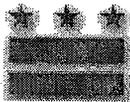


**Government of the District of Columbia**  
Department of Insurance, Securities and Banking



Thomas E. Hampton  
Commissioner

**BEFORE THE  
INSURANCE COMMISSIONER OF  
THE DISTRICT OF COLUMBIA**

Re: Report on Examination - **NCRIC, Inc.** as of December 31, 2005

**ORDER**

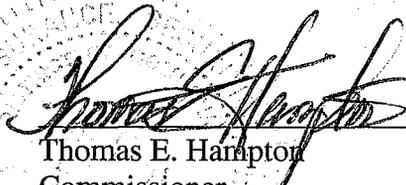
Pursuant to Examination Warrant 2006-1, a Financial Condition Examination of NCRIC, Inc. as of December 31, 2005 has been conducted by the District of Columbia Department of Insurance, Securities and Banking ("the Department").

It is hereby ordered on this 19<sup>th</sup> day of October, 2006, that the attached financial condition examination report be adopted and filed as an official record of this Department.

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, within 30 days of the issuance of the adopted report, the company shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted 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 report as private and confidential information for a period of 10 days from the date of this Order.

  
Thomas E. Hampton  
Commissioner

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



REPORT ON EXAMINATION

NCRIC, INC.

AS OF

DECEMBER 31, 2005

NAIC COMPANY CODE 41149

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Washington, D.C.  
August 1, 2006

Honorable Alfred W. Gross  
Chair, NAIC Financial Condition (E) Committee  
Commissioner, State Corporation Commission, Bureau of Insurance  
Commonwealth of Virginia  
Post Office Box 1157  
Richmond, Virginia 23218

Honorable Julie M. Bowler  
Secretary, Northeastern Zone, NAIC  
Commissioner  
Division of Insurance  
Commonwealth of Massachusetts  
One South Station, 5<sup>th</sup> Floor  
Boston, Massachusetts 02110

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

Dear Madam and Sirs:

In accordance with Section 31-1402 of the District of Columbia Official Code, we have examined the financial condition and activities of

**NCRIC, INC.**

(hereinafter called the Company) at its home office located at 1115 30<sup>th</sup> Street N.W., Washington, DC 20007, and the following Report on Examination is submitted.

**SCOPE OF EXAMINATION**

This examination, covering the period from January 1, 2004 to December 31, 2005, including any material transactions and/or events noted occurring subsequent to December 31, 2005, was conducted under the association plan of the National Association of Insurance Commissioners (NAIC) by examiners of the District of Columbia Department of Insurance, Securities and Banking representing the Northeastern Zone of the NAIC. The Southeastern Zone of the NAIC was invited to participate but did not respond to the examination call.

The last examination of the Company was a full scope examination, covering the period from January 1, 2000 to December 31, 2003. In accordance with the provisions of the District of Columbia Official Code, Section 31-1402, the Commissioner shall examine each domestic insurer at least once every five years, but may perform examinations as often as deemed appropriate. In this regard, the next scheduled financial examination of the Company would have been for the five-year period January 1, 2004 to December 31, 2008.

Subsequent to the prior examination, the Company was acquired by ProAssurance Corporation, an insurance holding company. Consistent with the plan of operation presented to the Department during the review of the proposed acquisition, immediately subsequent to the July 2005 approval of the acquisition by the Commissioner, in August 2005 the Company and ProAssurance Corporation began making preparations to move the Company's accounting operations from the Company's home office in Washington, D.C., to Birmingham, Alabama, at the location of the home office of ProAssurance Corporation. However, prior to this move taking place, management of the Company and of ProAssurance Corporation requested that the Department perform a full-scope financial examination of the Company. The Department agreed to this request and this examination was therefore ordered to be conducted.

Our examination was conducted in accordance with examination policies and standards established by the District of Columbia Department of Insurance, Securities and Banking and procedures recommended by the NAIC and, accordingly, included such tests of the accounting records and such other procedures as we considered necessary in the circumstances.

Our examination included a review of the Company's business policies and practices, management and corporate matters, a verification and evaluation of assets and a determination of the existence of liabilities. In addition, our examination included tests to provide reasonable assurance that the Company was in compliance with applicable laws, rules and regulations. In planning and conducting our examination, we gave consideration to the concepts of materiality and risk, and our examination efforts were directed accordingly.

The Company was audited annually by an independent public accounting firm. The firm expressed unqualified opinions on the Company's financial statements for calendar years 2004 and 2005. We placed substantial reliance on the audited financial statements for calendar year 2004, and consequently performed only minimal testing for that period. We concentrated our examination efforts on the year ended December 31, 2005. We reviewed the working papers prepared by the independent public accounting firm related to the audit for the year ended December 31, 2005, and directed our efforts to the extent practical to those areas not covered by the firm's audit.

## **STATUS OF PRIOR EXAMINATION FINDINGS**

Our examination included a review to determine the current status of the twelve recommendations made in our preceding Report on Examination dated September 30, 2004, which covered the period from January 1, 2000 to December 31, 2003.

During our current examination, we repeated one of the twelve recommendations made in our prior Report on Examination. See the "Capital Stock" section of this report for further comments regarding this recommendation.

## **HISTORY**

### **General:**

The Company was organized as National Capital Reciprocal Insurance Company on June 24, 1980, and commenced business on October 1, 1980, under the Fire and Casualty Act of Title 35 of the District of Columbia Code. The Medical Society of the District of Columbia (Medical Society) sponsored the Company's formation to provide professional liability and office premises liability insurance to physicians who were members of the Medical Society and who had their principal practice in the District of Columbia. In April 1993, the Company's by-laws were amended to eliminate the requirement that the Company's policyholders must also be members of the Medical Society.

In 1998, the Company was reorganized into a stock insurance company, with a mutual insurance holding company parent, NCRIC, A Mutual Holding Company. In addition, two intermediate holding companies, NCRIC Holdings, Inc., and NCRIC Group, Inc., were formed. NCRIC Group, Inc. owned all of the outstanding shares of the Company, NCRIC Holdings, Inc. owned 100 percent of NCRIC Group, Inc., and NCRIC, A Mutual Holding Company owned 100 percent of NCRIC Holdings, Inc. In addition, during 1998 the Company's name was changed to NCRIC, Inc.

