

REPORT ON EXAMINATION

OF THE

MEDICAL LIABILITY MUTUAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2006

DATE OF REPORT

MAY 21, 2009

EXAMINER

FE ROSALES, CFE

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STATE OF NEW YORK  
INSURANCE DEPARTMENT  
25 BEAVER STREET  
NEW YORK, NEW YORK 0004

May 21, 2009

Honorable Eric R. Dinallo  
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 22692 dated November 27, 2007 attached hereto, I have made an examination into the condition and affairs of Medical Liability Mutual Insurance Company as of December 31, 2006, and submit the following report thereon.

Wherever the designations "the Company" or "MLMIC" appear herein without qualification, they should be understood to indicate Medical Liability Mutual Insurance Company.

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 branch office located at 8 British American Boulevard, Latham, New York 12110.

## **1. SCOPE OF EXAMINATION**

This examination comprised of a verification of the Company's assets and liabilities as of December 31, 2006, a review of income and disbursements deemed necessary to accomplish such verification, and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners:

- Significant subsequent events
- Company history
- Corporate records
- Management and control
- Fidelity bonds and other insurance
- Territory and plan of operation
- 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, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

## **2. DESCRIPTION OF COMPANY**

The Company was incorporated as a mutual casualty insurance company pursuant to Section 4107 of the New York Insurance Law on September 30, 1976 as the Hospital Underwriters Mutual Insurance Company ("HUM"). Its membership was originally limited to hospitals and healthcare facilities; however, on January July 20, 1990, HUM received approval from the Department to issue policies to individual physicians, and on June 6, 1994, approval was granted to issue policies to allied healthcare professionals. On November 18, 1993, the Company changed its name to Healthcare Underwriters Mutual Insurance Company.

Effective July 18, 2001, HUM merged with Medical Liability Mutual Insurance Company ("Original MLMIC"), with HUM as the surviving entity and the new merged company was named

Medical Liability Mutual Insurance Company (“MLMIC” or “the Company”). The transaction was accounted for as a statutory merger. Original MLMIC was incorporated as a mutual insurance company under the laws of the State of New York on April 4, 1975 and began its operations on July 1 of the same year. It was formed under the auspices of the Medical Society of the State of New York (“MSSNY”).

MLMIC primarily writes professional liability insurance on a direct basis for physicians, surgeons, dentists, hospitals and managed care organizations, other healthcare professionals, community health centers, and nursing homes in New York and ten other states, primarily in the Northeast. The Company ranks as the largest writer of medical professional liability insurance in the United States and provides coverage on both an occurrence basis and claims-made basis.

All policyholders are deemed members of the Company. At any regular or special meeting of members, each individual member shall be entitled to cast one vote and each non-individual member shall be entitled to cast the following numbers of votes:

- a) Two votes if the member is a group-model health maintenance organization (“HMO”), a preferred provider organization (“PPO”) or a similar managed health care facility not having its own physical plant where medical treatment is provided; or
- b) Five votes if the member is a staff-model HMO, clinic, medical center or similar entity having its own physical plant where medical treatment is provided; or
- c) Ten votes if the member is a hospital.

A. Management

Pursuant to the Company’s amended and restated charter and by-laws, management of the Company is vested in a board of directors consisting of thirty nine persons, who shall be divided into three classes: Class I, Class II and Class III; each class to consist of thirteen directors, who are elected to serve a three-year term. It is noted, however, that there were only thirty eight directors as of the examination date because of the death in November 2006 of one director (Andrew Patterson, M.D.), who was also then president of the Company. This vacancy in the directorship was not filled until the next annual meeting of members in May 2007.

All except four of the directors of the corporation shall be members of the corporation.

The directors as of December 31, 2006 were as follows:

**Class I (to serve until May 2008)**

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Robert Breault, M.D. Schenectady, NY	Retired, Surgery
John Clowe, M.D. Englewood, FL	Retired, Family Practice
William Dolan, M.D. Rochester, NY	Orthopedic, Surgery
Mark Feldman, D.M.D. Garden City, NY	Dentistry, Treasurer and American Dental Association President-Elect
Samuel Gelfand, M.D. Rockville Centre, NY	Retired, Surgery
Kira Geraci-Ciardullo, M.D. Harrison, NY	Allergy, Pediatrics
Stanley Grossman, M.D. Newburgh, NY	Surgery (retired), President of MLMIC
Tarky J. Lombardi, Jr. Syracuse, NY	Attorney, Former Member of the New York State Senate
Samuel Madell, M.D. Fort Lee, NJ	Retired, Radiology
Robert Menotti, M.D. Clinton, NY	Surgery (retired), Vice President and Secretary of MLMIC
Nancy Nielsen, M.D. Orchard Park, NY	Internal Medicine; Speaker, American Medical Association House of Delegates
James Reed, M.D. Cohoes, NY	President and Chief Executive Officer, Northeast Health
William Streck, M.D. Cooperstown, NY	President and Chief Executive Officer, Bassett Healthcare

**Class II (to serve until May 2009)**

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Anthony Ascioti, M.D. Syracuse, NY	Anesthesiology
Charles Aswad, M.D. Binghamton, NY	Retired, Emergency Medicine
Ann M. Barbaccia, M.D. Rockville Centre, NY	Obstetrics & Gynecology
David Felton Hamilton, NY	President & Chief Executive Officer, Community Memorial Hospital
John Fracchia, M.D. New York, NY	Urology
Alvin Katz, M.D. New York, NY	Otolaryngology
Joseph Maldonado, Jr., M.D. Rome, NY	Urology
Paul Okosky, M.D. Saratoga Springs, NY	Family Practice
Kenneth Roberts Setauket, New York	President, John T. Mather Memorial Hospital
Anthony Santomauro, M.D. Williamsville, NY	Retired, Surgery
L. Arne Skilbred, M.D. Sag Harbor, NY	Retired, Orthopaedic Surgery
Salvatore Volpe, M.D. Staten Island, NY	Pediatrics, Internal Medicine
Murray Yost, Jr., M.D. Williamsville, NY	Obstetrics and Gynecology

