Government of the District of Columbia
Department of Insurance, Securities and Banking

Stephen C. Taylor
Acting Commissioner

BEFORE THE INSURANCE COMMISSIONER OF THE DISTRICT OF COLUMBIA

Re: Report on Limited–Scope Examination - Fairway Physicians Insurance Company, A Risk Retention Group

ORDER

In accord with the authority established by D.C. Official Code § 31-1402, a limited-scope examination of **Fairway Physicians Insurance Company, A Risk Retention Group ("Company")** has been conducted by the District of Columbia Department of Insurance, Securities and Banking ("Department"). The Department reported on the financial condition of the Company in the attached Report on Limited-Scope Examination ("Limited-Scope Examination Report").

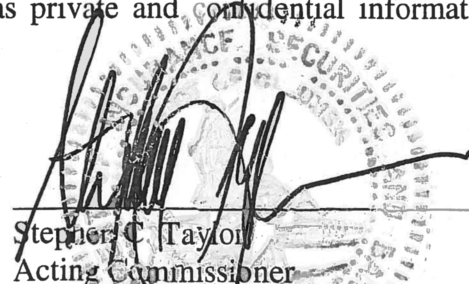
In accord with the provisions of D.C. Official Code § 31-1404 (c), it is hereby ordered, on this 17th day of September, 2015, that the attached Limited-Scope Examination Report be adopted and filed as an official record of this Department.

In accord with D.C. Official Code § 31-1404 (c) (1), it is hereby additionally ordered that the Company shall comply with the recommendations in the attached Limited-Scope Examination Report.

Pursuant to Section 31-1404(d) (1) of the D.C. Official Code, this Order is considered a final administrative decision and may be appealed pursuant to Section 31-4332 of the D.C. Official Code.

Pursuant to Section 31-1404(d) (1) of the D.C. Official Code, the Company shall, within 30 days of the issuance of the adopted Limited-Scope Examination Report, file affidavits executed by each of its directors wherein each of its Directors states under oath that they have received a copy of the adopted Limited-Scope Examination Report and related order.

Pursuant to Section 31-1404(e) (1) of the D.C. Official Code, the Department will continue to hold the content of the above-referenced report as private and confidential information for a period of 10 days from the date of this Order.



Stephen C. Taylor
Acting Commissioner

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND BANKING

REPORT ON LIMITED-SCOPE EXAMINATION

OF

FAIRWAY PHYSICIANS INSURANCE COMPANY, A RISK RETENTION GROUP

NAIC #11840

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Washington, D.C.
March 9, 2015

Honorable Stephen C. Taylor
Acting Commissioner
Department of Insurance, Securities and Banking
Government of the District of Columbia
810 First Street, NE, Suite 701
Washington, D.C. 20002

Dear Acting Commissioner Taylor:

In accordance with the provisions of the D.C. Official Code Title 31 Chapter 14 (Law on Examinations), we have conducted a limited-scope examination of certain activities of

Fairway Physicians Insurance Company, A Risk Retention Group

hereinafter referred to as the "Company" located at the office of its program manager, Thorson Specialty Insurance Services, Inc. ("TSI"), 30401 Agoura Road, Suite 101, Agoura Hills, California 91301.

The Company was incorporated under the captive laws of South Carolina on October 22, 2003 and was authorized to begin operating as a risk retention group on November 10, 2003. The Company commenced underwriting on January 1, 2004. On June 25, 2004 the Company re-domesticated to the District of Columbia under the District's captive insurance laws.

The Company is approved to provide medical professional liability coverage to physicians licensed to practice in the state of California and other states where the Company is approved to write business and is registered to do business. The Company also offers extended tail liability coverage to policyholders that terminate coverage. This coverage is free in the event of death or disability, or if the policyholder has been with the program for at least five years and is retiring.

BACKGROUND

The District of Columbia ("District") Department of Insurance, Securities and Banking ("Department") is responsible for the regulation of risk retention groups domiciled in the District. The Department completed a full-scope financial examination of the Company covering the period from January 1, 2008 through December 31, 2012, including any material transactions and/or events noted occurring subsequent to December 31, 2012. The report on the full-scope financial examination was dated January 21, 2014.

In March 2014, the Company filed its 2013 Annual Statement with the Department. For the purpose of submitting its regulatory financial statements, the Company uses accounting principles generally accepted in the United States ("GAAP") with the exception of variances

prescribed by or permitted by the Department. The Company reported a net underwriting loss of $3,368,279 on earned premiums of $10,482,187, and a net loss of $1,552,887 for the year ended December 31, 2013. In addition, the Company reported a decline in the ratio of Total Adjusted Capital compared to Authorized Control Level risk-based capital. During 2014, the Department corresponded with Company management to understand the conditions contributing to the net underwriting loss, the decline in the risk-based capital ratio, and actions taken by the Company to address these conditions. As a result of these conditions, this limited-scope examination was initiated on October 20, 2014.

Due to its limited-scope, this examination report is not intended to communicate all matters of importance necessary for understanding the current financial condition and operations of the Company. Our Report on Examination as of December 31, 2012, dated January 21, 2014, should be referred to for additional historical and background information.

SCOPE OF EXAMINATION

This examination was conducted by the Department in accordance with examination procedures established by the Department and procedures recommended by the National Association of Insurance Commissioners and, accordingly, included such tests of the accounting records and such other examination procedures as we considered necessary in the circumstances.