The 1998 reorganization separated the policyholders' contract rights, which remained with NCRIC, Inc., and membership interests, which were in NCRIC, A Mutual Holding Company. Each policyholder with a policy that was in force as of December 31, 1998, and who was a member of National Capital Reciprocal Insurance Company, pursuant to the reorganization, became a member of NCRIC, A Mutual Holding Company.

On July 29, 1999, NCRIC Group, Inc. completed an initial public offering of 3,700,000 shares; 40.1 percent to public shareholders and 59.9 percent retained by NCRIC Holdings, Inc. Based on the District of Columbia law, NCRIC, A Mutual Holding Company was required at all times to own, directly or indirectly, a majority of the outstanding voting stock of NCRIC, Inc.

On June 24, 2003, a plan of conversion and reorganization was approved by the members of NCRIC, A Mutual Holding Company and by the shareholders of NCRIC Group, Inc. In the conversion and related stock offering, NCRIC, A Mutual Holding Company, through its wholly owned subsidiary NCRIC Holdings Inc., sold its 59.9 percent ownership interest in NCRIC Group, Inc. for \$10.00 per share. As a result of the conversion and stock offering, NCRIC, A Mutual Holding Company and NCRIC Holdings, Inc., ceased to exist, and NCRIC Group, Inc. became a 100 percent publicly held company.

Effective December 31, 2003, the Company's wholly-owned insurance subsidiary, Commonwealth Medical Liability Insurance Company (CML), was merged into the Company.

Effective August 3, 2005, with approval of the Commissioner of the District of Columbia, Department of Insurance, Securities, and Banking, the Company's parent, NCRIC Group, Inc. was merged into NCP Merger Corporation, which was a subsidiary of ProAssurance Corporation, a publicly traded Delaware corporation. NCRIC Group, Inc. (now known as NCRIC Corporation) was the surviving company, and ProAssurance Corporation became the Company's ultimate controlling parent.

#### Capital Stock:

The Company's Articles of Incorporation authorize the Company to issue 1,000,000 shares of common stock with a par value of \$1 per share. As of December 31, 2005, the Company had issued 1,000,000 shares, all to NCRIC Corporation.

(Note: The Company's stock register did not accurately reflect the Company's issued and outstanding shares as of December 31, 2005. A similar condition was noted in the prior examination. During the current examination, the stock register was corrected, and going forward, the Company acknowledged the importance of maintaining an accurate stock ledger.)

#### Dividends to Stockholders:

The Company did not declare or pay any dividends to stockholders during the period under examination.

#### Management:

The following persons were serving as the Company's directors as of December 31, 2005:

<u>Name and Address</u>	<u>Principal Occupation</u>
A. Derrill Crowe, M.D. Birmingham, Alabama	Chairman and Chief Executive Officer ProAssurance Corporation
Victor T. Adamo Birmingham, Alabama	President ProAssurance Corporation
Paul R. Butrus Birmingham, Alabama	Vice Chairman ProAssurance Corporation
Howard H. Friedman Timonium, Maryland	President NCRIC, Inc.
Edward L. Rand, Jr. Birmingham, Alabama	Chief Financial Officer ProAssurance Corporation
Darryl K. Thomas Hoover, Alabama	Chief Claims Officer NCRIC, Inc.

The composition of the board of directors at December 31, 2005 was not in compliance with District of Columbia Official Code Section 31-706(c)(3), which requires that not less than 1/3 of the directors of the Company be persons who are not officers or employees of the Company, or of any entity controlling, controlled by, or under common control with the Company (i.e., the directors must be “independent”). During our examination, the Company requested and was granted an exemption from the provisions of District of Columbia Official Code Section 31-706(c)(3) on the condition that the board of directors of the Company’s ultimate controlling parent, ProAssurance Corporation, continues to meet these independence requirements in the future.

The following persons were serving as Company officers as of December 31, 2005:

Howard H. Friedman	President, Chief Underwriting Officer
Kathryn A. Neville	Secretary, Vice President
Rebecca B. Crunk	Treasurer, Chief Financial Officer
Edward L. Rand, Jr.	Senior Vice President
Eric R. Anderson	Senior Vice President
Frank B. O’Neil	Senior Vice President
Hayes V. Whiteside, M.D.	Senior Vice President
James J. Morello	Senior Vice President
Jeffery L. Bowlby	Senior Vice President
William E. Burgess	Senior Vice President
Darryl K. Thomas	Chief Claims Officer

Committees:

As of December 31, 2005, the Company's board of directors had established the following committees:

Investment Committee:

A. Derrill Crowe, M.D., Chair  
Victor T. Adamo  
Edward L. Rand, Jr.

Claims Committee (District of Columbia):

Bruce J. Ammerman, M.D., Chair  
Vincent G. Desiderio, Jr., M.D.  
Ronald D. Kurstin, M.D.  
Ian M. Lande, M.D.  
John C. Pan, M.D.  
Charise T. Petrovich, M.D.  
Marjorie A. Voith, M.D.

Underwriting Committee (District of Columbia):

Luther W. Gray, Jr., M.D., Chair  
Boisey O. Barnes, M.D.  
Richard V. Erkenbeck, M.D.  
Prudence P. Kline, M.D.  
Edward R. Lipsit, M.D.  
Steven D. Macht, M.D.  
Esther A. G. Pinder, M.D.  
Stanley R. Rothschild, M.D.  
April Rubin, M.D.  
Stanley A. Schwartz, M.D.  
Lowell M. Weiss, M.D.

Underwriting and Claims Committee (Virginia):

Leslie S. Burt, M.D., Chair  
Paul P. DiMartino, M.D.  
Janice L. Gibson-Neale, M.D.  
Joseph E. Gutierrez, M.D.  
Scott M. Sell, M.D.  
Robert Woo, M.D.