**Class III (to serve until May 2007)**

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Duane Cady, M.D. Lafayette, NY	Surgery (retired), Past Chairman, Board of Trustees of American Medical Association
Gerald Cassidy Delmar, NY	Retired, Former Vice President of MLMIC
John Dwyer, M.D. New York, NY	Retired, Obstetrics and Gynecology
Harold Herzog New Canaan, CT	Retired, Chairman, Finance Committee of MLMIC
Richard Karpinski, M.D. New York, NY	Plastic Surgery
Ezriel Kornel, M.D. White Plains, NY	Neurosurgery
John Lombardo, M.D. New York, NY	Ophthalmology
Norman Loomis, M.D. Ontario, NY	Retired, Family Practice
Richard Peer, M.D. Buffalo, NY	Surgery; President and Member, Council of Medical Society of the State of New York
David Sibulkin, M.D. New York, NY	Dermatology
Richard Waldman, M.D. Jamesville, NY	Obstetrics and Gynecology
Frederick Wetzel, D.D.S. Schenectady, NY	Dentistry, Member, Board of Governors, New York State Dental Association



The minutes of all meetings of the board of directors for the four-year period under examination were reviewed. The Company meets at least four times per year as required by its by-laws. The meetings were generally well attended as all directors have attendance records of over 50% of the board's meetings for the four years under examination.

In addition, the examiners' review of all available minutes of meetings of the board's finance and executive committees for the years under examination revealed that these committees have consistently approved the Company's investment transactions. Prior to 2005, the executive committee was responsible for approving the investment transactions. Starting in 2005, the finance committee has assumed this responsibility.

#### Conflict of Interest Statements

During the review of the directors' conflict of interest statements for 2006, it was noted that all directors signed their statements but nine of whom did not date their conflict of interest statements.

As indicated in the Company's conflict of interest policy declarations:

"the conflict of interest statement is intended to indicate procedures whereby any possible conflicting interest, which may arise from time to time will be promptly disclosed so that, if necessary, corrective or preventive action may be taken."

As such, by having the statement undated, it is not easily determinable whether or not the statement is being filled out on a regular basis (e.g. annually).

It is therefore recommended that the Company ensure that the conflict of interest statements completed by the board of directors are properly dated to ascertain that such statements are completed on a regular basis.

The principal officers of the Company as of December 31, 2006 were as follows:

<u>Name</u>	<u>Title</u>
Stanley L. Grossman, MD	President
Robert A. Menotti, MD	Vice President and Secretary
Donald J. Fager	Vice President and Assistant Secretary
Edward J. Amsler	Vice President and Assistant Treasurer
K. Wayne Kahle	Vice President and Comptroller
Daniel F. Canniff	Vice President

B. Territory and Plan of Operation

As of December 31, 2006, the Company is licensed to write business in twenty-five states and the District of Columbia. It is important to note, however, that the Company wrote the majority of its business in New York State.

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:

<u>Paragraph</u>	<u>Line of Business</u>
3	Accident and 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
20	Marine
21	Marine protection and indemnity
22	Residual value
26 (A-D)	Gap insurance
27	Prize indemnification
28	Service contract reimbursement
29	Legal service insurance
30	Substantially similar kinds of insurance

The Company is also licensed to write such workers' compensation insurance as may be incidental to coverages contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69<sup>th</sup> Congress as amended; 33 USC Section 901 et. seq. as amended) and as authorized by Section 4102(c) of the New York Insurance Law, reinsurance of

every kind or description. The Company is also licensed to write the business of special risk insurance pursuant to Article 63 of the New York Insurance Law.

Based upon the lines of business for which the Company is licensed to write, and pursuant to the requirements of Articles 13, 41 and 63 of the New York Insurance Law, MLMIC is required to maintain a minimum surplus to policyholders of \$35,000,000. Surplus to policyholders as of December 31, 2006, as reported in the Company's filed annual statement was \$162,145,985. The Company also reported a special contingent surplus pursuant to Section 4109 of the New York Insurance Law in the amount of \$1,650,000 and unassigned funds in the amount of \$160,495,985.

The Company is a direct writer and writes primarily medical malpractice insurance. All policies are issued on a non-assessable basis and coverage is provided on either a claims-made or occurrence basis.

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>New York State</u>	<u>Total United States</u>	<u>Premiums Written in New York State as a Percentage of United States Premiums</u>
2003	\$585,669,679	\$611,710,838	95.7%
2004	\$598,843,498	\$614,145,717	97.5%
2005	\$629,228,901	\$630,005,789	99.9%
2006	\$688,105,418	\$688,105,418	100.0%

C. Reinsurance

Assumed

The Company assumes a relatively small volume of business compared to its direct writings. Assumed premiums represented approximately 2.4% of its gross premiums written in 2006, compared to approximately 28.9% of its gross premiums written in 2002. The decrease in assumed premiums from the prior period is primarily due to a decrease in premiums assumed from affiliates. Approximately 24 percent of such assumptions stemmed from business assumed from its subsidiary, Princeton Insurance Company ("Princeton"). Approximately 76% of the Company's assumptions are from unaffiliated insurers. The Company's assumed reinsurance program consists mainly of

professional liability coverage as indicated further herein, assumed on a quota share and excess of loss basis, pursuant to the terms of facultative and treaty agreements with both authorized and unauthorized cedants. Additionally, the Company's participation in various mandated pools is reflected in its assumed reinsurance activity, except for the Company's participation in the Medical Malpractice Insurance Pool of New York State ("MMIP") in which the Company's share of such business is recorded as if it was directly written.

