records
- Management and control
- Fidelity bonds and other insurance
- 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

The Company is a reciprocal insurer, as defined in NYIL Section 107(a)(37) and was organized pursuant to the provisions of NYIL Article 61. Pursuant to the provisions of NYIL Section 6102(b), the declaration creating the Reciprocal was approved by the Superintendent of Financial Services (“Superintendent”) on November 6, 1981. The Reciprocal provides medical malpractice insurance, on both a claims-made and an occurrence basis, for physicians, podiatrists, chiropractors, dentists and healthcare facilities. Effective July 1, 1994, the Company began writing excess professional liability policies providing coverage of \$1 million over the limit of the underlying policy.

As the Company is a reciprocal insurer, its policyholders engage in the business of inter-insurance on the reciprocal plan. It has no employees, and it is owned by its subscribers. The Company’s business and affairs are managed by its attorney-in-fact, Administrators for the Professions, Inc. (“AFP”). The policyholders are, and only may be, subscribers. To provide surplus for the Company, the subscribers were required, as prerequisite to the initial purchase of their insurance policies, to contribute to the Company’s surplus in varying amounts. Effective January 1, 1998, the Company eliminated the requirement that new subscribers contribute to surplus.

A. Corporate Governance

Pursuant to a declaration, which was executed and approved in accordance with NYIL Section 6102, a board of governors was elected to act on behalf of the subscribers with the power to supervise and control the attorney-in-fact and to control the investment activities of the Reciprocal, as well as such other powers as may be conferred by the subscribers’ agreement.

Also, pursuant to NYIL Section 6105(h), the board of governors shall consist of at least nine individuals elected by the subscribers. As of December 31, 2014, the board of governors was comprised of the following nine members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Anthony J. Bonomo, Esq. Manhasset, NY	Chief Executive Officer, Administrators for the Professions, Inc.
Carl Bonomo Massapequa, NY	Executive Vice President, Administrators for the Professions, Inc.
Mehmet Cetin, M.D. Sarasota, FL	Physician Private Practice Physician
Gerald Dolman, Esq. Melville, NY	President, Administrators for the Professions, Inc.
Sanford R. Goldberg, M.D. Merrick, NY	Physician Private Practice Physician
Howard D. Kolodny, M.D. Great Neck, NY	Physician Private Practice Physician
Andrew J. Kolodny, M.D. Douglaston, NY	Physician Maimonides Medical Center
Philip A. Robbins, M.D. Roslyn, NY	Physician Private Practice Physician
Barry F. Schwartz, M.D. Little Neck, NY	Physician Private Practice Physician

The Reciprocal's board of governors met at least four times during each calendar year. A review of the minutes of these meetings indicated that they were generally well attended and each board member had an acceptable record of attendance. Subsequent to the examination date, Dr. Mehmet Cetin was replaced by Dr. Barry Fisher, effective July 2016.

As of December 31, 2014, the officers of the Reciprocal were as follows:

<u>Name</u>	<u>Title</u>
Mehmet Cetin, M.D.	Chairman
Howard D. Kolodny, M.D.	Treasurer
Sanford R. Goldberg, M.D.	Secretary
Barry F. Schwartz, M.D.	Vice Chairman

Attorney-in-Fact

Pursuant to the management agreement dated December 17, 1981, AFP was appointed as the Company's attorney-in-fact and manager. The management agreement was amended and became effective January 1, 2012 through December 31, 2017. Under the amended agreement, AFP provided underwriting, administrative and investment services for a fee, which is a percentage of the Company's direct written premium. The amended agreement was approved by the Department on May 25, 2010.

As of the examination date, all outstanding shares of AFP were owned by AJB Ventures, Inc., which was in turn owned 70% by Anthony Bonomo, Esq. and 10% by each of his three children. Mr. Bonomo is currently AFP's Chief Executive Officer.

As of December 31, 2014, the directors and officers of AFP were as follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Anthony J. Bonomo, Esq. Manhasset, NY	Chief Executive Officer, Administrators for the Professions, Inc.
Carl Bonomo Massapequa, NY	Executive Vice President, Administrators for the Professions, Inc.
Gerald Dolman, Esq. Melville, NY	President, Administrators for the Professions, Inc.

Officers

<u>Name</u>	<u>Title</u>
Anthony J. Bonomo, Esq.	Chief Executive Officer
Carl Bonomo	Executive Vice President
Gerald Dolman	President
Bernard McArthur	Chief Technology Officer
Jeanne Braun	Executive Vice President for Hospitals & Special Programs
Marjorie Thomas	Senior Vice President for Underwriting & Risk Management
Christine Quinn	Vice President for Risk Management
Mark Paykin	Senior Vice President & Chief Actuary
Martin Bassaly	Chief Compliance Officer
Rick Barrow	Chief Financial Officer
Roy Kaufman	Vice President for Claims & Hospital
Tim Daugherty	Vice President for Claims

Subsequent to the examination period, the Superintendent issued her July 6, 2017 Order Pursuant To New York Insurance Law Article 61 (the "Order"), which stated the Department's findings regarding certain improprieties committed by AFP and its top executives in respect of PRI. The Order's decretal paragraphs state, among other things, that the authority of AFP to act as the attorney-in-fact for PRI, or any of PRI's parents, subsidiaries or affiliates, was withdrawn and revoked upon issuance of the Order. The Company subsequently replaced AFP as attorney-in-fact with a subsidiary of PRI, PRIMMA LLC. Litigation was commenced in connection with the transfer of the attorney-in-fact role from AFP to PRIMMA LLC.