Underwriting and Claims Committee (Delaware)

Janice E. Tildon-Burton, M.D., Chair

William H. Duncan, M.D.

James P. Marvel Jr., M.D.

Paul W. Montigney, M.D.

Edward F. Quinn III, M.D.

Joseph R. Stokes

Michael R. Zaragoza, M.D.

As of December 31, 2005 the Company was not in compliance with District of Columbia Official Code Section 31-706(c)(4), which requires that the board establish one or more committees comprised of individuals who are not officers or employees of the Company, or of any entity controlling, controlled by or under common control with the Company. This committee or committees shall have responsibility for recommending the selection of independent certified public accountants, reviewing the Company's financial condition, nominating candidates for director, evaluating the performance of officers of the Company, and recommending to the board the selection and compensation of principal officers. Specifically, the Company did not have such a committee or committees. Management explained that these functions required by the above-mentioned section of the District of Columbia Official Code are performed by board committees of ProAssurance Corporation. During our examination, the Company requested and was granted an exemption from the provisions of District of Columbia Official Code Section 31-706(c)(4), on the condition that the Company's ultimate controlling parent, ProAssurance Corporation, continues to meet this requirement in the future.

In addition, as of December 31, 2005 the Company was not in compliance with various provisions of its own by-laws requiring the establishment of certain committees. During our examination, the Company amended its by-laws, resolving the non-compliance issues, and acknowledged the future intent to and importance of maintaining compliance with its by-laws.

Conflicts of Interest:

Directors, officers and responsible employees of the Company regularly responded to conflict of interest questionnaires. If possible conflicts were disclosed, Company officials scrutinized them further. Our review of the responses to the questionnaires completed for 2005 disclosed no conflicts that would adversely affect the Company. Furthermore, no additional conflicts of interest were identified during the course of our examination.

Corporate Records:

We reviewed the minutes of the meetings of the shareholders, board of directors and committees for the period under examination. Based on our review, it appeared that the minutes documented the Company's significant transactions and events, and that the directors approved those transactions and events.

**AFFILIATED COMPANIES**

The Company is a member of the ProAssurance holding company system, and is ultimately owned by ProAssurance Corporation (ProAssurance), a publicly traded holding company. As of December 31, 2005, no stockholders owned or controlled 10 percent or more of the outstanding shares of ProAssurance.

Companies in the ProAssurance group are specialty insurers, writing primarily medical professional liability insurance in over 20 states and the District of Columbia.

The Company has a number of subsidiaries, including American Captive Corporation, an inactive District of Columbia captive insurance company.

The following organizational chart summarizes the Company's significant affiliates as of December 31, 2005:

	<u>Domiciliary Jurisdiction</u>
ProAssurance Corporation	Delaware
Medical Assurance, Inc. (100%)	Delaware
The Medical Assurance Company, Inc. (100%) (NAIC# 33391)	Alabama
Woodbrook Casualty Insurance, Inc. (100%) (NAIC# 23272)	Alabama
ProAssurance Group Services Corporation (100%)	Alabama
NCRIC Corporation (100%)	Delaware
<b>NCRIC, Inc. (100%) (NAIC # 41149)</b>	<b>District of Columbia</b>
American Captive Corporation (100%) (NAIC# 11131)	District of Columbia
National Capital Insurance Brokerage, Ltd (100%)	District of Columbia
National Capital Risk Services, LLC (50%)	Nevada
NCRIC Insurance Agency, Inc. (100%)	District of Columbia
HealthCare Compliance Purchasing Group, LLC (100%)	District of Columbia
E-Health Solutions Group, Inc. (18.75%)	Delaware
Professionals Group, Inc. (100%)	Michigan
ProNational Insurance Company (100%)(NAIC# 38954)	Michigan
Red Mountain Casualty Insurance Company, Inc. (100%) (NAIC# 10179)	Alabama

## **INTERCOMPANY AGREEMENTS**

As of December 31, 2005, the Company was a party to the following significant intercompany agreements:

### **Tax Sharing Agreement:**

Effective January 1, 2002, the Company entered into a tax sharing agreement with its affiliated companies. Based on the agreement, all companies in the NCRIC group file a consolidated income tax return with the Internal Revenue Service, with allocation of the total tax liabilities based on each company's individual taxable income compared to the consolidated taxable income of the group. This agreement was terminated on August 31, 2005.

Effective September 1, 2005, the Company entered into a tax sharing agreement with its affiliated companies within the ProAssurance holding company system. Based on the agreement, the consolidated tax liability of the group is allocated among the members based on the portion of the consolidated taxable income attributable to each member having taxable income compared to the consolidated taxable income of the group. The payments or intercompany account adjustments should be made no later than the date such payments would have been required by the Internal Revenue Service if the member had filed a separate return, or as soon thereafter as possible. This agreement was submitted by the Company to the District of Columbia Department of Insurance Securities and Banking and was approved.

### **Administrative Services Agreement:**

Effective June 25, 2003, the Company entered into an administrative services agreement with its parent and affiliated companies in the NCRIC group. Based on the agreement, each party to the agreement may request certain administrative services from other parties, and reimburse the services based on the actual or allocated expense of other parties. During 2005, the Company provided certain services to its subsidiaries with allocations totaling \$293,000.

This agreement was terminated on December 31, 2005, and replaced by Expense Sharing and Management Services Agreements with ProAssurance Corporation and its affiliates. The new agreements became effective on January 1, 2006. The new agreements were submitted to the District of Columbia Department of Insurance, Securities and Banking and were approved.

## **FIDELITY BOND AND OTHER INSURANCE**

The Company was a named insured under a fidelity bond issued to its ultimate parent, ProAssurance Corporation. The fidelity bond provides coverage in the amount of \$3,000,000 with a single loss deductible of \$50,000. The coverage meets the minimum

amount of fidelity bond coverage recommended by the National Association of Insurance Commissioners for the Company and its affiliates on a consolidated basis.

In addition, the Company is covered under other insurance coverage in-force at December 31, 2005, including property and liability, workers' compensation, umbrella liability, general liability and directors and officers liability policies. Based on our review, the Company's other insurance coverage appeared to be adequate.