Effective July 1, 2002, the Company assumed 80% quota share of the net retained liability of Princeton under policies written on an occurrence, claims-made or occurrence-plus form for policies in force as of the effective date covering the following lines of business:

- Health Care Facility Professional Liability, Comprehensive General Liability, Personal Injury Liability, Environmental Damage Liability, Premises Medical Payments, and Employee Benefits Liability
- Professional Liability
- Miscellaneous Professional Liability

MLMIC and Princeton executed a termination addendum terminating this quota share agreement on a cut-off basis as of March 31, 2003. MLMIC returned the unearned premium, net of commission, and as such, will not be liable for any losses with accident dates subsequent to the termination date.

Effective December 31, 2000, MLMIC assumed 100% of the aggregate ultimate losses settled by Princeton on and after January 1, 2001, covering professional liability claims held covered by Princeton and giving rise to losses that are first notified to Princeton subsequent to insureds having cancelled or not renewed their coverage with Princeton ("tail policies"). This agreement remains in force and effect until any and all liability of Princeton as respects the business reinsured has been exhausted either by settlement of losses up to an aggregate overall limit of \$180 million or until coverage is terminated. Princeton established a "Funds withheld" account exclusively for business reinsured for which premium amounts and interest are credited and settlement amounts due to Princeton are effected until such time, if any, as this "Funds withheld" account is exhausted. It should be noted that the "Funds withheld" account is segregated in a separate trust account. As of December 31, 2006, this account has a balance of approximately \$69 million.

Effective July 1, 2003, the Company established a trust account for the benefit of OHIC Insurance Company (“OHIC”), a wholly owned subsidiary, to fund the Company’s obligations under three reinsurance agreements previously terminated and currently in run-off. This trust account was initially funded by MLMIC in the amount of \$125.8 million which represents reinsurance payable by MLMIC to OHIC as of June 30, 2003. As of December 31, 2006, the trust account balance was approximately \$48.4 million.

The Company assumed from Professional Liability Insurance Company of America (“PLICA”), MLMIC’s former subsidiary, 80% quota share of the amount of ultimate net loss incurred under all policies written or renewed. This contract took effect in 1997 and continues until terminated by either party. As a condition of the sale of PLICA in 2004, the contract was superseded by the assumption agreement attached to the PLICA purchase agreement. Under the assumption agreement, the Company assumed 100% of the policy liabilities and recorded it as retroactive reinsurance. As of December 31, 2006, the retroactive reinsurance assumed payable reported in the Company’s filed annual statement was approximately \$2.1 million.

Pursuant to an amended and restated opinion and decision of the Superintendent of Insurance of the State of New York dated July 3, 2000, the Company assumed, effective June 30, 2000, 100% of the policy liabilities of Medical Malpractice Insurance Association (“MMIA”) totaling approximately \$379 million, on a novation basis. MMIA was a non-profit, unincorporated association consisting of all insurance companies authorized to write within New York on a direct basis, personal injury liability insurance and was established by Article 55 of the New York Insurance Law for the purpose of providing, for a specified period, a market for medical malpractice insurance when availability of such coverage was severely limited. Effective July 1, 2000, MMIA was dissolved pursuant to Section 5502(c) of the New York Insurance Law and, as such, ceased issuing and renewing policies. As of December 31, 2006, the discounted loss and loss adjustment expense reserves reported by the Company for MMIA was \$104 million.

Effective July 1, 2002, the Company has a quota share participation in the net retained liability of Transatlantic Reinsurance Company under any and all new and renewal binders, cover notes, policies, acceptances, contracts, certificates or agreements of reinsurance, effective between July 1, 2002 and June 30, 2003, with attachment points of \$1 million or greater, written and classified by the Company as health care and/or health care related business. With respect to treaty business, the Company had 75% quota share participation up to a maximum liability limit, each program, each

loss of \$1.125 million (being 75% of 15% of \$10 million). With respect to facultative business, the Company had 75% quota share participation up to a maximum liability limit, each account, each loss of \$1.125 million (being 75% of 15% of \$10 million). This contract was cancelled on a runoff basis effective June 30, 2003.

The Company also entered into excess of loss reinsurance contracts with Mutual Insurance Company of Arizona effective January 1, 2003 in respect of policies attaching on or after such date, and remaining in force for an indefinite period. This contract was cancelled on a runoff basis effective December 31, 2003.

Effective July 1, 2006 the Company assumed physicians excess business in a 50% quota share arrangement with Healthcare Professionals Insurance Company (“HPIC”), a New York domestic company.

The examiner reviewed all assumed reinsurance contracts in effect as of the examination date. The following were noted:

i. Offset Clause

The quota share reinsurance agreement with Princeton (tail) contains a provision allowing for broad offset rights, as follows:

“Each party hereto shall have and may exercise at any time and from to time the right of offset any balance or balances ... under this agreement and/or any other agreements between the parties...” (Emphasis added).

In reinsurance agreements containing such broad rights to offset, this Department requires that the following language be included:

“In the event of the insolvency of either party to this agreement then offsets shall only be allowed to the extent permitted by the provision of Section 7427 of the New York Insurance Law.”