Board Compensation

During the examination, it was noted that the Company paid compensation to all board members for board services. The Company also paid consulting fees to four board members. The board meeting minutes for this period did not reflect specific approvals relating to these payments.

The Company paid total compensation and consulting fees of approximately \$7.8 million to its board members during the examination period, of which \$3.7 million (or 47%) were consulting fees. Each year during this period, the Company reported a negative surplus.

It is recommended that the Company's board approve annually all compensation and consulting fees paid to its board members.

It is also recommended that the Company re-evaluate the compensation of the board members to determine if it is reasonable given the Company's poor financial condition.

As noted above, the Company paid four board members for monthly consulting services totaling \$3.7 million for attending claim conferences with attorneys and for reviewing claim files. No contracts for the services were available for review during the examination. Also, the services were not disclosed in the board members' conflict of interest statements completed during the examination period.

It is recommended that board members who engage in consulting services for the Company disclose any such services they perform in their conflict of interest statements completed annually.

Executive Compensation

Upon review of the Company's board minutes, it was noted that no discussion or approval of executive compensation was documented in the meetings of the board of directors. The Company paid a portion of AFP's four executive officers' salaries, which was in addition to the management fees.

The Company and its manager did not maintain documentation for the basis of allocating AFP's executive officers' salaries between the Company and its manager for expenses not covered by the management fee.

Department Regulation No. 30, Part 109.2, Section (b)(2) states:

The effects of the classification to each operating expense classification of all basis of allocation shall be shown on records kept in clear and legible form. Such records shall be readily available for examination.

It is recommended that the Company's board discuss and approve any compensation paid to executive officers of its attorney-in-fact and ensure that documentation of the board's actions is maintained in the minutes.

It is also recommended that the Company maintain documentation for the basis of its attorney-in-fact's allocation of salaries of its executive officers between itself and the Company, as required by Department Regulation No. 30, Part 109.2, Section (b)(2).

Furthermore, the Company paid bonuses to AFP's employees in claims, legal, risk management and education departments; however, the Company did not have any documentation for the basis used to determine the bonuses. Also, the Company did not maintain documentation for the bonuses in the board minutes to show that they were specifically approved by the board.

The bonuses were incentives the Company paid to AFP's employees who performed PRI's job functions. AFP paid the bonuses, which were reimbursed by PRI. The bonuses were paid in addition to the contracted management fee the Company paid to AFP. These bonuses were paid to AFP's employees through December 2014.

It is recommended that the Company, as well as its manager, maintain the basis of determining bonuses paid to employees.

It is also recommended that the board approve employee bonuses and document such approvals in the minutes of the board.

Board of Directors Election

NYIL Section 6105 (i) states:

Members of the advisory committee may be elected and reelected to a term of office of not less than one year nor more than four years, and terms may be staggered to provide for continuity.

It was noted that although the nine board members have staggered terms, they have been on the board for an average of 20 years. It appears that the same members have been re-elected continuously.

Conflict of Interest Transactions

The examination revealed the following transactions that presented conflict of interests:

- 1) The Company shares a monthly rent obligation with AFP for an office building it leased from 1800 Northern Blvd. LLC. The Company was not a party to the lease agreement signed by AFP, but the Company provided \$7,950,000 as collateral supporting a letter of credit issued by its manager to the landlord for rent escrow security.

The Company's inherent risk in the lease transaction is that it would lose the escrow if AFP defaults. It is important to note that the management agreement Section 2, Paragraph 2 states:

AFP shall lease office space adequate to conduct the business of PRI, and shall suitably furnish and equip such offices.

The lease term was from May 1, 2008 to April 30, 2023, which was extended through April 30, 2028. The extension was not filed with the Department as required by NYIL Section 6111(f). The rental property is 50 percent indirectly owned by AFP's principal owner, who is also a board member of the Company. Although the Company notified the Department of the initial transaction, the owner of AFP still should disclose the transaction in the Company's conflict of interest statements completed annually.

It is recommended that the Company ensure that AFP file its lease extension with the Department in accordance with NYIL Section 6111(f).

It is recommended that the Company ensure that its board member disclose this transaction in the conflict of interest statement completed annually.

- 2) During the examination period, the Company's reinsurance intermediary and one of the entities owned by the Company's manager co-brokered an agreement for reinsurance business placed on behalf of the Company. The transaction was not disclosed in the annual conflict of interest statements the owner of the Company's manager completed during the examination period as a Company board member.

The agreement allows the parties to share equally reinsurance commissions the intermediary receives from reinsurers relating to the Company's reinsurance placement. They shared commissions for 2010 and 2011 contracts. The owner of the Company's manager served on the board during the examination period.

Therefore, it is recommended that the Company ensure its manager's owner disclose the transaction in his conflict of interest statements completed annually as a Company board member.