### **PENSION, STOCK OWNERSHIP AND INSURANCE PLANS**

The Company sponsors a defined contribution 401(k) profit-sharing plan. Full-time regular employees become eligible to enroll in the plan if they are 21 years or older and have 90 days of employment with the Company. The Company is not required to make matching contributions to the plan, but may make discretionary contributions. In 2005, the Company's contribution to the plan was \$178,000. Effective January 1, 2006, the NCRIC 401(k) plan was merged into the ProAssurance Corporation 401(k) plan, and eligible employees of the Company became participants in the ProAssurance Corporation plan.

The Company's parent, NCRIC Corporation, had a stock option plan for directors and officers in the NCRIC group. The plan was assumed by ProAssurance Corporation as part of the 2005 acquisition of the Company. In addition, NCRIC Corporation maintained an Employee Stock Ownership Plan (ESOP) for employees of the Company. The ESOP was terminated immediately prior to the acquisition by ProAssurance. Effective January 1, 2006, employees of the Company became eligible to participate in ProAssurance's Employee Stock Purchase Plan.

The Company also provides various health insurance and other benefits to its employees. The Company provides group health and dental benefits for eligible full-time regular employees and their eligible dependents. In addition, the Company provides life and long-term disability insurance to its eligible full-time regular employees. ProAssurance Corporation employee benefit plans are available to the Company's employees effective January 1, 2006.

### **STATUTORY DEPOSITS**

The Company is not required to maintain a statutory deposit in the District of Columbia. However, the Company has established such a deposit, and had deposited in trust with the District of Columbia Department of Insurance, Securities and Banking, United States Treasury Notes with a total par value of \$95,000 and a market value of \$92,369, as of December 31, 2005. These funds were held for the protection of all policyholders.

In addition, the Company had statutory deposits, consisting of United States Treasury Notes and Bonds with the following jurisdictions. These deposits were held for the protection of the policyholders in those jurisdictions.

	<u>Par Value</u>	<u>Book Value</u>	<u>Market Value</u>
Maryland	\$ 100,000	\$ 119,116	\$ 126,867
Virginia *	<u>550,000</u>	<u>553,681</u>	<u>534,765</u>
Total	<u>\$ 650,000</u>	<u>\$ 672,797</u>	<u>\$ 661,632</u>

\* In its Annual Statement as of December 31, 2005, the Company reported its special deposit with Virginia at a book value of \$649,317 and a market value of \$627,134. As indicated in the above chart, the correct book and market values are \$553,681 and \$534,765, respectively. This error did not impact the Company's total assets and surplus, which were accurately reported. During our examination, the Company acknowledged this error and indicated its intent to correct it in future financial filings.

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

As of December 31, 2005, the Company was licensed to transact business in Maryland, Delaware, Virginia, West Virginia, and the District of Columbia. During 2005, the Company wrote premiums totaling approximately \$80.9 million. The Company wrote approximately \$24.8 million in premiums in the District of Columbia, \$22.6 million in Virginia, \$16.3 million in Delaware, \$12.9 million in Maryland, and \$4.3 million in West Virginia.

Over 99 percent of the Company's business was medical malpractice coverage, written for groups, as well as individual physicians, dentists, and other healthcare providers.

The Company markets its products directly and through independent agents/brokers. The Company's underwriting department directly writes most of the District of Columbia business and independent agents/brokers write most of the Company's business in jurisdictions other than the District of Columbia. During 2005, one broker wrote more than 20 percent of the Company's new business.

Effective January 1, 2006, the Company stopped writing new business in West Virginia; effective March 1, 2006 the Company stopped writing new business in Virginia and Delaware; and effective September 5, 2006 the Company stopped writing new business in Maryland. After these dates in the respective states, all policies renewed in these states will be rewritten by ProAssurance affiliates.

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

The District of Columbia's Market Conduct Unit has never conducted an examination of the market conduct affairs of the Company, and as of the date of this Report, the Unit was not planning to conduct a market conduct examination of the Company. In addition, no other market conduct examinations of the Company by other jurisdictions have ever been performed. A market conduct examination would include detailed reviews of the Company's sales and advertising, agent licensing, underwriting, and rating, claims processing and complaint handling practices and procedures.

The scope of our examination did not include market conduct procedures, including, but not limited to, market conduct procedures in the following areas:

- Policy Forms
- Fair Underwriting Practices
- Advertising and Sales Materials
- Treatment of Policyholders:
  - Claims Processing (Timeliness)
  - Complaints

## **REINSURANCE**

### **Assumed Reinsurance:**

As of December 31, 2005, the Company had no assumed business.

### **Ceded Reinsurance:**

The Company entered into reinsurance agreements with various reinsurers. The reinsurance program is comprised of several contracts and the Company's maximum net risk retention on any one loss is \$1 million. The Company's reinsurance program provides the Company with the ability to offer policy limits up to \$9 million, as follows:

A primary excess loss treaty provides \$1 million coverage in excess of the \$1 million retention on an individual loss basis.

A secondary excess loss treaty (clash) reinsures the Company's multiple claim exposure and provides coverage of \$2 million excess of \$2 million on an occurrence basis.

A third excess treaty provides the Company the ability to issue policy limits in excess of \$2 million. The treaty covers policy limits up to \$9 million for each insured, each claim made in excess of \$2 million.

A catastrophe treaty insures extra contractual obligations and excess policy limit awards up to \$5 million of ultimate net loss.

During 2005, the Company ceded premiums totaling approximately \$18 million. As of December 31, 2005, the Company had recorded loss and loss expense reserve credits related to estimated amounts recoverable from reinsurers totaling approximately \$41 million and unearned premium reserve credits from reinsurers totaling approximately \$4.8 million. If the reinsurers were not able to meet their obligations under these agreements the Company would be liable for any defaulted amounts.

Our review of the Company's reinsurance treaties disclosed no unusual provisions. The Company's reinsurance program appears to provide adequate coverage for amounts above the Company's stated retention limits.