It is recommended that the offset provision of the “tail” quota share reinsurance agreement with Princeton be amended to state that in the event of the insolvency of either party to this agreement then offsets shall only be allowed to the extent permitted by the provision of Section 7427 of the New York Insurance Law. It is further recommended that all future reinsurance agreements with an offset provision entered into by the Company include such required language.

The Company utilizes reinsurance accounting as defined in National Association of Insurance Commissioners (“NAIC”) Accounting Practices and Procedures Manual Statements of Statutory Accounting Principles (“SSAP”) No. 62 for all of its assumed reinsurance business.

Ceded

As of December 31, 2006, the Company had the following excess of loss reinsurance program in place:

<u>Type of Treaty</u>	<u>Coverage</u>
Hospital Professional Liability (7/1/99 until terminated) 100% Authorized	<u>Sections A &amp; B</u> 75% of the amount in excess of \$1,000,000 ultimate net loss not to exceed 75% of the combined per-occurrence limit provided by the policy minus the retention of \$1 million subject to a maximum of \$7.5 million for each loss occurrence.
Casualty Catastrophe Excess of Loss 60% Authorized	\$5,000,000 in excess of \$6,000,000, each event; the sum recoverable is subject to a maximum of \$10 million for the term of the contract. This covers MLMIC’s core book of business.

Effective January 1, 2002, the Company also entered into an excess of loss reinsurance contract for Medical Professional Liability for the business originally written by the Company prior to the merger with Original MLMIC (“Old HUM business”). This reinsurance agreement, however, was terminated on a run-off basis as of February 29, 2004.

<u>Type of Treaty</u>	<u>Coverage</u>
Medical Professional Liability (2 layers) 100% Authorized	<u>Section A – Specific (Exhibit A)</u> \$3,000,000 in excess of \$2,000,000 ultimate net loss on each occurrence and/or claim made (as applicable), each insured, each policy \$20,000,000 in excess of \$5,000,000 ultimate net loss on each occurrence and/or claim made (as applicable), each insured, each policy  <u>Section B – Aggregate (applies to policies with aggregate limits greater than \$6,000,000)</u> \$3,000,000 in excess of \$6,000,000 aggregate ultimate net loss on each insured, each policy, and each location with respect to Residential Care Facilities and all other

Type of TreatyCoverage

insureds.

\$20,000,000 in excess of \$9,000,000 aggregate ultimate net loss on each insured, each policy, and each location with respect to Residential Care Facilities and all other insureds.

Section C – Clash Excess of Loss

\$4,000,000 in excess of \$1,000,000 ultimate net loss on each occurrence and/or claim made plus a proportionate share of applicable loss expense.

Effective March 1, 2004, the Company started retaining full policy limits (i.e. no reinsurance protection) for medical professional liability business written in Old HUM's Latham, NY branch office.

MLMIC also maintains a 50% loss portfolio transfer quota share agreement with an authorized reinsurer, whereby it cedes 50% of the losses outstanding as of November 15, 1999, including incurred but not reported, for Healthcare Professional Liability insurance written for Mercy Medical Center occurring during the period October 1, 1985 through November 15, 1999. The reinsurer's limit of liability applies to any combination of loss, extra contractual obligations and excess of policy limits.

Additionally, during the examination period MLMIC maintained facultative certificates for two of its hospital policies.

Effective July 1, 2006, the Company entered into a quota share agreement with an authorized company whereby MLMIC cedes 50% of physicians excess losses incurred in policy year 2006, including loss adjustment expense, extra contractual obligations, and loss in excess of policy limits arising from such policies.

Effective July 1, 2006, MLMIC entered into a quota share agreement with an authorized company whereby MLMIC cedes 50% of hospital business underwritten by the Company's Latham office. The business is subject to a limit of \$3 million on any occurrence and \$7 million in the aggregate. This contract applies to all policies issued or renewed with an effective date during the 18-month term extending from July 1, 2006 to December 31, 2007.



Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's chief executive officer pursuant to 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 paragraph 6 of SSAP No. 62.

The examiners reviewed all ceded reinsurance contracts in effect during the examination period. Except as noted herein, these contracts all contained the required clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

i. Arbitration clause

A review of the Company's ceded reinsurance contract with American Reinsurance Company (now known as Munich Re America) revealed that this contract do not contain an arbitration clause. It is recommended that the Company include an arbitration clause in all of its reinsurance agreements.

ii. Errors and omissions clause

A review of the Company's ceded reinsurance contract with American Reinsurance Company (now known as Munich Re America) also revealed that this contract does not contain an errors and omissions clause. This clause can protect the ceding company from losing protection as a result of inadvertent and unintentional errors and omissions in ceding risks.