Additionally, the transaction is required to be filed pursuant to NYIL Section 6111(f), which states:

Unless the reciprocal is subject to the provisions of article fifteen of this chapter or substantially similar legislation in its state of domicile, all material transactions between or among the reciprocal, its subscribers, the attorney-in-fact and any affiliate of the attorney-in-fact shall not be entered into, unless they have been filed with the superintendent at least thirty days prior thereto and the superintendent has not disapproved them . . .

The reinsurance contracts placed in 2010 and 2011 were material for purposes of NYIL Section 6111(f) excerpted above. Therefore, it is recommended that the Company and its manager file the agreement with the Department as required by NYIL Section 6111(f).

B. Territory and Plan of Operation

As of December 31, 2014, the Company was licensed to write business in New York State only.

As of the examination date, the Company was authorized to transact the kinds of insurance defined in the following numbered paragraphs of NYIL Section 1113(a):

<u>Paragraph</u>	<u>Line of Business</u>
3	Accident & health
13	Personal injury liability
14	Property damage liability
15	Worker's compensation and employer's liability
19	Motor vehicle and aircraft physical damage
29	Legal Service

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

<u>Calendar Year</u>	<u>Direct Premiums Written</u>
2010	\$397,222,330
2011	\$390,487,264
2012	\$373,292,370
2013	\$380,471,638
2014	\$383,989,838

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 NYIL Articles 13, 41 and 61, the Company is required to maintain a minimum surplus to policyholders in the amount of \$650,000. This amount changed from \$1,300,000 because the Company's Special Risk license pursuant to NYIL Article 63 was no longer approved by the Department.

The Company writes medical professional insurance liability for physicians, chiropractors, dentists, and healthcare facilities, and general liability for healthcare facilities in New York. Policies are issued on a claims-made and an occurrence basis. Primary coverage for physicians is provided up to \$1.3 million per occurrence and \$3.9 million in the aggregate. The Company provides an additional layer of excess insurance protection of \$1million/\$3million above the primary coverage. This excess coverage is provided at no additional cost to physicians and dentists who meet certain requirements. The premiums for the coverage are paid through a program funded by New York State.

Further, the Company participates in the Medical Malpractice Insurance Pool ("MMIP") based on its proportionate market share of the New York medical professional liability insurance market. As a writer of medical professional liability insurance in New York, the Company is required to share in the business

of MMIP. This entity is a state-created insurance pool designed to provide insurance to all physicians and medical professionals who cannot obtain medical professional liability insurance through a voluntary market.

The Company writes business directly and produces most of its business through independent brokers.

C. Reinsurance

Assumed

Effective October 1, 2014, the Company entered into an Adverse Loss Development Reinsurance Contract (“ALD Cover”) with Pennsylvania Physicians Reciprocal Insurers (“PaPRI”). The ALD Cover provides that the Company assumes \$11,500,000 of losses in excess of the PaPRI’s \$4,800,000 retention for a deposit premium of \$4,500,000 to be paid by PaPRI to the Company. Up to \$6,500,000 of the \$11,500,000 coverage can be used by PaPRI to pay for uncollectible reinsurance from its other reinsurance contracts.

In addition, Article VII of the ALD Cover states that the Company will maintain an Experience Refund Account (“ERA”) of the operating expenses (includes daily expenses) of the PaPRI that will initially be credited with \$1,400,000. All operation expenses paid after July 1, 2014 will be charged to the ERA. If the ERA has a negative balance after October 1, 2014, the Company will pay all future operating expenses on behalf of the PaPRI. The transaction was approved by the Department and by the Pennsylvania Insurance Department.

Ceded Reinsurance

During the examination period, the Company entered into one health care liability per loss occurrence excess reinsurance contract. Six reinsurers participated in the contract. The reinsurance coverage provided a coverage of \$6,700,000 excess of \$3,300,000 per loss occurrence. The Company placed only 90 percent of the coverage. The agreement covered the Company’s business classified as medical malpractice for physicians and for hospitals and/or related medical facilities. The reinsurers were all authorized reinsurers.

In addition, effective June 30, 2014, the Company entered into a professional liability reinsurance agreement with Futuro Insurance Company, Ltd. (“Futuro”) with respect to its Separate Account – Neurological Surgery, P.C. Futuro is a Bermuda domestic captive company and a wholly-owned subsidiary of the Company. The Company cedes the first \$500,000 of each loss occurrence for professional liability claims with an aggregate limit of \$5,000,000 per policy year. Since the captive was an unauthorized reinsurer, it provided the Company with a Letter of Credit as security for losses and loss adjustment expenses recoverable that might be due on the contract. The transaction was approved by the Department.

All significant ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of NYIL Section 1308.

Examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in Statement of Statutory Accounting Principle (“SSAP”) No. 62R. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's Chief Executive Officer and Chief Financial Officer pursuant to the NAIC Annual Statement Instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62R.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Letters of credit and trust accounts obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulations Nos. 133 and 114, respectively. No exceptions were noted.