Effective January 1, 2006, the Company non-renewed its existing treaties and became a party to a number of reinsurance treaties utilized by companies in the ProAssurance group. As a result, all above reinsurance treaties were non-renewed and are in runoff.

### **ACCOUNTS AND RECORDS**

The Company's general accounting records consisted of an automated general ledger and various subsidiary ledgers (e.g., cash receipts, cash disbursements). Our review did not disclose any significant deficiencies in these records. However, the Company did not have its accounting and claims handling policies and procedures fully documented. See the "Comments and Recommendations" section of this Report, under the caption "Documentation of Accounting and Claims Handling Policies and Procedures" for further comments regarding this condition.

In addition, our examination disclosed two areas in which the Company's electronic data processing controls could be improved. These conditions are discussed further in the "Comments and Recommendations" section of this Report, under the caption "Information System General Controls".

Beginning in November 2005, the Company began transitioning its computer data center to that of its ultimate parent, ProAssurance Corporation, in Birmingham, Alabama. At the conclusion of this process, expected to be completed during 2006, the majority of the Company's data processing functions, including the general ledger accounting system and premiums and claims processing systems, will be located in Birmingham.

In August 2006, the Company requested, and was subsequently granted permission by the Commissioner to transfer all material accounting records of the Company to Birmingham, Alabama, at the location of the home office of ProAssurance Corporation, its ultimate parent.

## FINANCIAL STATEMENTS

The following financial statements reflect the financial condition of the Company as of December 31, 2005, as determined by this examination:

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The accompanying "Notes to Financial Statements" are an integral part of these financial statements.

**BALANCE SHEET**

**ASSETS**

	Assets	Nonadmitted Assets	Net Admitted Assets	Examination Adjustment Increase (Decrease)	Net Admitted Assets Per Examination
Bonds (NOTE 1)	\$ 206,578,242	\$ 0	\$ 206,578,242	\$ 0	\$ 206,578,242
Common stocks	1,156,780		1,156,780		1,156,780
Cash (\$7,060,403), cash equivalents (\$0) and short term investments (\$23,197,146)	30,257,549		30,257,549		30,257,549
Receivables for securities	20,091		20,091		20,091
Subtotals, cash and invested assets	\$ 238,012,662	\$ 0	\$ 238,012,662	\$ 0	\$ 238,012,662
Investment income due and accrued	2,525,706		2,525,706		2,525,706
Uncollected premiums and agents' balances in course of collection	4,477,925	124,161	4,353,764		4,353,764
Deferred premiums, agents' balances and installments booked but deferred not yet due	1,692,279	51,132	1,641,147		1,641,147
Amounts recoverable from reinsurers (NOTE 2)	3,573,373		3,573,373	(1,722,844)	1,850,529
Current federal and foreign income tax recoverable and interest thereon	1,228,448		1,228,448		1,228,448
Net deferred tax asset	18,248,594	14,025,418	4,223,176		4,223,176
Electronic data processing equipment and software	1,529,400	1,256,111	273,289		273,289
Furniture and equipment	180,568	180,568			
Receivables from parent, subsidiaries and affiliates	5,519,446		5,519,446		5,519,446
Aggregate write-ins for other than invested assets	427,393	427,393			
Totals	\$ 277,415,794	\$ 16,064,783	\$ 261,351,011	\$ (1,722,844)	\$ 259,628,167

**LIABILITIES, SURPLUS AND OTHER FUNDS**

	Amounts per Annual Statement	Examination Adjustments	Amounts per Examination
Losses (NOTE 3)	\$ 104,239,000	\$	\$ 104,239,000
Loss adjustment expenses (NOTES 2 AND 3)	42,652,000	(1,722,844)	40,929,156
Commissions payable, contingent commissions & other similar charges	1,092,565		1,092,565
Other expenses (excluding taxes, licenses and fees)	1,874,174		1,874,174
Taxes, licenses and fees (excluding federal and foreign income taxes)	334,662		334,662
Unearned premiums (after deducting ceded reinsurance unearned premiums of \$4,797,214) (NOTE 4)	34,977,470		34,977,470
Advance premiums	3,956,499		3,956,499
Ceded reinsurance premiums payable (net of ceding commissions)	4,017,619		4,017,619
Funds held by company under reinsurance treaties	476,057		476,057
Amounts withheld or retained by company for accounts of others	58,433		58,433
Provision for reinsurance	1,089,000		1,089,000
Aggregate write-ins for liabilities (NOTE 5)	<u>19,500,000</u>		<u>19,500,000</u>
Total liabilities	<u>\$ 214,267,479</u>	<u>\$ (1,722,844)</u>	<u>\$ 212,544,635</u>
Common capital stock	\$ 1,000,000		\$ 1,000,000
Gross paid in and contributed surplus	50,434,666		50,434,666
Unassigned funds (surplus)	<u>(4,351,134)</u>		<u>(4,351,134)</u>
Surplus as regards policyholders	<u>\$ 47,083,532</u>		<u>\$ 47,083,532</u>
Total liabilities and surplus	<u><u>\$ 261,351,011</u></u>	<u><u>\$ (1,722,844)</u></u>	<u><u>\$ 259,628,167</u></u>

## STATEMENT OF INCOME

### Underwriting Income:

Premiums earned		<u>\$ 67,868,875</u>
Underwriting deductions:		
Losses incurred	\$ 44,651,464	
Loss expenses incurred	25,036,618	
Other underwriting expenses incurred	<u>11,874,762</u>	
Total underwriting deductions		<u>\$ 81,562,844</u>
Net underwriting loss		<u>\$ (13,693,969)</u>

### Investment Income:

Net investment income earned	\$ 8,491,363	
Net realized capital gains (losses) less capital gains tax of \$1,572,961	<u>2,921,213</u>	
Net investment gain		<u>\$ 11,412,576</u>