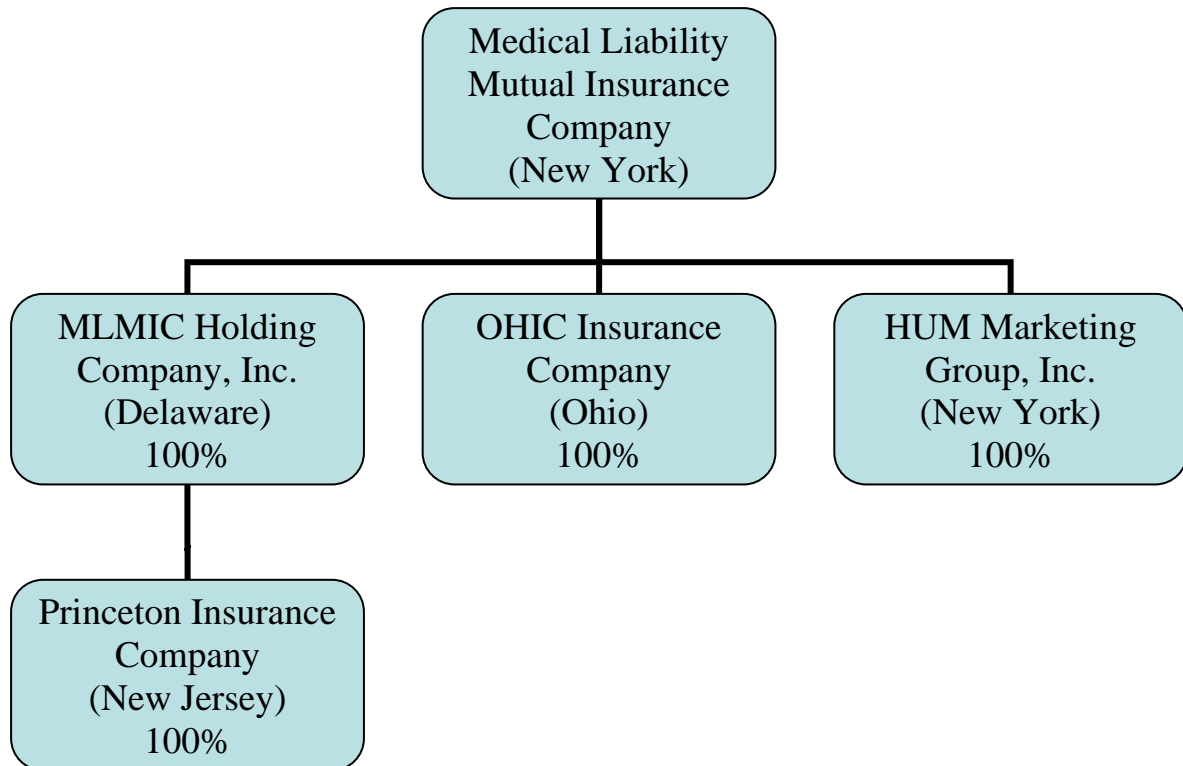
It is recommended that all reinsurance agreements entered into by the Company include an errors and omissions clause.

D. Holding Company System

MLMIC is the ultimate parent company of several entities, including two property and casualty insurers – Princeton Insurance Company (“Princeton”), a New Jersey domestic insurer and OHIC Insurance Company (“OHIC”), an Ohio domestic insurer.

Pursuant to Section 1502(a) of the New York Insurance Law, MLMIC is exempt from the filing requirements of Article 15. However, pursuant to Circular Letter No. 17 (2001) and Department Regulation 53, the Company makes certain filing with the Department.

The following chart depicts the Company in relationship to its subsidiaries within the holding company system as of December 31, 2006:



Effective January 10, 2007, MLMIC sold its ownership interest in OHIC, including surplus notes held by the Company totaling \$58 million.

#### Surplus Notes

As of December 31, 2006, the Company held surplus notes totaling \$98 million from two of its insurer subsidiaries; \$58 million from OHIC and \$40 million from Princeton. The Company reported the notes as admitted assets under the caption "Other invested assets" pursuant to the provisions of paragraphs 9 and 10 of SSAP No. 41. These surplus notes were filed with and non-objected to by the Department.

As of the examination date, the Company is a party to two agreements with affiliated parties, as follows:

1. Service and Expense Allocation Agreement

Effective June 26, 2002, the Company and its insurer subsidiaries – OHIC, and Princeton (collectively, “the Companies”) entered into a service and expense allocation agreement pursuant to which the Companies have agreed to provide and make available to each other the services of their personnel, the apportionment of space, and the use of equipment. This agreement provides that cost and expenses of providing the facilities, equipment and services are to be allocated on a fair and equitable basis and in conformity with customary insurance practices consistently applied. Out of pocket expenses directly calculable, which can be allocated directly to the appropriate parties, shall be so allocated whenever feasible, and otherwise such allocations shall be made in accordance with Department Regulation 30.

The review of the allocation of expenses among the parties revealed that the charges are reasonable and in accordance with the requirements of Department Regulation No. 30.

The agreement was filed with this Department and was non-objected to by letter dated November 28, 2001.

2. Amended and Restated Allocation of Consolidated Tax Liability Agreement

The Company is also a party to an allocation of consolidated tax liability agreement. This agreement was entered into on January 15, 2002, between MLMIC (the common Parent) and Princeton Insurance Company, MLMIC Holding Company, Inc., Princeton Advertising & Marketing Group Inc., Princeton Agency, Inc., Princeton Risk Protection, Inc., Princeton Insurance Agency, Inc. HUM Holding Inc., OHIC Insurance Co., HUM Healthcare Systems, Inc., HUM Marketing Group, HUM Affiliates, Inc., collectively, the “Subsidiaries.” MLMIC and each Subsidiary (the “Group”) will file consolidated federal income tax returns so long as they are eligible to file such returns under the Tax Code, or until such time as they elect not to file such returns in compliance with the Treasury Department Regulations pursuant to Section 1504 of the Tax Code. MLMIC and each Subsidiary allocate the consolidated federal income tax liability of the Group among the members of the Group. The agreement shall be effective for all taxable years ending on or after December 31, 2001.