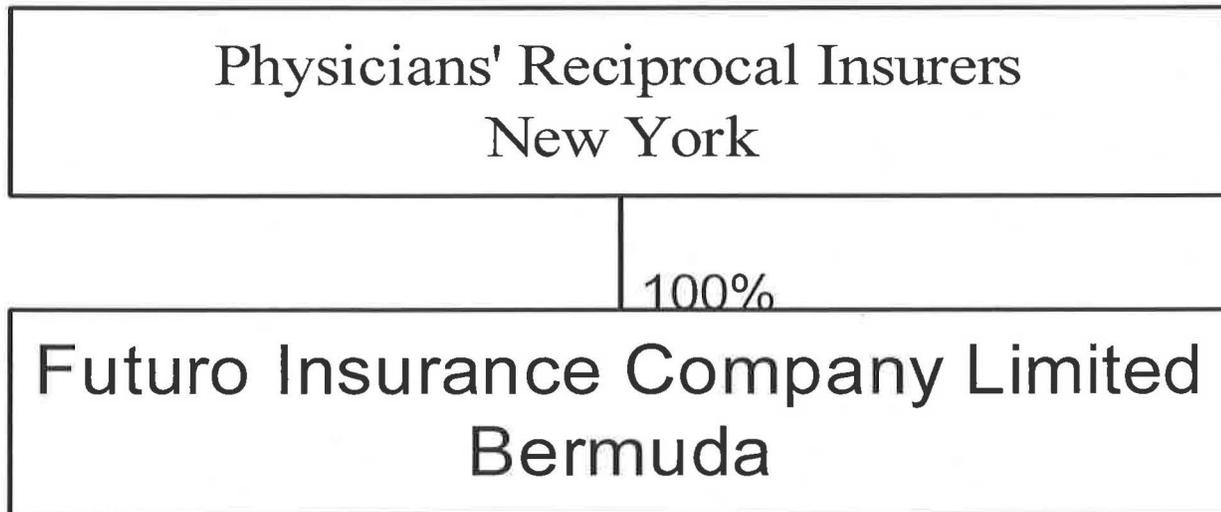
D. Holding Company System

Pursuant to NYIL Section 6111(f), all material transactions between or among the reciprocal, its subscribers, and the attorney-in-fact and any affiliates of the attorney-in-fact shall not be entered into, unless they have been filed with the Superintendent at least thirty days prior thereto and the superintendent has not disapproved them. Any such transaction involving five percent or more of the Reciprocal's admitted assets shall be subject to prior approval of the Superintendent, and all transactions shall meet the following standards:

1. The terms shall be fair and equitable.
2. Charges or fees for services performed shall be reasonable.
3. Expenses incurred and payments received shall be allocated to the Reciprocal on an equitable basis in conformity with statutory insurance accounting practices consistently applied.

As earlier noted in this report (Section 2.A – Management – Conflict of Interest), the Company has not complied with NYIL Section 6111(f).

Effective June 3, 1999, the Company's wholly-owned subsidiary, Futuro Insurance Company Limited, became licensed under the laws of Bermuda, with an initial capital contribution of \$1 million. In 2012, the Company received a dividend of \$1,650,000 from the subsidiary. As of December 31, 2014, the total capital contribution to the subsidiary was \$2,850,000, and it was registered as a Class 3 Insurer under the Bermuda Insurance Act, 1978. The transaction was approved by the Department.



E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2014, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	999%*
Adjusted liabilities to liquid assets (cash and invested assets less investments in affiliates)	129%*
Premiums in course of collection to surplus as regards policyholders	999%*

The above ratios denoted with asterisks fall outside the benchmark ranges set forth in the NAIC Insurance Regulatory Information System (“IRIS”).

The ratios are out of usual range because the Company was found to be insolvent.

The underwriting ratios presented below are on an earned/incurred basis and encompass the 5-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$1,759,023,303	94.57%
Other underwriting expenses incurred	359,249,406	19.31
Net underwriting loss	<u>(258,249,694)</u>	<u>(13.88)</u>
Premiums earned	<u>\$1,860,023,015</u>	<u>100.00%</u>

F. Accounts and Records

1. Custodian Agreement

In 2013, the Company revised its custodian agreement. The current agreement between the Company and its custodian lacks most of the provisions required by NAIC Financial Condition Examiners’ Handbook, which are suggested safeguards to protect the Company’s investments held by custodians.

It is recommended that the Company ensure its custodian agreement meets all of the required provisions as set forth in the NAIC Financial Condition Examiners’ Handbook.

2. Investment Policy Statement

The Company did not comply with Section IV of its investment policy statement, which states that the maximum allocation to any one corporation/issuer/partnership shall not exceed 1% of the investment portfolio. The Company's investments in two limited partnerships exceed the limitation established by its policy statement. The amount above the limitation was disallowed and reported as part of Item 6b, Other Invested Assets below, pursuant to the NYIL:

It is recommended that the Company comply with Section IV of its investment policy statement regarding its investment limitation.

3. Compliance with Management Agreement between the Company and AFP

During the examination period, the AFP did not comply with all of Paragraph 5, Items A to C of the Management Agreement by not providing the Company's board of governors with the financial statements and reports pursuant to the Management Agreement, which state in part:

AFP shall prepare and submit to the Board of Governors of PRI the following financial statements and reports:

A. At each regular meeting of the Board of Governors, a report on the financial condition of PRI and all material transactions during the period since the last meeting;

B. Within 45 days after the end of each calendar quarter, except for the last quarter of each calendar year, a balance sheet as of the end of such quarter and a statement of operations showing the results of operations for the quarter and for the portion of the calendar year ending on the date of such statement;

C. Within 45 days after the end of each calendar quarter, a report setting forth the policies of insurance issued during such quarter, the classification and ratings of the insureds under such policies, the policies of insurance canceled or not renewed during the quarter and a summary of the reasons therefor, and a cumulative report of all outstanding claims, including separately claims reported during the quarter, the reserve established for such claims, and the amount of claims paid during such quarter...