### Other Income:

Net gain (loss) from agents' or premium balances charged off (amount recovered \$4,018; amount charge off \$53,532)	\$ (49,484)	
Finance and service charges not included in premiums	32,187	
Aggregate write-ins for miscellaneous income ( <b>NOTE 5</b> )	<u>(19,507,044)</u>	
Total other income		<u>\$ (19,524,341)</u>
Net income after dividends to policyholders and before federal and foreign income taxes		<u>\$ (21,805,734)</u>
Federal and foreign income taxes incurred		(1,889,783)
Net loss		<u>\$ (19,915,951)</u>

## CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2003	\$ 70,371,686
Net loss, 2004	\$ (8,984,166)
Change in net unrealized capital gains or (losses)	1,010,702
Change in net deferred income tax	3,138,327
Change in nonadmitted assets	(2,542,062)
Net change in surplus as regards policyholders, 2004	(7,377,199)
Surplus as regards policyholders, December 31, 2004	\$ 62,994,487
Net loss, 2005	\$ (19,915,951)
Change in net unrealized capital gains or (losses)	(2,221,761)
Change in net deferred income tax	7,768,127
Change in nonadmitted assets	(8,452,370)
Change in provision for reinsurance	(1,089,000)
Paid in surplus ( <b>NOTE 6</b> )	8,000,000
Net change in surplus as regards policyholders, 2005	(15,910,955)
Surplus as regards policyholders, December 31, 2005	\$ 47,083,532

## **ANALYSIS OF EXAMINATION CHANGES TO SURPLUS**

There were no changes to the Company's surplus as a result of our examination.

**COMPARATIVE FINANCIAL POSITION OF THE COMPANY**

The comparative financial position of the Company for the five-year period ended December 31, 2005, is as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Assets	\$259,628,167	\$229,863,043	\$197,014,566	140,298,083	115,750,459
Liabilities	212,544,635	166,868,556	126,642,880	96,028,780	82,991,612
Policyholders surplus (NOTE 7)	47,083,532	62,994,487	70,371,686	44,269,303	32,758,847
Premiums earned	67,868,875	66,461,860	47,264,094	30,089,634	20,965,591
Net underwriting loss (NOTE 7)	(13,693,969)	(17,632,697)	(13,898,983)	(4,078,931)	(3,003,861)
Net investment gain	11,412,576	7,260,947	7,606,738	5,695,786	5,764,840
Net income (loss) (NOTE 7)	(19,915,951)	(8,984,166)	(4,900,441)	(1,510,554)	593,450

**Note:** Amounts in the preceding financial statements for the years ended December 31, 2001 and 2002 are combined amounts for the Company and its former subsidiary, Commonwealth Medical Liability Insurance Company (CML). Amounts for the years ended December 31, 2001, 2002, and 2004 were taken from the Company's/CML's Annual Statements as filed with the Department. Amounts for the years ended December 31, 2003 and 2005 are amounts per examination.

## NOTES TO FINANCIAL STATEMENTS

### 1. Pledged Assets:

The Company reported “Bonds” totaling \$206,578,242. As of December 31, 2005, bonds comprising approximately \$40 million of this amount were pledged as collateral. Under applicable statutory accounting guidelines, the pledged bonds are admitted assets. See further comments regarding the Company’s pledged bonds in the “Comments and Recommendations” section of this Report under the caption “Pledged Assets”.

### 2. Amounts Recoverable From Reinsurers:

The Company reported “Amounts recoverable from reinsurers” totaling \$3,573,373. This amount was comprised of paid losses and loss adjustment expenses totaling \$1,850,529, already billed to reinsurers, which were recoverable from the reinsurers under the Company’s reinsurance treaties. In addition, the amount included \$1,722,844 related to paid loss adjustment expenses, which the Company estimated would be recoverable from the reinsurers at a future date. However, these amounts were not yet recoverable from the reinsurers under the Company’s reinsurance treaties and had not been billed to the reinsurers.

During our examination, we discussed with management the appropriate statutory accounting treatment for these amounts related to future estimated amounts recoverable from reinsurers. Management agreed that these amounts would more appropriately be reported as reinsurance “credits”, reductions to the Company’s reported liability, “Loss adjustment expenses” reserves. Management indicated its intent to record these estimated amounts recoverable in this manner in future financial filings.

Accordingly, we reclassified these amounts by reducing “Amounts recoverable from reinsurers” by \$1,722,844, from \$3,573,373 to \$1,850,529, and reducing “Loss adjustment expenses” reserves by \$1,722,844, from \$42,652,000 to \$40,929,156. This reclassification did not affect the Company’s surplus.

### 3. Loss Reserves:

The Company reported “Losses” and “Loss adjustment expenses” reserves totaling \$104,239,000 and \$42,652,000, respectively. These reserves, which represent management’s best estimate of the amounts necessary to pay all claims and related expenses that had been incurred but still unpaid as of December 31, 2005, are shown net of estimated amounts recoverable from various reinsurance companies under the Company’s reinsurance treaties. Reserve credits taken as of December 31, 2005 for cessions to reinsurers totaled approximately \$41,281,000 (\$28,145,000 for Losses and \$13,136,000 for Loss adjustment expenses). If the reinsurers were not able to meet their obligations under the reinsurance treaties, the Company would be liable for any defaulted amounts.

The methodologies utilized by the Company to compute reserves, and the adequacy of the loss and loss adjustment expense reserves as of December 31, 2005, were reviewed as part of our examination. As part of our review, we relied on the Company's independent actuary, who concluded that the methodologies and reserves appeared to be sufficient. In addition, the methodologies utilized by the Company to compute these reserves, and the adequacy of the loss reserves and loss adjustment expense reserves were reviewed by an independent actuary engaged as part of our examination. This independent actuary engaged as part of our examination also concluded that the methodologies and reserves appeared to be sufficient. However, our independent actuary also made certain recommendations related to the Company's loss reserves. See the "Comments and Recommendations" section of this Report, under the caption "Loss Reserves", for further comments regarding these recommendations.

Although the Company's independent actuary, as well as the independent actuary engaged as part of our examination, both concluded that the Company's methodologies and reserves appeared to be sufficient, during our examination we discussed with management a number of issues related to its reserves:

A. Adverse Loss Development:

During 2004 and 2005, as a result of adverse loss development on prior years' loss and loss adjustment expense reserves, the Company strengthened its loss and loss adjustment expense reserves. Specifically, during 2004, reserves on losses incurred in prior years were increased by approximately \$17.2 million, and during 2005, reserves on losses incurred in prior years were increased by approximately \$14.5 million.