Each of the Subsidiaries compute a separate return tax liability for each taxable year and shall pay to MLMIC an amount equal to the tax liability as computed had they filed separately. If any of the Subsidiary would have been entitled to carry back a loss or credit to a prior taxable year within the consolidated period had that Subsidiary filed a separate federal income tax return for such then ended consolidated year and for all prior years, then MLMIC shall pay to that Subsidiary the difference between such Subsidiary's liability for the carry-back year less the Subsidiary's liability in such carry-back year recomputed taking into account such loss or credit.

Payments by each of the Subsidiaries to MLMIC shall be made on a quarterly basis based on estimates of each Subsidiary's separate return tax liability for the period prepared by each Subsidiary and approved by MLMIC.

The agreement requires that MLMIC shall maintain a separate escrow account for each insurance subsidiary included in the MLMIC consolidated federal income tax return that is subject to Department Circular Letter No. 33 for each taxable years consisting of assets eligible for investment by such insurance subsidiary in the amount equal to the excess, if any, of the net payments of the subsidiary's separate tax liability for the taxable year, over the payments made by MLMIC to the Internal Revenue Service ("IRS") for the taxable year with respect to such insurance subsidiary's share of the Group's tax liability. The MLMIC consolidated federal income tax return showed no taxes due or paid to the IRS for 2006. However, one of the Subsidiaries (Princeton) owed alternative minimum tax ("AMT") for this tax period and made payments into the MLMIC tax escrow in 2007 prior to filing the 2006 federal income tax return.

Termination of the agreement shall be subject to prior written notice to the Commissioner of Banking and Insurance of the State of New Jersey pursuant to holding company provisions.

The agreement was filed with this Department and was non-objected to by letter dated April 8, 2002.

The review of the agreement revealed that it is in compliance with Department Circular Letter No. 33 (1979).

#### E. Underwriting and Claims Service Agreement

MLMIC is party to a service agreement with Donald J. Fager & Associates, Inc. (“Fager”). This agreement authorizes Fager to accept applications for insurance coverage, which show no losses or reported claims, and to submit to the underwriting committee of the Company all other applications for determination as to insurability. In addition, Fager will provide the administration of all claims, except that all policy decisions with respect to the handling of claims, including the appointment of legal counsel and approval of the ultimate disposition of claims, will be the sole responsibility of the board of directors of the Company and/or the officer(s) or committee(s) of the Company to whom such functions have been assigned by the said board of directors.

A review of the Company’s corporate minutes revealed that the management of the Company resides with the board of directors.

#### F. Medical Malpractice Insurance Pool

MLMIC administers the operation of Medical Malpractice Insurance Pool (“MMIP” or “Pool”) pursuant to a management agreement between MLMIC and each member of MMIP. Member companies or participants of MMIP include insurers licensed in New York writing medical malpractice insurance. The Pool is a joint underwriting facility that was created after the dissolution of Medical Malpractice Insurance Association (“MMIA”) effective July 1, 2000.

MLMIC’s participation percentage in MMIP of 57.6% as of December 31, 2006 was the highest participation among all member companies. Annually, all members of the Pool have to execute a participation agreement. This agreement supplements the plan of operations of the Pool and specifies the participation of members as to premiums and loss payments expressed as a percentage based on the net direct medical malpractice insurance premiums written by member companies in New York State. In addition, this agreement indicates that a management agreement is entered into with a servicing company (such being MLMIC) selected by the members’ committee of MMIP.

MLMIC maintains a working fund account on behalf of the Pool. It is noted that these funds are reported as part of invested assets in MLMIC’s financial statements. However, an offsetting liability is recorded; hence, there is no effect on MLMIC’s surplus.

MMIP pays a twelve percent (12%) management fee to MLMIC as the servicing company. Accordingly, MLMIC absorbs all expenses of the Pool with the exception of pass-through expenses such as actuarial, audit and examination fees.

MMIP prepares on a quarterly basis its financial statements which show the members' deficits.

G. Significant Operating Ratios

The following ratios have been computed as of December 31, 2006, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	418%	*
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	107%	*
Premiums in course of collection to surplus as regards policyholders	36%	

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$4,162,502,192	156.27%
Other underwriting expenses incurred	224,003,493	8.41
Net underwriting loss	<u>(1,722,793,964)</u>	<u>(64.68)</u>
Premiums earned	<u>\$2,663,711,721</u>	<u>100.00%</u>

H. Accounts and Records

1. Contract with Company's Independent Auditors

The examiner's review of the Company's contract (engagement letter) with its independent auditors, KPMG, LLP dated September 27, 2004 for the 2004 audit, amended by letters dated June 28, 2005 and July 14, 2006, for the 2005 & 2006 audits, revealed that the contract did not fully comply with the requirements specified in Part 89.2 of Department Regulation No. 118.

Section 89.2(b) requires the CPA notify the superintendent in writing within 15 calendar days if the insurer has misstated its financial condition as reported to the superintendent or that the insurer does not meet the minimum capital or surplus to policyholder requirements set forth in the Insurance law.

Instead of requiring KPMG to notify the superintendent if the insurer does not meet either conditions, the contract requires notification if the insurer does not meet both the minimum capital and surplus requirement.

In addition, the contract is missing the following provisions specified in Section 89.2 (c) which states in part:

"The CPA must retain for review such workpapers and communications in accordance with the provisions of Part 243 of this Title (Regulation 152). More specifically, such workpapers and communications must be retained by the CPA for the period specified in sections 243.2(b)(7) and (c) of this Title. For the purposes of this subdivision, the workpapers and communications shall be deemed to have been created on the date the filing required by section 89.2(a) of this Part was submitted to the superintendent."