As stipulated in the agreement, the attorney-in-fact was required to provide such information to the Company's board of governors to help them in carrying out their oversight responsibilities, but not all such information was provided. The Company's management was informed of the requirements. They contended that some of the reports

were not provided to the board of governors, but were presented to and discussed with them at each board meeting. Therefore, it is recommended that the Company comply with the requirements in Paragraph 5 of the Management Agreement.

Further, the Company and its manager established separate accounting books and records, but some of the Company's detailed records were kept by its manager. Although the manager made all its books and records available for examination, it must ensure its books and records are maintained according to its Management Agreement, Section 4, which states:

All books and records shall be maintained on behalf of PRI in such form and detail as may be required by the insurance laws and regulations of the State of New York, and any other applicable governmental authorities, and in accordance with such additional reasonable standards as may be fixed from time to time by the Board of Governors of PRI. All such books, records and files shall be the property of PRI. AFP shall be entitled to make copies at its own expense for its records."

(Emphasis added).

4. Management Fee Determination

During examination period, the Company's attorney-in-fact has incorrectly determined the contracted management fees by including PRI's share of MMIP (Pool) premiums written that were not directly produced by PRI. These premiums were supposed to be excluded from the total premiums used in the management fees determination.

In accordance with SSAP No. 63, Paragraph 8, the Department has required MMIP members to incorporate the Pool premiums in its members' direct premiums written for financial statement reporting purposes. This directive was not meant to allow such premiums to be a component of the premiums for calculating the management fees. By including the MMIP's premiums in the calculation of management fees for the five-year examination period, the Company received about \$7.2 million of additional management fees from PRI.

The premiums from MMIP are shared by its Pool member companies, pursuant to NYIL Article 55 and Department Regulation No. 170, based on their proportionate market share of the New York State medical professional liability insurance market. The state created the insurance pool to provide insurance

to all physicians and medical professionals who could not obtain medical professional liability insurance through a voluntary market.

Pursuant to NYIL Section 5507(a), MMIP acts as an administrator, and it allocates premiums, expenses, servicing allowance, management fees and losses to each member of the Pool every quarter in each member's proportionate share of their aggregate net written premiums.

In 1981, the Company contracted with AFP to manage the Company's financial affairs and operations. In 2006, the management was changed following the sale of AFP to Bonomo and his immediate family members. Following the sale, the agreement has continued under the current management, as amended. The latest amendment extended the agreement to December 31, 2017. The agreement provides that AFP perform underwriting, administrative, and investment services for a management fee based on a percentage of PRI's direct premiums written. As of December 2014, the fee represented about 99.56 percent of the manager's total revenue. During the five year examination period, the management fees the Company paid to its manager were approximately \$50 million in 2010, \$49 million in 2011, \$48 million in 2012, \$48 million in 2013, and \$49 million in 2014.

Further, the Company's Amended & Restated Management Agreement dated January 1, 1999, Paragraph 2 states in part:

AFP agrees to manage the insurance operations of PRI during the term of this AGREEMENT by furnishing all of the services necessary for PRI's operation as a licensed insurance company including but not limited to solicitation of subscribers, investigation of applicants, underwriting services, issuance of policy forms, cancellation of policies, claims reporting and processing, reinsurance, risk management, education, data processing, investment, and accounting services...

The management fee determination should be based on the services AFP provides and should not be based on the premiums reported in the annual statement. Hence, it is recommended that the Company calculate its management fees as prescribed by the agreement. It also is recommended that AFP reimburse PRI for its overpayment to AFP resulting from incorrectly including MMIP's premiums in calculating management fees.

5. Discounting of Loss and Loss Adjustment Expenses

The reserves for losses and loss adjustment expenses estimate of the Company were discounted to present value using an annual effective interest rate. The effective interest rate the Company used to discount its reserves has been decreasing since 2011. The rate was 5 percent for all years prior to 2011, 4.5% for 2012, 3.5% for 2013 and 3.0% for 2014.

As of the examination date, the Company booked a negative liability of \$189 million for reserves discount in the annual statement. Based on Department actuarial analysis, the amount was determined to be a negative liability of \$161 million, which was \$28 million lower than the Company's amount, as reflected in Section 5, "Anticipated Future Investment Income on Losses and LAE Reserves." The examination amount was developed using discounted cash flow at a discount rate of 2.5 percent for the next two years and 3.5 percent for subsequent years.