The examination focused on the Company’s underwriting and compliance with its approved business plan. Additional procedures on reinsurance, losses, general and administrative expenses, deferred income taxes, corporate governance and related parties were performed. The following is a summary of procedures performed:

Premiums and Underwriting

1. Review and evaluation of underwriting processes and procedures;

2. Review of premiums recorded and collected;

3. Review of underwriting files to determine if approved policy forms, policy limits, and premium rates are being used by the Company, and to determine if the policies are being written in approved jurisdictions and for approved classes of insureds;

4. Analysis of non-renewed and replaced policies;

5. Reconciliation of premiums written from the bordereau to Schedule T as of December 31, 2013 and September 30, 2014;

6. Analysis of commission process and review of commission payments;

7. Assessment of provider facility types covered and whether temporary employees are covered by the Company's policies;

8. Review of the premium finance process;
9. Inquiry on commission rebating and review of cash activity for any such rebates;
10. Review of processes to determine premium deficiency reserves; and
11. Assessment of the need for updated pricing studies.

Plan of Operation

1. Review of the Company's compliance with the Department-approved business plan; and
2. Review of compliance with service provider agreements as approved by the Department.

Reinsurance

1. Review and understanding of the Company's reinsurance program;
2. Review and testing of reinsurance applied as part of the underwriting process;
3. Review of any reinsurers' audit reports recently issued;
4. Review and assessment of the independent auditor's evaluation of risk transfer; and
5. Review and evaluation of reinsurance payment activity.

Losses Cycle

1. Review of compliance with the claim administrator agreement and understand claim handling guidelines;
2. Documentation and evaluation of the claims handling and reserving processes;
3. Review of claims cash account activity for any unusual claim payments;
4. Review of recent operating results and loss development, and assessment of the potential causes of any poor results;
5. Analysis and payment of claims fees; and
6. Consideration of the need for additional actuarial review of loss and LAE reserves.

General and Administrative Expenses

1. Review and testing of general and administrative expenses.

Deferred Income Tax Asset

1. Review and analysis of deferred income tax asset.

Corporate Records and Corporate Governance

1. Review corporate governance practices;
2. Review of board of director and committee minutes;
3. Review of management conflict of interest statements and procedures; and
4. Assessment of board of director oversight of underwriting and claims operations.

Related Party Transactions

1. Review of related party transactions, expense charges and segregation of funds in trust accounts; and
2. Review of premium and claim settlement activity.

FINDINGS AND RECOMMENDATIONS

The Department noted the following findings and recommendations as a result of this limited-scope examination. Except as noted below, nothing came to our attention that warrants inclusion in this report.

Premiums and Underwriting; Plan of Operation

Findings:

We reviewed the Company's premium bordereau from 2010 to 2014, and we judgmentally selected twenty-nine underwriting files for further detailed review. Based on our review of the premium bordereau and of the selected underwriting files, we noted the following:

1. Policyholders are required to contribute 30 percent of the first year premium in capital stock, payable over the first three years in equal installments, and are also required to sign a stock subscription agreement. However, the Company has not consistently required policyholders to comply with this requirement. Specifically, fourteen of the twenty-nine files reviewed showed capital stock assessments less than the 30 percent requirement, with one of these fourteen files reflecting that a capital stock assessment was not imposed. In these instances of reduced capital contributions, the Company's standard stock subscription agreement had been modified to reflect the reduced capital charge. Examples of reduced capital charges include policyholders assessed less than the required 30 percent of first year premiums; and policyholders assessed one-third of the required capital contribution in year one with no capital assessments in years two and three, even though the policyholder's coverage remained in-force for three years. Our review indicated potential capital stock undercharges of approximately $175,600.

   In addition, nine files had no signed stock subscription agreements. In the cases where signed subscription agreements have not been received, the stock certificates are not issued and not reflected in the stock ledger, but the capital stock is reflected in the financial statements. As of September 30, 2014, $510,978 had been collected for capital stock and reflected on the Company's financial statements but the related stock certificates had not been issued and subscription agreements had not been signed. This raises several questions. First, there is a question of whether recording the capital stock in the financial statements is proper, since the executed subscription agreements have not been received and the stock certificates have not been issued. There is also a question of whether the Company has a liability to return the capital already paid but where the stock certificates have not been not issued and the subscription agreements were not signed. A question also exists about whether the policyholders/owners of the Company, who have not executed subscription agreements and received their stock certificates, are owners in compliance with the Liability Risk Retention Act.

   We also noted that the Company's standard stock subscription agreement has not been updated to reflect changes made in 2010 to the stated purchase price of the Company's stock.

As a result of these conditions, the Company is not collecting all of the required capital contributions, and policyholders are being treated differently as regards capital contributions. In addition, uncertainties exist with regard to the rights of policyholders who are not charged the required capital amounts, and uncertainties exist regarding the rights and responsibilities of policyholders who have not executed stock subscription agreements and of the responsibilities of the Company with regard to these policyholders who have not executed stock subscription agreements.

2. Twelve policies reviewed were written in a total of six states in which the Company had not registered to write. We identified premiums totaling approximately $1.5 million from 2010 to 2014 written in unregistered states. For five of these states - Connecticut, Massachusetts, Minnesota, New Jersey and Utah, the Company had never requested approval from the Department to register in these states. And for the sixth state, South Carolina, the Department had approved the Company's request to register but the Company had never done so. For the five states in which the Department has never approved the Company to register, the Department has no rates on file for these states and therefore a determination could not be made regarding the appropriateness or adequacy of the rates used by the Company in these states.

   Premiums written in the above unregistered states were reported by the Company in its premium bordereau, in its annual and quarterly filings, and in its premium tax returns, as being written in other registered states, and the Company never filed premiums tax returns in the unregistered states. As a result, the Company potentially owes premium taxes, fines and penalties in the unregistered states in which it wrote business but never reported this business to the respective states. And the Company has overpaid premium taxes in the registered states in which it incorrectly reported premiums. As a result, the Company is potentially at risk for not being able to recover these overpayments, and is potentially at risk for additional regulatory actions in these states.