As a result of these reserve strengthenings, the Company reported significant underwriting losses in 2004 and 2005, and significant reductions in surplus.

According to management, the adverse loss development was related to new business written during the period 2000 to 2004 in Virginia, West Virginia, Delaware and Maryland. The Company's written premium in these four states increased from approximately \$5 million in 2000 to approximately \$62 million in 2004. Much of this business was written by the Company's former subsidiary, Commonwealth Medical Liability Insurance Company (CML), which was merged into the Company in 2003. During this period of growth in these jurisdictions, the Company/CML relied on industry experience to develop its rates and its reserve estimates. However, the Company's/CML's actual loss experience in these states was worse than expected, and its rates and initial reserve estimates proved inadequate. In addition, even in the District of Columbia, where the Company had many years of experience as the market leader, claims severity began to increase for claims reported in 2003 and 2004, and claims development patterns changed. This resulted in adverse development for the Company's District of Columbia business also.

As of December 31, 2005, management believes its reserves reflect the most recent experience and are intended to ensure against future adverse development. In addition, as indicated above, the Company's independent actuary, as well as an independent actuary engaged as part of our examination both concluded that the Company's reserves appeared to be sufficient.

B. Negative IBNR:

Included in the Company's total "Losses" reserves are various components, including case reserves and incurred but not reported (IBNR) reserves. In its Annual Statements for the 2 years under the current examination, the Company reported negative IBNR "Losses" reserves. In addition, the Company had also reported negative IBNR "Losses" reserves for the years 2000 through 2003.

During our examination, we discussed the Company's negative IBNR with management and the potential effect(s) on the Company's reserve estimates (e.g., whether the consistent reporting of this negative IBNR has contributed to the need for the recent reserve strengthenings, etc.).

Management explained that in the years the Company has reported negative IBNR, its actuarially estimated ultimate direct loss reserves have been less than the sum of the Company's individual direct case reserves. Management believes its conservative individual case reserving philosophy is appropriate, and in lieu of reducing its overall case reserves to the level of its estimate of ultimate direct indemnity loss reserves, management records negative IBNR in order to reduce its total reported reserves to the level of its estimate of ultimate direct indemnity loss reserves.

According to management, the Company has reviewed and evaluated its case reserving practices in the past, and is constantly evaluating whether improvements to these practices are warranted. However, management believes its current practices are appropriate. In addition, management's belief is that consistent case reserving practices over a long period are necessary in order for the case reserving practices to result in overall reserve estimates as accurate as possible. Management indicated the Company's independent actuary also monitors and evaluates the Company's case reserving practices and has advised against changing those practices. As indicated above, the Company's independent actuary, as well as an independent actuary engaged as part of our examination both concluded that the Company's reserving methodologies were appropriate.

4. Unearned Premium Reserves:

The Company reported "Unearned premiums" totaling \$34,977,470. This amount was net of ceded unearned premiums totaling \$4,797,214. Of the \$34,977,470 net unearned premium reserve balance, \$9,876,550 represents a reserve related to Death, Disability, and Retirement coverage (DD&R) extended reporting endorsements ("free tail coverage"). The Company

issues policies which include provisions to extend coverage to its eligible policyholders in the event of death, disability or retirement. The DD&R extended reporting endorsement covers claims occurring during periods covered under the Company's policies but not reported until after death, disability or retirement of the policyholder. The Company used actuarial methodologies to allocate a portion of its premium to fund the "free tail" coverage. The methodologies and assumptions used by the Company in its calculation of the DD&R reserve, and the adequacy of the reserve as of December 31, 2005, were reviewed by our independent actuary and were determined to be reasonable and adequate.

5. Litigation Liability and Expense:

The Company reported "Aggregate write-ins for liabilities" totaling \$19,500,000, and "Aggregate write-ins for miscellaneous income" totaling negative \$19,507,044. The entire amount of "Aggregate write-ins for liabilities", and \$19,500,000 of the negative \$19,507,044 "Aggregate write-ins for miscellaneous income" relate to litigation liability and expense recorded by the Company.

These amounts relate to a February 13, 2004 \$18.2 million civil verdict by a District of Columbia Superior Court jury against the Company in favor of Columbia Hospital for Women Medical Center, Inc. (CHW).

Originally, the Company had attempted to collect payment for approximately \$3 million in premiums that the Company alleged it was owed under a contract with the hospital that expired in 2000. The jury rejected the Company's claim, and returned a verdict in favor of CHW, which had countersued the Company.

The Company is seeking to overturn the verdict on appeal. If the verdict is upheld, the \$18.2 million award could be subject to interest calculated from the original verdict date of February 13, 2004. The Company has accrued \$19,500,000 related to this litigation.

NCRIC Corporation, the Company's immediate parent, has indemnified the Company for up to \$5.5 million (after tax) of any final judgment from this litigation. Based on commitments from NCRIC Corporation, and from the Company's ultimate parent, ProAssurance Corporation, NCRIC Corporation and/or ProAssurance Corporation will continue to pay all post-trial legal costs.

6. Paid In Surplus:

During 2005 and early 2006, the Company received capital contributions totaling \$8 million from its parent, NCRIC Corporation. Specifically, in August 2005, the Company received a \$3 million capital contribution in the form of fixed maturity securities. In addition, a capital contribution totaling \$5 million was accrued as of December 31, 2005. The Company received the cash funding for this contribution in February 2006. Under applicable statutory accounting guidelines, and with the approval of the Department, this contribution was recorded as a 2005 capital contribution.

## 7. Recent Financial Results:

As indicated in the “Comparative Financial Position of the Company” section of this Report, in 2004 and 2005, the Company experienced significant declines in surplus, and continuing net underwriting and total net losses.