It should be noted that the Company's actual investment yields according to the IRIS ratios for each year of the examination period are as follows:

<u>Year</u>	<u>Yield</u>
2010	3.9%
2011	3.9%
2012	3.5%
2013	3.3%
2014	2.8%

As of December 31, 2014, the discount reduced the Company's loss reserves by \$161 million and improved the negative surplus position. If the reserves were not discounted, the surplus position would have further deteriorated more than the reported examination surplus of \$295,705,493.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2014 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Examination</u>	<u>Net Admitted</u>	<u>Company</u>	<u>Surplus</u>
		<u>Assets Not Admitted</u>	<u>Assets</u>	<u>Net Admitted Assets</u>	<u>Increase (Decrease)</u>
Bonds	\$982,331,753	\$5,551,432	\$976,780,321	\$982,331,753	\$ (5,551,432)
Preferred stocks	5,075,610		5,075,610	5,075,610	
Common stocks	26,448,528	224,158	26,224,370	26,224,370	
First liens - mortgage loans on real estate	744,052		744,052	\$744,052	
Cash, cash equivalents and short-term Investments	53,898,748		53,898,748	53,898,748	
Other invested assets	79,482,347	46,898,181	32,584,166	77,719,563	(45,135,397)
Receivables for securities	5,463,834		5,463,834	5,463,834	
Investment income due and accrued	7,875,511	27,345	7,848,166	7,848,166	
Uncollected premiums and agents' balances in the course of collection	47,326,911	1,791,262	45,535,649	45,535,649	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	95,301,757		95,301,757	95,301,757	
Amounts recoverable from reinsurers	196,675		196,675	196,675	
Current federal and foreign income tax recoverable and interest thereon	1,235,110		1,235,110	1,235,110	
Net deferred tax asset	81,193,307	81,193,307			
Prepaid expenses	159,270	159,270			
Miscellaneous receivable	4,295,026	105,871	4,189,155	4,189,155	
Medical Mal Ins Pool of New York State	95,160,335	417	95,159,918	95,159,918	
NYS income taxes receivable	923,672		923,672	923,672	
Note receivable	<u>1,183,062</u>	<u>1,183,062</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total assets	<u>\$1,488,295,508</u>	<u>\$137,134,305</u>	<u>\$1,351,161,203</u>	<u>\$1,401,848,032</u>	<u>\$(50,686,829)</u>

Liabilities, surplus and other funds	<u>Examination</u>	<u>Company</u>	Surplus Increase <u>(Decrease)</u>
Losses and loss adjustment expenses	\$1,564,999,535	\$1,433,999,535	\$(131,000,000)
Reinsurance payable on paid losses and loss adjustment expenses	104,182	104,182	
Other expenses (excluding taxes, licenses and fees)	1,586,620	1,586,620	
Unearned premiums	210,300,470	210,300,470	
Advance premium	3,331,565	3,331,565	
Ceded reinsurance premiums payable (net of ceding commissions)	5,047,348	5,047,348	
Amounts withheld or retained by company for account of others	\$164,396	164,396	
Payable for securities	4,585,500	4,585,500	
Paid to attorney-in-fact	100,408	100,408	
Due to subscribers	3,137,826	3,137,826	
Anticipated future investment income on losses and LAE reserves	(161,391,995)	(189,391,995)	(28,000,000)
Reinsurance deposit liability	4,290,000	4,290,000	
Miscellaneous liabilities	6,728,808	6,728,808	
Premium deficiency reserve	3,008,781	3,008,781	
Investment payable-MMIP	<u>873,252</u>	<u>873,252</u>	<u>0</u>
Total liabilities	<u>\$1,646,866,696</u>	<u>\$1,487,866,696</u>	<u>\$(159,000,000)</u>
 <u>Surplus and other funds</u>			
Gross paid in and contributed surplus	\$ 25,131,767	\$ 25,131,767	
Unassigned funds (surplus)	<u>(320,837,260)</u>	<u>(111,150,431)</u>	<u>(209,686,829)</u>
Surplus as regards policyholders	<u>\$(295,705,493)</u>	<u>\$(86,018,664)</u>	<u>\$(209,686,829)</u>
Total liabilities, surplus and other funds	<u>\$1,351,161,203</u>	<u>\$1,401,848,032</u>	

Note: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2010 through 2014. 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.

This examination has determined that as of December 31, 2014, the Company was insolvent in the amount of \$295,705,493, and its capital of \$650,000 was impaired in the amount of \$296,355,493. Additionally, the Company's minimum required to be maintained surplus of \$650,000 was impaired in the amount of \$296,355,493.

B. Statement of Income

Net loss for the five-year examination period amounted to \$75,926,937, as detailed below.

Underwriting Income

Premiums earned		\$1,860,023,015
Deductions:		
Losses and loss adjustment expenses incurred	\$1,759,023,303	
Other underwriting expenses incurred	<u>359,249,406</u>	
Total underwriting deductions		<u>2,118,272,709</u>
Net underwriting gain or (loss)		\$(258,249,694)

Investment Income

Net investment income earned	\$189,495,577	
Net realized capital gain	<u>106,536,925</u>	
Net investment gain or (loss)		296,032,502

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (376,453)	
Finance and service charges not included in premiums	391,813	
Discount on Loss and LAE reserve	(132,438,381)	
Miscellaneous Income from MMIP	17,147,369	
Retroactive reinsurance	<u>12,000</u>	
Total other income		<u>(115,263,652)</u>
Net income before federal and foreign income taxes		(77,480,844)
Federal and foreign income taxes incurred		<u>(1,553,907)</u>
Net loss		<u>\$(75,926,937)</u>