3. Thirteen policies were written for dentists and non-medical doctor naturopaths, classes of insureds which the Company is not approved to write, and for which rates have not been actuarially established.

4. Eight files contained underwriting errors. For example, incorrect class or territory factors were used. In addition, for some files reviewed, we were not able to understand how some rating factors (primarily judgmental risk modifier discounts) were determined or where such factors were documented in approved rates or underwriting guidelines.

5. Filed rates and underwriting guidelines in non-California jurisdictions have not been updated since 2009 and California rates have not been updated since 2008.

<u>Recommendations:</u>

As a result of the above conditions, we recommend the following:

1. a. The Company shall require all new policyholders to contribute 30 percent of the first year premium as capital stock and execute a stock subscription agreement. In addition, the Company shall develop and submit to the Department, by December 31, 2015, a policy addressing the requirements for capital stock contributions. This policy shall include the requirement that all new policyholders contribute 30 percent of the first year premium as capital stock and execute a stock subscription agreement. If the Company determines there may be instances when policyholders will not be required to contribute 30 percent of the first year premium as capital stock, this policy shall clearly define when contributions less than 30 percent of the first year premium will be permitted. This policy shall also address the policies and procedures for: obtaining executed stock subscription agreements and instances in which a policyholder fails to execute a stock subscription agreement; recording capital stock contributions; and instances in which policyholders, including former policyholders, fail to make the required capital contributions.

   b. The Company shall review all insurance policies issued since inception of the Company and determine the following:

      (1) For any policies that do not have a corresponding stock subscription agreement on file, the Company shall attempt to obtain an executed agreement. By December 31, 2015, the Company shall report to the Department the results of this review and status of efforts to obtain executed agreements.

      (2) All policies for which capital stock assessments were/are less than the 30 percent of the first year premium, including all policies which had no capital stock assessment. A list of such policies shall be provided to the Department by December 31, 2015 and shall include an explanation for each policy as to why the policyholder was charged less than the required 30 percent.

      (3) All policies for which capital stock assessments, whether the required 30 percent, or a lesser amount, are overdue. A list of such overdue amounts shall be provided to the Department, and shall include whether the policy is currently in force. To the extent that the Company determines that capital stock assessments are overdue for any policies which were cancelled prior to being in force for three years after policy inception, the Company shall make efforts to collect such overdue amounts and report to the Department by December 31, 2015 regarding these collection efforts.

      (4) The Company shall submit to the department, by December 31, 2015, a legal opinion as to whether the practice of charging less than the required amount of 30 percent of first year premium has resulted in disparate treatment of policyholders. The opinion shall also address whether the Company is in compliance with the Federal Liability Risk Retention Act with regard to those policyholders/owners who have not purchased any

stock in the Company; those who have not signed a subscription agreement; and those who have not been issued stock certificates.

(5) The Company shall submit to the Department, by December 31, 2015, an analysis of whether the Company's practice of recording the capital stock in its financial statements prior to the execution of the related stock subscription agreements and prior to the issuance of stock certificates is in compliance with applicable accounting guidance. This analysis shall be done in consultation with the Company's independent auditor and shall also include a determination of whether a liability or contingency shall be recorded for capital stock contributions recorded in the financial statements for which there are no corresponding executed stock subscription agreements and stock certificates. If a determination is made that the Company must return any capital contributions, the Company shall request prior approval from the Department for any such returns.

(6) The Company shall revise the standard subscription agreement to reflect the correct number of shares of stock purchased by the policyholder and other related per share information as a result of the change in stock price in 2010. The revised subscription agreement shall be submitted to the Department by December 31, 2015.

2. a. The Company shall comply with its approved business plan, and only write business in states in which it has been pre-approved by the Department to write; has registered to write; and for which it has submitted rates to the Department. By December 31, 2015, the Company shall submit to the Department a summary of steps taken to ensure future policies are not written in states in which it has not been pre-approved by the Department to write and/or has not registered to write.

b. Premiums shall be accurately reported to the states in which they are written and shall be accurately recorded and reported in the Company's premium bordereau and annual and quarterly filings.

c. The Company shall report all premiums previously written in unregistered states to the respective states, and shall file premiums tax returns in those states. The Company shall require its managing general agent, TSI, to reimburse the Company for any penalties and interest assessed to the Company related to the failure to previously file premium tax returns and timely pay premium taxes in the unregistered states. In addition, the Company shall file amended premium tax returns for all years and in all states in which incorrect returns have been filed and shall attempt to obtain refunds from the states in which it has overpaid premium taxes. The Company shall require TSI to reimburse the Company for any premium taxes previously overpaid by the Company that the Company is unable to recover, and for any penalties assessed to the Company related to the prior filing of inaccurate returns. The Company shall provide to the Department, by December 31, 2015, and on an on-going basis after that date, all newly filed premium tax returns in unregistered states, all amended premium tax

returns filed in registered states, and all correspondence from all states regarding the new and amended returns, requested refunds and any potential penalties, interest, or other actions against the Company taken by these states.

3. The Company shall not write business for non-approved classes, such as dentists and naturopaths, unless pre-approved by the Department as part of its business plan. By December 31, 2015, the Company shall submit to the Department a summary of steps taken to ensure future policies are not written for unapproved classes of insureds.