Section 243(b)(7) of Regulation 152 states in part that:

"Except as otherwise required by law or regulation, an insurer shall maintain a financial record necessary to verify the financial condition of an insurer, including ledgers, journals, trial balances, annual and quarterly statement workpapers, evidence of asset ownership, and source documents, for six calendar years from its creation or until after the filing of the report on examination in which the record was subject to review, whichever is longer."

It is therefore recommended that the Company ensure that the contract with its CPA firm comply with the requirements of Department Regulation 118.

## 2. Check Signatory Requirements

It was noted during the review of Cash account that MLMIC requires only one signatory for their general, operating and draft accounts.

It is recommended that the Company revise their signatory requirement on cash disbursement to at least two signatories over a certain threshold as this is a good business practice.

### **3. FINANCIAL STATEMENTS**

#### A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2006 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Examination</u> Assets Not Admitted	Net Admitted <u>Assets</u>	<u>Company</u> Net Admitted <u>Assets</u>	Surplus Increase <u>(Decrease)</u>
Bonds	\$3,984,768,458	\$0	\$3,984,768,458	\$3,984,768,458	\$ 0
Preferred stocks	26,154,598	0	26,154,598	26,154,598	0
Common stocks	224,548,687	0	224,548,687	224,548,687	0
Properties occupied by the company	5,422,619	0	5,422,619	5,422,619	0
Cash, cash equivalents and short-term investments	140,007,840	0	140,007,840	140,007,840	0
Contract loans	0	0	0	0	0
Other invested assets	98,000,000	0	98,000,000	98,000,000	0
Investment income due and accrued	32,240,422	0	32,240,422	32,240,422	0
Uncollected premiums and agents' balances in the course of collection	63,026,632	5,176,609	57,850,023	57,850,023	0
Deferred premiums, agents' balances and installments booked but deferred and not yet due	381,701,870	2,189,670	379,512,200	379,512,200	0
Amounts recoverable from reinsurers	3,080,136	0	3,080,136	3,080,136	0
Funds held by or deposited with reinsured companies	70,677,922	0	70,677,922	70,677,922	0
Net deferred tax asset	473,442,229	473,442,229	0	0	0
Guaranty funds receivable or on deposit	0	0	0	0	0
Electronic data processing equipment and software	565,166	0	565,166	565,166	0
Furniture and equipment, including health care delivery assets	1,121,766	1,121,766	0	0	0
Receivables from parent, subsidiaries and affiliates	6,000	0	6,000	6,000	0
Aggregate write-ins for other than invested assets	<u>2,773,585</u>	<u>2,773,585</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total assets	<u>\$5,507,537,930</u>	<u>\$484,703,859</u>	<u>\$5,022,834,071</u>	<u>\$5,022,834,071</u>	<u>\$ 0</u>



Liabilities, Surplus and Other Funds

<u>Liabilities</u>	<u>Examination</u>	<u>Company</u>	Surplus Increase (Decrease)
Losses and loss adjustment expenses	\$3,899,320,883	\$4,143,120,883	\$243,800,000
Reinsurance payable on paid losses and loss adjustment expenses	16,733,748	16,733,748	0
Commissions payable, contingent commissions and other similar charges	377,940	377,940	0
Other expenses (excluding taxes, licenses and fees)	3,240,507	3,240,507	0
Taxes, licenses and fees (excluding federal and foreign income taxes)	63,853	63,853	0
Unearned premiums	343,657,248	343,657,248	0
Ceded reinsurance premiums payable (net of ceding commissions)	26,393,687	26,393,687	0
Amounts withheld or retained by company for account of others	264,981,766	264,981,766	0
Provision for reinsurance	544,000	544,000	0
Drafts outstanding	359,456	359,456	0
Payable for securities	17,145,754	17,145,754	0
Aggregate write-ins for liabilities	<u>44,069,244</u>	<u>44,069,244</u>	<u>0</u>
Total liabilities	<u>\$4,616,888,086</u>	<u>\$4,860,688,086</u>	<u>\$243,800,000</u>
<u>Surplus and Other Funds</u>			
Aggregate write-ins for special surplus funds	\$1,650,000	1,650,000	0
Unassigned funds (surplus)	<u>404,295,985</u>	<u>160,495,985</u>	<u>\$243,800,000</u>
Surplus as regards policyholders	<u>\$405,945,985</u>	<u>162,145,985</u>	<u>\$243,800,000</u>
Total surplus and other funds	<u>\$5,022,834,071</u>	<u>\$5,022,834,071</u>	<u>\$ 0</u>

NOTE: The congressional Joint Committee on Taxation has completed its consideration of the Internal Revenue Service special report (made to satisfy the requirements of Section 6405 of the Internal Revenue Code of 1986) on the Company's consolidated Federal Income Tax returns through tax year 2002. There were no adjustments arising from this review. MLMIC is not aware of any current Internal Revenue Service tax audits of the Company. Additionally, 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 \$3,899,320,883 is \$243,800,000 less than the \$4,143,120,883 reported by the Company in its December 31, 2006 filed annual statement. The redundancy represents 6% of the Company's carried reserves at December 31, 2006 and 173% of its reported surplus as regards policyholders. This examination change reflects the reserve savings already recognized by the Company through its March 31, 2009 quarterly statement on its net loss and loss adjustment expenses incurred prior to December 31, 2006.

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 2007 and 2008 annual statements, as well as its March 31, 2009 quarterly statement.