C. Capital and Surplus Account

Surplus as regards policyholders decreased by \$116,117,029 during the five-year examination period January 1, 2010 through December 31, 2014, detailed as follows:

Surplus as regards policyholders per Company as of December 31, 2009			\$(179,588,464)
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net loss		\$75,926,937	
Net unrealized capital gains or (losses)	\$ 9,162,588		
Change in net deferred income tax	81,193,307		
Change in non-admitted assets		126,268,161	
Change in provision for reinsurance	194,152		
Prior year adjustments	225,400		
Change in Subscriber balance	0	4,697,378	
Net increase (decrease) in surplus	<u>\$90,775,447</u>	<u>\$206,667,076</u>	<u>(116,117,029)</u>
Surplus as regards policyholders per report on examination as of December 31, 2014			<u>\$(295,705,493)</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination net undiscounted liability for the captioned items of \$1,564,999,535 is \$131,000,000 more than the \$1,433,999,535 reported by the Company in its December 31, 2014 filed annual statement. The examination analysis of the loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and statutory accounting principles, including SSAP No. 55.

Based on the analysis, the Department considers the Company's carried reserves as of December 31, 2014 to be materially deficient.

5. ANTICIPATED FUTURE INVESTMENT INCOME ON LOSSES AND LAE RESERVES

The examination liability for the captioned item of \$(161,391,995) is \$28,000,000 less than the \$(189,391,995) reported by the Company in its December 31, 2014, filed annual statement.

The examination adjustment resulted because the interest rate selected to discount examination reserves for losses and loss adjustment expenses was lower than the rate the Company selected. Pursuant to NYIL Section 4117(e), the Department provisionally granted a permitted practice to the Company to discount its reserves for losses and loss adjustment expenses.

NYIL Section 1303 states:

Every insurer shall...maintain reserves in an amount estimated in the aggregate to provide for the payment of all losses or claims incurred on or prior to the date of statement, whether reported or unreported, which are unpaid as of such date and for which such insurer may be liable, and also reserves in an amount estimated to provide for the expenses of adjustment or settlement of such losses or claims.

Further, Paragraph 10 of SSAP No. 55 states:

The liability for claim reserves and claim liabilities, unpaid losses, and loss/claim adjustment expenses shall be based upon the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience.

It is recommended that the Company address these ongoing reserving inadequacies and increase its carried reserves to an appropriate level, pursuant to the provisions of NYIL Section 1303 and Paragraph 10 of SSAP No. 55.

6. BONDS

The examination admitted asset of \$976,780,321 for the captioned item is \$5,551,432 less than the \$982,331,753 reported by the Company as of December 31, 2014.

The examination adjustment was due to the Company's failure to value the bonds in accordance with the provisions of SSAP No. 26, which states that bonds with investment ratings from 3 to 6 shall be valued at the lower of amortized cost or fair value. The Company used amortized cost that was higher than fair value, and the bonds had NAIC's investment ratings between 3 and 6. Therefore, it is recommended that the Company value its bond investments in accordance with the provisions of SSAP No. 26.

7. OTHER INVESTED ASSETS

The examination admitted assets of \$32,584,166 is \$45,135,397 less than the \$77,719,563 reported by the Company as of December 31, 2014.

The examination adjustments were due to the following:

- a) The Company did not value some of its limited partnership investments in accordance with SSAP Nos. 48 and 97. The SSAPs require that such investments be valued using the most recent audited financial statements. The examination change of \$36,714,520 was determined from the value reported in the partnerships' most recent audited financial statements. Included in the examination change was \$29,306,274 of invested asset in another limited liability company at December 31, 2014. Subsequent to the examination date, the investment was written down to zero; and as such, the value reported was considered to be doubtful, pursuant to NYIL Section 1302 (b).
- b) The Company reported excess investment of \$8,420,877 in a limited partnership, pursuant to NYIL Section 1404 (8)(A)(i) and (B)(ii), which states in part:

(A) Investments in common shares or partnership interests of any solvent American Institution, if: (i) all its obligations and preferred shares, if any,

are eligible as investments under this subsections and... No Insurer subject to the provisions of paragraph two of subsection (a) or (b) of section one thousand four hundred three of this article shall invest in or loan upon any one institution's outstanding equity interests as amount exceeding one percent of the insurer's admitted assets as shown by its last statement on file with the superintendent...

It is recommended that the Company value its investment in partnerships in accordance with SSAP Nos. 48 and 97.

It is recommended that the Company limit its partnership investments to not more than one percent of its admitted assets, pursuant to the provisions of NYIL Section 1404 (8)(A)(i) and (B)(ii).

It is recommended that the Company report any partnership asset of a doubtful value in accordance with NYIL Section 1302 (b).

In addition, NYIL Section 1412(a) and (b) states:

In determining the financial condition of any such insurer, the value of any wholly ineligible investments, and the value of any investment in excess of any limitation prescribed in this chapter, shall be deducted as a non-admitted asset of such insurer.

The Company reported a value for a limited partnership that exceeded its investment limitation prescribed by law. Therefore, it is recommended that the Company report any ineligible amount of the partnership's investments in compliance with NYIL Section 1412(b).