4. The Company shall have its captive manager complete a semi-annual review of the underwriting files and premium bordereau in compliance with the District's Managing General Agents ("MGA") Act Section 31-1504 (c) to determine the following:

   - Policies are in compliance with the approved business plan, including that policyholders are located in states approved by the Department and in states where the Company is registered;
   - Classes of insureds are in compliance with the approved business plan;
   - Premiums charged are in compliance with the rates filed with the Department and underwriting debits/credits applied are consistent with those filed with the Department, are appropriately applied, and are documented and approved;
   - Classifications assigned to policyholders are consistent with the Company's underwriting guidelines as submitted to the Department;
   - Capital stock assessments are determined in accordance with applicable requirements and that signed subscription agreements are on file.

   A report of this semi-annual review, including procedures performed, corresponding findings, and recommendations for improvements, shall be provided to the Company, TSI and the Department, within 60 days of the date of the review.

5. In conjunction with its actuary, the Company shall determine if an update to its 2009 actuarial study of non-California rates, to reflect more recent industry loss data and updates to new classes of physicians and territories added since the 2009 study, is necessary. In addition, the Company shall determine, in conjunction with its actuary, if an update to its 2008 California rate study is necessary. The Company shall report to the Department, by December 31, 2015, whether or not updated actuarial studies of rates are necessary. If such updated actuarial studies are deemed not necessary, the Company shall provide adequate justification, including explanations from its actuary as to why updated rate studies are unnecessary. If such updated actuarial studies are deemed necessary, the Company shall provide these updated studies to the Department by June 30, 2016.

Losses Cycle

Findings:

The Company's daily business operations are managed by TSI, which acts as the Company's program manager and managing general agent and performs various administrative functions including underwriting, marketing and overall program management services. Thorson's affiliate, Risk Management Services Group, Inc. ("RMSG"), which is located in California, provides claims management services to the Company. The RMSG claims manager is primarily responsible for managing the Company's claims, and has nearly 40 years of experience in reviewing, settling and reserving claims, including medical malpractice claims. The claims manager is located in California and through oversight of contracted local defense counsel manages claims in all jurisdictions in which the Company does business.

While we noted no significant concerns regarding the Company's claims and noted no anticipated changes in the Company's claims management in the near future, we did note that although the majority of the Company's policyholders have historically been located in California, an increasing number of policyholders in recent years are from other jurisdictions, including a number of east-coast jurisdictions. We also noted that RMSG has functioned as the Company's claims manager since inception of the Company. In addition, under the provisions of the MGA Act, D.C. Official Code § 31-1504(c), which the Company became subject to during 2014, the Company is required to conduct an on-site review of the claims processing operations of the managing general agent at least semiannually.

Recommendations:

1. To ensure continuity of the Company's claims management function, we recommend that the Company develop a succession plan for the claims management function, including plans in the event RMSG or its claims manager were no longer available to manage the Company's claims. The succession plan shall be submitted to the Department by December 31, 2015.

2. We recommend the Company, as more of its policyholders come from jurisdictions other than California, ensure that adequate claims handling resources and expertise are available in the jurisdictions outside of California. A report of the Company's assessment of claims handling resources and expertise shall be submitted to the Department by December 31, 2015.

3. The Company shall have its captive manager complete a semi-annual review of the claims operations in compliance with the Managing General Agents Act, D.C. Official Code § 31-1504(c). A report of this semi-annual review, including procedures performed, corresponding findings, and recommendations for improvements, shall be provided to the Company, TSI, and the Department, within 60 days of the date of the review.

Deferred Income Tax Asset

Findings:

In its Annual Statement for the year ended December 31, 2013, the Company reported Net deferred tax asset ("DTA") totaling $1,990,622, primarily representing operating losses experienced in prior years that management believes will be available for use in future years to offset against operating profits in future years to reduce future years' income taxes. In accordance with Generally Accepted Accounting Principles (GAAP), the admissibility of the DTA is based upon the Company's ability to realize future operating profits. In addition, in estimating the ability of the Company to realize future operating profits, GAAP requires that more weight be placed on historical operating performance than on future financial projections. As previously indicated in the "Background" section of this Report, for the year ended December 31, 2013, the Company reported a net underwriting loss of $3,368,279 on earned premiums of $10,482,187. In addition, in five of the six years prior to 2013, the Company reported net underwriting losses. And for the year ended 2014, the Company reported a net underwriting loss of approximately $1.5 million on earned premiums of approximately $11.6 million. We therefore question, based on historical performance, the Company's ability to generate future profits and utilize the DTA. During our examination we were informed by management that an analysis of the DTA to determine future recoverability has not been performed.

Recommendations:

We recommend that the Company request its independent auditor to complete, for the year ended 2014, a DTA recoverability test to determine if a valuation allowance should be recorded against the Company's DTA. This analysis shall be submitted to the Department by October 15, 2015. In addition, until approved otherwise by the Department, the Company shall request its independent auditor to complete, on an annual basis, a DTA recoverability test. The annual test shall be submitted to the Department by March 2 for the prior year ended December 31.

Corporate Records and Corporate Governance

Findings:

Under the provisions of the MGA Act, D.C. Official Code § 31-1504(g), which the Company became subject to during 2014, an officer, director, employee, subproducer or shareholder of the MGA may not serve on the Company's board of directors. However, David Thorson, President of the Company's MGA, TSI, serves on the Company's board of directors. (After bringing this issue to the Company's attention during the examination, Mr. Thorson resigned from the Company's board of directors effective May 15, 2015.) In addition, Mr. Thorson also serves as the Company's president.