The breakdown by segment of undiscounted & discounted direct, assumed and ceded loss and loss adjustment expense ("LAE") reserves as reported in MLMIC's 2006 filed annual statement are as follows:

(000's omitted)

	Description	Undiscounted Loss & LAE	DISCOUNT	Discounted Loss & LAE
Direct	"Old" MLMIC	\$3,657,515		\$3,188,537
	Latham	419,048		368,365
	MMIP	<u>416,942</u>		<u>346,821</u>
	Total Direct	<u>\$4,493,506</u>	<u>\$589,783</u>	<u>\$3,903,723</u>
Assumed from Affiliates	OHIC	\$43,373		\$38,984
	Princeton	<u>98,252</u>		<u>86,235</u>
	Total Assumed from Affiliates	<u>\$141,625</u>	<u>\$16,406</u>	<u>\$125,219</u>
Assumed from Others	MMIA	\$119,649		\$104,397
	HPIC	6,095		4,114
	Others	<u>50,735</u>		<u>49,205</u>
	Total Assumed from Others	<u>\$176,480</u>	<u>\$18,763</u>	<u>\$157,717</u>
Ceded	"Old" MLMIC	\$(38,108)		\$(34,185)
	Latham	<u>(10,745)</u>		<u>(9,353)</u>
	Total Ceded	<u>\$(48,853)</u>	<u>\$(5,316)</u>	<u>\$(43,538)</u>

RECAP:

Direct	\$4,493,506		\$3,903,723
Assumed	318,105		282,936
Ceded	<u>(48,853)</u>		<u>(43,538)</u>
Total carried net unpaid	<u>\$4,762,757</u>	<u>\$619,636</u> (See Note 1)	<u>\$4,143,121</u> (See Note 2)

NOTES:

- The Company discounts loss and LAE reserves using interest rates within a range permitted by the Department. The interest rates used to discount loss reserves may be adjusted from time to time based upon management's judgments about long-term trends in interest rates, anticipated claims settlement patterns, the current interest rate environment, the historical and expected yields on invested assets, and the risks inherent in the loss reserving process. MLMIC uses various interest rates for different years of business. A discount rate is selected for the most recent years, and progressively lower rates are used to discount groups of older years of business as the oldest years' reserve liabilities, on average, mature most quickly. The unpaid loss and LAE reserves as of December 31, 2006 are discounted at interest rates varying from 4% to 0% {e.g. 4% for the most recent policy years (2002-2006); 3% for policy years 1997-2001; 2% for policy years 1992-1996; 1% for policy years 1987-1991 and 0% for policy years 1975-1986}. It is noted that the Company received permission from the Department to discount each year.

The nontabular discounts for loss and LAE at December 31, 2006 were \$496,175,000 and \$123,461,000, respectively for a total discount of \$619,636,000.

- This amount is broken down as follows:  
(000's omitted)

Losses – per annual statement, page 3, line 1	\$3,324,463
Loss adjustment expenses – per annual statement, page 3, line 3	<u>818,658</u>
Total Loss and loss adjustment expenses as reported in the annual statement as of December 31, 2006	<u>\$4,143,121</u>

## **5. MARKET CONDUCT ACTIVITIES**

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department.

The general review was directed at practices of the Company in the following areas:

- A. Claims
- B. Complaint handling

No problem areas were encountered.

## 6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
It is recommended that the Company ensure that the conflict of interest statements completed by the board of directors are properly dated to ascertain that such statements are completed on a regular basis.	7
B. <u>Reinsurance</u>	
i. It is recommended that the offset provision of the “tail” quota share reinsurance agreement with Princeton be amended to state that in the event of the insolvency of either party to this agreement then offsets shall only be allowed to the extent permitted by the provision of Section 7427 of the New York Insurance Law. It is further recommended that all future reinsurance agreements with an offset provision entered into by the Company include such required language.	12
ii. It is recommended that the Company include an arbitration clause in all of its reinsurance agreements.	15
iii. It is recommended that all reinsurance agreements entered into by the Company include an errors and omissions clause.	15
C. <u>Accounts and Records</u>	
i. It is recommended that the Company ensure that the contract with its CPA firm comply with the requirements of Department Regulation 118.	21
ii. It is recommended that the Company revise their signatory requirement on cash disbursement to at least two signatories over a certain threshold as this is a good business practice.	21

Respectfully submitted,

\_\_\_\_\_  
/S/  
Fe Rosales, CFE  
Associate Insurance Examiner

STATE OF NEW YORK    )  
                                          )SS:  
                                          )  
COUNTY OF NEW YORK )

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

\_\_\_\_\_  
/S/  
Fe Rosales

Subscribed and sworn to before me  
this \_\_\_\_\_ day of \_\_\_\_\_, 2009.

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, Eric R. Dinallo, Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**Fe Rosales**

*as proper person to examine into the affairs of the*

**MEDICAL LIABILITY MUTUAL INSURANCE COMPANY**

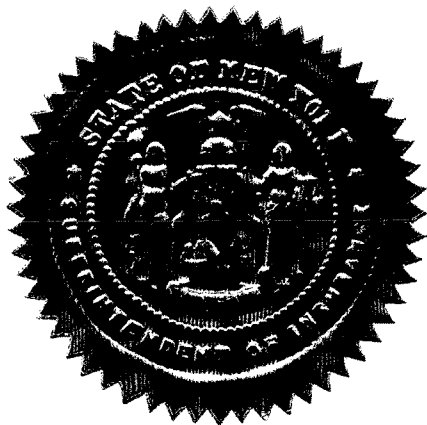
*and to make a report to me in writing of the condition of the said*

**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 27th day of November, 2007*



A handwritten signature in black ink, appearing to read "Eric R. Dinallo".

ERIC R. DINALLO

Superintendent of Insurance