Further, the Company initial cost of investment in the partnership noted in Item(a), above was \$19,468,804. The investment is material to the Company's financial condition, pursuant to NYIL Section 6101(e), which states:

"Material transaction" means a transaction, other than claim payments, that involves more than one-half of one percent of the reciprocal's admitted assets as of the thirty-first day of December of the prior year.

At December 31, 2014, the Company's one-half of one percent of its admitted assets was \$6.8 million and is material as the law dictates. It is recommended that the Company be guided by NYIL Section 6101(e) when investing its funds.

8. CONCLUSION

This examination has determined that as of December 31, 2014, the Company was insolvent in the amount of \$295,705,493, and its capital of \$650,000 was impaired in the amount of \$296,355,493. Additionally, the Company's minimum required to be maintained surplus of \$650,000 was impaired in the amount of \$296,355,493.

9. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Surplus Impairment</u>	
This examination has determined that as of December 31, 2014, the Company was insolvent in the amount of \$295,705,493, and its capital of \$650,000 was impaired in the amount of \$296,355,493. Additionally, the Company's minimum required to be maintained surplus of \$650,000 was impaired in the amount of \$296,355,493.	20,26
B. <u>Board Compensation</u>	
i. It is recommended that the Company's board approve all compensation paid to its board members.	6
ii. It is recommended that the Company and its manager re-evaluate the compensation of the board members to determine if it is reasonable given the Company's poor financial condition	6
iii. It is recommended that board members who engage in consulting services for the Company disclose any such services they perform in their conflict of interest statements completed annually.	6
C. <u>Executive Compensation</u>	
It is recommended the Company's board discuss and approve its executive compensation and ensure that documentation of the board actions is maintained in the minutes.	7
It is recommended that the Company maintain documents for the bases of allocating salaries of its executive officers between itself and its manager, as required by Department Regulation No. 30, Part 109.2 (b)(2).	7
It is recommended that the Company, as well as its manager, maintain the basis of determining bonuses paid to employees.	7
It is also recommended that the board approve employee bonuses and document such approvals in the minutes of the board.	7
D. <u>Conflict of Interest Transactions</u>	
i. It is recommended that the Company ensure that AFP file its lease extension with Department in accordance with NYIL Section 6111(f).	88

	ii. It is recommended that the Company ensure that its board member disclose the transaction in the conflict of interest statement completed annually.	8
	iii. It is recommended that the Company ensure its manager's owner disclose the transaction in his conflict of interest statements completed annually as a Company board member.	9
	iii. It is recommended that the Company and its manager file the agreement with the Department as required by NYIL Section 6111(f).	9
E.	<u>Accounts and Records</u>	
	<u>Custodian Agreement</u>	
	It is recommended that the Company ensure its custodial agreement meets all of the required provisions as set forth in the NAIC Financial Condition Examiners' Handbook.	14
	<u>Investment Policy Statement</u>	
	It is recommended that the Company comply with Section IV of its investment policy statement regarding its investment limitation.	15
	<u>Compliance with Management Agreement</u>	15
	It is recommended that the Company comply with the requirements in Paragraph 5 of the Management Agreement.	
	<u>Management Fee Determination</u>	
	It is recommended that the Company calculate its management fees as prescribed by the agreement.	16
	It is recommended that AFP reimburse PRI for its overpayment to AFP resulting from incorrectly including MMIP's premiums in calculating management fees.	17
F.	<u>Anticipated Future Investment Income on Losses and LAE Reserves</u>	
	It is recommended that the Company address its ongoing reserving inadequacies and increase its carried reserves to an appropriate level, pursuant to the provisions of NYIL Section 1303 and Paragraph 10 of SSAP No. 55.	23

G. Bonds

It is recommended that the Company value its bond investments in accordance with SSAP No. 26 24

H. Other Invested Assets

i. It is recommended that the Company value its investment in partnerships in accordance with SSAP Nos. 48 and 97. 25

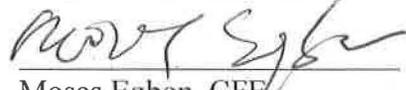
ii. It is recommended that the Company limit its partnership investments to not more than one percent of its admitted assets, pursuant to the provisions of NYIL Section 1404 (8)(A)(i) and (B)(ii). 25

iii. It is recommended that the Company report partnership asset of a doubtful value in accordance with NYIL Section 1302 (b). 25

iv. It is recommended that the Company report any ineligible amount of partnership's investment in compliance with NYIL Section 1412 (b). 25

v. It is recommended that the Company be guided by NYIL Section 6101(e) when investing its funds. 25

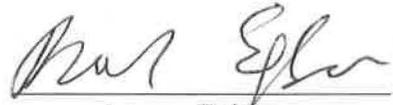
Respectfully submitted,



Moses Egbon, CFE
Financial Services Examiner 4

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

Moses Egbon, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.


Moses Egbon

Subscribed and sworn to before me

this 29th day of January, 2019.



IAN D. MARTIN
NOTARY PUBLIC, STATE OF NEW YORK
NO. 01MA6242911
QUALIFIED IN KING COUNTY
COMMISSION EXPIRES JUNE 13, 2019