Recommendations:

We recommend that the Company ensure compliance with the above-mentioned provisions of the MGA Act and not allow officers, directors, employees, sub-producers or shareholders of the MGA to serve as Company directors. In addition, although not prohibited by the MGA Act, we recommend, to provide additional independence between the Company and its MGA, the Company should consider replacing Mr. Thorson as President of the Company. By December 31, 2015, the Company shall report to the Department regarding the status of replacing Mr. Thorson as President of the Company.

Related Party Transactions

Findings:

The Program Manager Agreement between the Company and TSI provides for the Company to reimburse Thorson for expenses and other costs incurred by Thorson as part of the administration of the Company's insurance program upon presentation of invoices and other itemized lists and schedules of expenses and other costs. During 2013, the Company was charged approximately $122,000 by TSI for various expenses (e.g., information technology and administrative services). In addition, the Company was charged approximately $61,900 by Thorson and Associates, a company owned by David Thorson, for rent. However, the Company is not party to an agreement with Thorson and Associates. In addition, the amounts charged to the Company by TSI and Thorson and Associates were not supported with details of how these amounts were calculated (e.g., time and usage studies, square footage, etc.).

Recommendations:

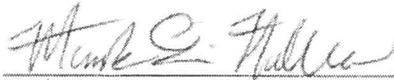
The Company shall not accept services from and shall not pay for services from companies with which it has not entered in to a service agreement. In addition, the Company shall prepare a detailed budget to support the annual allocation of expenses billed to the Company pursuant to service agreements. The budget shall be supported by details of how these amounts are estimated (e.g., time and usage studies, square footage, etc.) and shall be approved annually by the Company's board of directors. Upon billing to the Company for allocated expenses, any variances shall be explained and approved by the Company's board of directors.

SIGNATURES

In addition to the undersigned, the following examiners representing the District of Columbia Department of Insurance, Securities and Banking participated in certain phases of this examination:

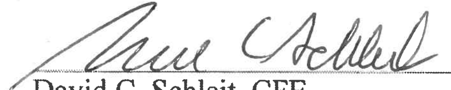
Dana W. Rudmose, CIE, AIR

Respectfully submitted,



Mark G. Noller, CIE, AIRC
Examiner-In-Charge
Rudmose & Noller Advisors, LLC

Under the Supervision of,



David C. Schleit, CFE
Supervising Examiner
District of Columbia Department of Insurance,
Securities and Banking

Government of the District of Columbia
Department of Insurance, Securities and Banking

Stephen C. Taylor
Acting Commissioner

July 27, 2015

David Thorson, President
Fairway Physicians Insurance Company, A Risk Retention Group
C/o Lawrence Prudhomme
GPW and Associates, Inc.
2700 North Third Street, Suite 3050
Phoenix, AZ 85004

RE: Limited –Scope Examination of Fairway Physicians Insurance Company, A Risk Retention Group

Dear Mr. Thorson:

Pursuant to the provisions of Section 31-1404 of the D.C. Official Code, enclosed is a draft copy of the Report on Limited –Scope Examination ("Report") of certain activities of Fairway Physicians Insurance Company, A Risk Retention Group.

Please submit, to my attention, a written response calling attention to any errors or omissions. In addition, the Company's response shall include responses to each of the recommendations included in the "Findings and Recommendations" section of this Report. These responses should indicate the Company's agreement or disagreement with each recommendation, as well as a summary of the corrective measures which will be taken by the Company for each recommendation. If the Company disagrees with any of these recommendations, the response shall indicate the reason(s) for the disagreement, as well as an explanation of alternative measures to be taken by the Company to address the condition which lead to the recommendation.

The response must be in writing and shall be furnished to this Department by August 26, 2015. In addition to a hard-copy response, please also furnish the response electronically via e-mail to me, in a Microsoft "Word" format, to sean.odonnell@dc.gov.

Sincerely,

Sean O'Donnell

Sean O'Donnell
Director of Financial Examination,
Risk Finance Bureau

Enclosure

September 2, 2015

Sean O'Donnell
Director of Financial Examination
Risk Finance Bureau
D. C. Department of Insurance, Securities and Banking
810 First Street, NE, Suite 701
Washington, DC 20002

Re: Response to Final Draft Exam – Dated March 9, 2015

Mr. O'Donnell,

This letter is in response to the March 9, 2015 draft Limited Scope Exam ("Report") of Fairway Physicians Insurance Company ("Company").

While the Company continues to disagree with some of the Report's findings as set forth in the attached copies of the Company's March 5th correspondence to the District and RNA, and the February 26, 2015 email from company's legal counsel, the Company herewith accepts the recommendations contained in the Report.

The company would like to thank the DISB, Dana Rudmose and Mark Noller for the time spent working on this Report.

Sincerely,

Bob Wiley
Chief Financial Officer

March 5, 2015

District of Columbia Department of Insurance, Banking and Securities
Dana Sheppard, Associate Commissioner, Risk Finance Bureau
Sean O'Donnell, Director of Financial Examination
David Schleit, Examiner

RNA
Dana Rudmose, CPA, Principal
Mark Noller, CPA, Principal

RE: Fairway Physicians Insurance Company, A Risk Retention Group
Limited Scope Examination covering the period from January 1, 2013 to January 21, 2014

Gentlemen:

Fairway Physicians Insurance Company, a risk retention group, is pleased to submit its written response to the draft report on the Limited Scope Examination ("Examination") provided under cover of an email dated February 27, 2015. We incorporate by reference our prior communications with you regarding this Examination.

Executive Summary

In the eleven years that Fairway has been operating, it has a demonstrable record of good faith material compliance with its Plan of Operation and all applicable laws and regulations in every jurisdiction where it is registered and/or approved. Fairway has continued a pattern of investing in improved systems and personnel to provide exemplary service to its policyholders/owners. Although the Company is not a guarantor of the performance of its subscribing policyholders/owners, it has and will continue to enhance its efforts to timely collect all capital subscriptions that are contractually required to be paid. As noted below, the Company agrees with most of the Department's Recommendations.

In each section that follows this Executive Summary, we will, where appropriate, address the Findings and the Recommendations of the Department.

Premium Underwriting and Plan of Operations

<u>Findings</u>

The Department found that the Company had written 13 risks in unapproved or unregistered states. In two of the three affected states, only one risk was so written and after self-reporting in those jurisdictions, no fines or penalties have been assessed, and there is every indication that no fines or penalties will be assessed. There will be an adjustment and appropriate reporting of premium taxes and the registration process is also being addressed.

30401 Agoura Road, Suite 101, Agoura Hills, CA 91301 | Tel: (800) 859-7013 | Fax: (818) 979-8003 | fairwayphysicians.com

With respect to the state of New Jersey which involved the other risks in question, again, the discrepancy was self-reported to the Department of Banking and Insurance which has indicated that upon registration there will be no fine or penalty assessed against Fairway. Thus, the Company is not at risk for any financial penalties or additional regulatory actions in any such jurisdictions.

The second Finding that we address relates to the underwriting of naturopaths and dentists.

It was, and remains, the view of the Company that dentists and naturopaths are "doctors" within the scope of the Plan of Operation. During the Examination, the Company was advised that its underwriting of dentists and naturopaths was inconsistent with its Plan of Operation and should be discontinued. Despite the fact that the Company disagreed with that analysis, it immediately took steps to eliminate all such low-risk physicians as insureds. That has now been accomplished. In our call with the Department last week on February 25, the Department indicated that Fairway should target such low-risk physicians as a fairly dependable source of profitable premium.

Recommendations

The Company believes that it has been in material compliance with its approved Plan of Operation. The Company will comply with all the recommendations as outlined in its letter of January 23, 2015.

Capital Contributions and Related Stock Subscription and Participation Agreements

Findings

Each policyholder is provided with a Stock Subscription and Participation Agreements which is a predicate to their participation in the Risk Retention Group. At no time has the Company made any exceptions with respect to the obligation of a policyholder to execute a Stock Subscription and Participation Agreements and remit the funds contractually obligated to be paid.

There are essentially three issues which are raised by the Department.

1. Appropriate charges for capital.
2. Execution of Stock Subscription and Participation Agreements.
3. Issuance of shares of Class B stock in Fairway.

We will address each one of those issues sequentially.

Policies are issued and Stock Subscription and Participation Agreements routinely timely forwarded to the policyholder/owner for execution. There can be no question but that the Company is in material compliance with this requirement.

The Company has reviewed the suggestion of the Department that there are potential undercharges of $175,600 and takes exception to that "Finding." The Company previously provided the Department with a spreadsheet with granular detail of this issue demonstrating that only $27,446 was potentially at issue which, although important qualitatively, does not raise any question of material disparate quantitative treatment of policyholders. We note the last paragraph of Finding 1 and we would appreciate further clarification from the Department as suggested in that sentence respecting nonrenewal of coverage.[1]

The second point that the Department has raised is unsigned Stock Subscription and Participation Agreements and stock certificates which have not been issued.

The issuance of a stock certificate does not, in the opinion of our counsel, create any material misstatements of financial records or alter the status of a policyholder/owner. Additionally, efforts are consistently made to secure the execution of Stock Subscription and Participation Agreements where policies have been issued. The Company, however, cannot be a guarantor of the performance of its policyholders/owners. Fairway has been diligent in its efforts to secure the execution of those Stock Subscription and Participation Agreements and will continue to enhance its process in that regard. However, in the view of our counsel, the lack of an executed Stock Subscription and Participation Agreements should not in any matter negate the agreement of the insured to the Stock Subscription and Participation Agreement.

The core question presented by this Finding is what constitutes the contract between Fairway and its policyholders/owners. There can be no question but that here the contract consists of both the policy and the Stock Subscription and Participation Agreements. When policies are underwritten, they are done so based upon the Stock Subscription and Participation Agreements and the Offering plan which is accepted by the insured when they agree to be insured by Fairway and remit the premium charged. Indeed, Article 2 of the Stock Subscription and Participation Agreements specifically acknowledges receipt of the insurance policy and the integration clause, Article 7.3, specifically refers to not just Schedules, but also Exhibits. It is the considered view of our counsel that the acceptance of the policy by the insured is also an enforceable ratification of the Stock Subscription and Participation Agreements regardless of whether a signature has been obtained. This is consistent with the second recital on the first page of the Stock Subscription and Participation Agreements. Our view in this respect is also bolstered by the sequencing as set forth in Article 3.1(f)(iii) which provides that shares are not issued until after a policy of insurance is issued. Thus, taken as a whole, no reasonable person could debate whether the Stock Subscription and Participation Agreements is binding upon a policyholder/owner regardless of whether there has been execution of the document.[2]

It is the opinion of our counsel that regardless of receipt of executed Stock Subscription and Participation Agreements and issuance of stock certificates, the Stock Subscription and Participation Agreements is binding upon all such policyholders/owners.

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[1] Is the Department suggesting that there are additional capital stock assessments if coverage is renewed in the second or third years?

[2] We also note Article 5.1(b) which once again, closely and contractually ties the issuance of the policy of insurance to the stock subscription and participation agreement.

A question was raised in correspondence with the Department regarding the validity of the corporate veil in the absence of issuance of stock certificates. We responded to the Department on February 26 in that regard, a copy of which is attached to this Response for its convenience.

The Company agrees with the Department that it should enhance its process for securing signed Stock Subscription and Participation Agreements and developing an electronic delivery system for documents such as stock certificates. However, the Company does not believe that there are any material financial reporting contingencies that are raised by the failure of a policyholder/owner to comply with its contractual obligation.

The Company would also note that the stock subscription participation agreement contains a mandatory arbitration clause with respect to any disputes between Fairway and any subscriber. The Company has been reasonably diligent in pursuing executed Stock Subscription and Participation Agreements and payment of all amounts due by subscribers. It is also mindful of the costs that would otherwise be incurred in commencing arbitrations against physicians to legally require compliance with the agreement. The relatively *de minimis* amount of uncollected subscription funds[3] militates against a significantly more strident approach by Fairway in securing compliance.

Although it is true that, as set forth in Finding 3 that the Stock Subscription and Participation Agreement does provide in limited cases redemption of shares, several of those "triggers" require that a significant penalty be ascribed to the subscriber of 50%. Moreover, 4.4(f) adds additional limitations upon any redemption of such shares.

Recommendations

As a general overview to the recommendations of the Department, we strongly recommend that a cost-benefit analysis is important in placing the policyholders' interests as the priority. Initiating dispute resolution proceedings or retaining counsel or other debt collectors to secure payment of subscriptions from physicians who are no longer members of Fairway may not be a cost effective approach. In view of the calculations of the Company that the amount that is due is almost $27,446, we suggest that the counsel fees from one such arbitration (including the cost of an arbitrator) would in and of itself eclipse the benefit otherwise sought.

It is the opinion of the Company and its legal counsel that the activities of the Company with respect to the agreement have not created disparate treatment of policyholders. Those policyholders/owners who are in breach of their agreement, in whole or in part, do not receive the benefits of ownership in Fairway or the full redemption rights that are otherwise afforded to those policyholders/owners who are compliant.

Other than as set forth above, the Company agrees with the recommendations of the Department.

[3] $27,446.

Underwriting Process Improvement and Rate Adequacy

The Department is mandating that the Company update its 2009 actuarial study. As was made clear in the conference call on February 25, empirical evidence from other insurers in the marketplace strongly suggests that an updated study might result in a reduction of rates which would be adverse to the financial well-being of Fairway. The Company agrees to review the rates they are currently charging with the actuary and determine if a new study is warranted. Further the Company agrees to conduct a new rate study in any states that it begins to write business in going forward.

The Company will also continue to work closely its Captive Manager in all aspects of its Operations and has been assured that any activity deemed not in compliance with the District's Managing General Agents ("MGA") Act Section 31-1504 (c) will be reported to the Company, TSI and the Department.

Following is a summary of items which have previously been addressed by the Company during the course of the examination and are provided again for the sake of completeness.

Affiliate Expense Allocations

The Company agrees to the recommendation that TSI, Thorson and Associates and the Company shall jointly prepare a detailed expense budget to support the allocation of expenses billed to the Company. The budget shall be approved by the Company's Board of Directors.

Deferred Income Tax Asset

The Company agrees to coordinate with its independent auditors to ensure that all customary accounting procedures are followed for its annual audit including the DTA recoverability test.

Corporate Governance Compliance with the MGA Act

Fairway, TSI and Thorson and Associates believe that they have at all times been in compliance with the recently amended MGA Act. However, to be responsive to DIBS and ensure that corporate governance at Fairway complies with both the letter and spirit of the law, David Thorson will resign from the Board and Fairway will consider a replacement as president.

Fairway and TSI appreciate the perspective of DIBS in considering corporate governance issues in a more comprehensive manner, recognizing that in a few years, there may be more restrictive rules applicable to risk retention groups and captives.

Reporting to Policyholders/Owners

Fairway has complied with applicable law in requiring a code of conduct and ethics compliance as well as conflict of interest disclosures. All such material has been disclosed to the Board. Such information and all statutory accounting statements have been available at all times to any policyholder/owner requesting the same and presented at shareholder meetings.

The Company will establish a vehicle, most likely posting of information on the website, so that such information and statutory filings are easily available to policyholder/owners.

Claims Manager Succession Planning and Claims Oversight

The Company is fortunate to have an experienced claims staff as well as seasoned trial attorneys throughout the United States with whom it has a long and successful tenure. The issue of succession is important for every insurance operation and Fairway is no exception. Just as it has increased its underwriting staff, RMSG has and will continue to seek out talented individuals who may be candidates to work in its claims department.

The Company appreciates the opportunity to be able to respond to the Findings and Recommendations set forth in the examination report. We look forward to the completion of this examination and return to matters of business.

Sincerely,

David Thorson, President

From: Kroll, Elliott M. [mailto:Elliott.Kroll@arentfox.com]
Sent: Thursday, February 26, 2015 2:32 PM
To: 'Mark Noller'
Cc: Larry Prudhomme; bwiley@thorsoninsurance.com; dthorson@thorsoninsurance.com; Aimee Andersen; Schleit, David (DISB); 'O'Donnell, Sean (DISB)'; Sheppard, Dana (DISB); Dana Rudmose
Subject: RE: Fairway Subscription Agreement Matters

Mark,

Many thanks for the quick response. We will review the subscription agreement in due course.

On the issue of piercing a corporate veil by reason of a failure to issue stock, I think the DIBS can have comfort that no insured or claimant can realistically anticipate piercing the corporate veil here.

A court will not consider piercing the corporate veil in the absence of a showing that: (1) the owners exercised complete domination of the corporation with respect to the transaction attacked, and (2) that such domination was used to commit a fraud or wrong against the plaintiff which resulted in the plaintiff's injury. Morris v. New York State Dept. of Taxation and Finance, 82 N.Y.2d 135, 141 (1993). Thus, without an alleged wrong or fraud, a court will not pierce the corporate veil. In deciding whether prong 1 is satisfied, courts use a multi-factor test to determine whether the owners exercised complete dominion. No one factor is determinative in the analysis. Fantazia Int'l Group v. CPL Furs New York, Inc., 67 A.D.3d 511,512 (1st Dep't. 2008) (no one factor is dispositive in deciding to pierce the corporate veil). And, "[b]ecause a decision whether to pierce the corporate veil in a given instance will necessarily depend on the attendant facts and equities, the New York cases may not be reduced to definitive rules governing the varying circumstances when the power may be exercised." Morris, 82 N.Y.2d at 141.

The factors necessary to determine domination and control, include, but are not limited to, inadequate capitalization; intermingling of funds; overlap in ownership, officers, directors and personnel; common office space or telephone numbers; the degree of discretion demonstrated by the allegedly dominated corporation; whether dealings between the entities are at arm's length; whether the corporations are treated as independent profit centers; the payment or guaranty of the corporation's debts by the dominating entity; and the absence of formalities which are part and parcel of normal corporate existence, such as the issuance of stock, the election of directors, and the keeping of corporate records. Fantazia, 67 A.D.3d at 512; Walter E. Heller & Co. v. Video Innovations, Inc., 730 F.2d 50, 53 (2d Cir. 1984)(applying New York law).

Given that no one factor is determinative in deciding whether a corporation was completely dominated, it seems unlikely that a court would find that the mere failure to issue stock is sufficient to pierce the corporate veil where other corporate formalities (board meetings, elections, keeping corporate records, etc.) were observed. See Island Seafood Co., Inc. v. Golub Corp., 303 A.D.2d 892, 895 (3d Dep't. 2012) (disregard of some aspects of corporate form coupled with observance of others was insufficient evidence of domination and control). Indeed, all of the cases I found in which the court permitted veil piercing contained extensive violations of the corporate form.

In In re Adler, 467 B.R. 279, 287 (E.D.N.Y 2012) (applying New York law), for example, the court pierced the corporate veil where the debtor and sole-shareholder of a close corporation failed to issue stock to himself or "exercise even the most basic corporate formalities" such as "contemporaneous bookkeeping, maintenance of financial records, issuance of income tax forms to employees and independent contractors, and the filing of timely tax returns." Id. Importantly, the court noted that formality requirements are relaxed for close corporations and that, standing alone, the lack of formality would "not necessarily have been dispositive." Id. at 288. The court then relayed a litany of other violations that justified veil-piercing. Likewise, in Rose Ocko Foundation, Inc. v. Lebovits, 259 A.D.2d 685, 689 (2d Dep't. 1999), the corporate veil was pierced where there was an "utter lack of observation of corporate form including "stock certificates, corporate records, or meetings, other than the 1983 certificate of incorporation and the certificate of dissolution filed with the Secretary of State in August 1987." Id. Thus, although the failure to issue stock certificates is evidence of the disregard the corporate form (an important factor in the veil piercing analysis), New York case law strongly suggests that a court would not allow veil-piercing based solely upon the failure to issue stock certificates.

Please see the attached cases. If you have any additional questions on this point, please kindly advise.

Regards,
Elliott

Elliott M. Kroll
Partner

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Government of the District of Columbia
Department of Insurance, Securities and Banking

Stephen C. Taylor
Acting Commissioner

September 15, 2015

David Thorson, President
Fairway Physicians Insurance Company, A Risk Retention Group
C/o Lawrence Prudhomme
GPW and Associates, Inc.
2700 North Third Street, Suite 3050
Phoenix, AZ 85004

RE: Limited –Scope Examination of Fairway Physicians Insurance Company, A Risk Retention Group ("Fairway")

Dear Mr. Thorson:

We are in receipt of a response, dated September 2, 2015, from Bob Wiley, Chief Financial Officer, regarding the Report on Limited –Scope Examination of Fairway Physicians Insurance Company, A Risk Retention Group ("Report").

Thank you for notification of Fairway's acceptance of the recommendations contained in the Report. We look forward to receipt of all items required by the recommendations. Please ensure all deadlines as indicated in the Report are met by Fairway as we are not in a position to grant extensions on any of these items.

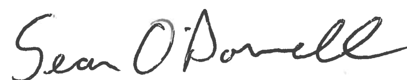
In addition, we note the Company's March 5, 2015 response (page 2, third paragraph, last sentence) indicates the following regarding Fairway's writing of naturopaths and dentists: "In our call with the Department last week on February 25, the Department indicated that Fairway should target such low-risk physicians as a fairly dependable source of profitable income". Please note the Department did not make any such statement and Fairway is authorized to write only those classes approved as part of the Company's business plan. In addition, as was discussed on the February 25 call, the writing of dentists has resulted in significant losses to Fairway.

The adopted Report (which includes a copy of this letter), and the Order evidencing such adoption are enclosed. Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the adopted Report will be held private and confidential for a period of 10 days from the date of the Order evidencing such adoption. After this 10 day period has passed, the Report will be publicly available. The Department of Insurance, Securities and Banking will forward the adopted Report electronically to each jurisdiction in which the Company is registered and to the National Association of Insurance Commissioners.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the date of the above-mentioned Order, affidavits executed by each Company director stating under oath that he or she has received a copy of the adopted examination Report and related Order shall be filed with this Department. Please send these affidavits to my attention at the Department.

Please contact me at 202-442-8153 if you have any questions.

Sincerely,



Sean O'Donnell
Director of Financial Examination,
Risk Finance Bureau

Enclosure