Management attributes this trend to a variety of factors:

- 2004 and 2005 adverse loss development (see **NOTE 3** above).
- 2005 litigation accrual (see **NOTE 5** above).
- The years 2001 to 2004 were difficult and challenging years for medical malpractice writers in general. Companies experienced increased severity of claims during this period, reinsurance costs increased, particularly after the September 11, 2001 terrorist attacks, and interest rates were down during this period.

As a result of the above conditions, management of the Company and of the Company’s ultimate parent, ProAssurance Corporation, has taken the following steps to address the downward trend in surplus and operating results:

- During 2004, management of the Company began the process of soliciting acquisition bids and searching for an established medical malpractice company with access to sufficient resources to be able to provide capital to the Company to enable the Company to withstand volatility of earnings. ProAssurance was selected and completed the acquisition during 2005.
- During 2004, in addition to the annual review of its reserves by its appointed actuary, the Company engaged a second, independent actuary to perform an independent review of its reserves.
- During 2005 and early 2006, the Company received capital contributions totaling \$8 million from its parent (see **NOTE 6** above).
- Beginning in 2006, all non-District of Columbia business is being renewed in other companies in the ProAssurance group. Management believes this will reduce the Company’s risk profile and need for capital, and believes this will have a positive impact on operating results in 2006 and future years. During the period 2000 to 2004, the Company and its former subsidiary, Commonwealth Medical Liability Insurance Company had expanded into new markets, including West Virginia, Virginia, Delaware and Maryland. The majority of the recent adverse loss development experienced by the Company arose from business written in these jurisdictions. While management acknowledges that this action will not provide immediate relief in terms of loss development as the current claims will remain with the Company, it should provide long term relief as no new risks will be written by the Company in these jurisdictions.
- Regarding the aforementioned litigation, NCRIC Corporation has indemnified the Company for up to \$5.5 million (after tax) of any final judgment, and NCRIC Corporation as well as the Company’s ultimate parent, ProAssurance Corporation,

have committed to continue to pay all post-trial legal costs. This litigation is not related to coverage under a medical malpractice insurance contract and is considered by management to be a one-time event.

- Implemented rate increases for District of Columbia business of approximately 15 percent in both 2004 and 2005.
- Management of ProAssurance Corporation, the Company's ultimate parent, has indicated its commitment to supporting the Company.

In the first half of 2006, the Company reported significantly improved operating results. Specifically, although the Company reported a net underwriting loss of approximately \$188,000 for the six-month period ending June 30, 2006, this loss was significantly less than the underwriting losses reported in 2004 and 2005. Management attributes the improved operating results to the measures outlined above, and believes future operating results will continue to be positively impacted by these measures. In addition, the Company's reported surplus increased by over \$4 million from December 31, 2005 (\$47,083,532) to June 30, 2006 (\$51,243,693), and management believes that going forward, the above measures, coupled with more stable reinsurance, interest rate and premium environments in the medical malpractice industry, will continue to have a positive impact on the Company's surplus.

## COMMENTS AND RECOMMENDATIONS

### Documentation of Accounting and Claims Handling Policies and Procedures:

The Company did not have its accounting and claims handling policies and procedures fully documented. Although the Company was able to provide the examiners with written summaries of various policies and procedures requested by the examiners during the course of the examination, the Company did not have these policies and procedures readily documented. Documentation of the Company's accounting and claims handling policies and procedures would help to ensure that accounting and other records are properly maintained on a consistent basis from period to period, and that the statutory financial statements are prepared consistently from period to period, particularly in the event of turnover of key personnel. We were informed by management that the Company has, or will soon be converting, many of its policies and procedures, including accounting, to those of ProAssurance Corporation, and that these ProAssurance Corporation policies and procedures are documented. **We recommend that the Company ensure that policies and procedures utilized to process its accounting and claims transactions are formally documented.**

### Information Systems General Controls:

The Company utilized an electronic data processing system to process the majority of its significant functions (e.g., reserving, claims processing, general ledger, etc.). During our review of the procedures and controls over the Company's electronic data processing system, we noted the following areas where controls could be improved:

#### Monitoring of Administrator Level Access:

Due to their job responsibilities, certain employees in the Company's information systems department had been granted "administrator" privileges, which allowed unlimited access to the systems, including applications, data and system security. In order to allow management to monitor system activity, the Company's systems had the ability to track user activity by users with "administrator" privileges. However, the Company had not utilized this security feature to monitor activity by employees with "administrator" privileges. As a result, unauthorized changes could go undetected. **To improve control over its data processing operations, we recommend that the Company generate system activity reports that track user activity by users with "administrator" access, and that these reports be reviewed for unauthorized activities by management not having administrator level authority.**

#### Outside Service Provider:

The Company utilized an outside service provider to perform premium billing and collection services. However, the Company did not periodically review the procedures and controls in place at the service center to ensure the service center was processing the Company's transactions in accordance with the agreement between the Company and the service center,

and that the Company's data processed by the service center was adequately protected. **We recommend that the Company periodically (e.g., annually) review the procedures and controls in place at the service center. Such a review could be performed by an independent auditor (i.e., "SAS 70" review), or could be performed by the Company's internal auditor.**

#### Pledged Assets:

As previously noted in **NOTE 1** in the "Notes to Financial Statements" section of this report, approximately \$40 million of the Company's reported "Bonds" totaling \$206,578,242 were pledged as collateral. Under applicable statutory accounting guidelines, the pledged bonds are admitted assets. However, the Company did not properly disclose in its 2005 Annual Statement filed with the Department that these investments had been pledged. Specifically, the National Association of Insurance Commissioners (NAIC) "Annual Statement Instructions" require the disclosure in the Annual Statement of investments pledged as collateral. Such disclosure is required in the "Notes to Financial Statements" and "General Interrogatories" sections of the Annual Statement, as well as in the investment schedules of the Annual Statement. **We recommend that the Company disclose pledged assets in its Annual Statements in accordance with the NAIC Annual Statement Instructions.**

#### Loss Reserves:

As indicated in **NOTE 3** the "Notes to Financial Statement" section of this Report, the Company reported "Losses" and "Loss adjustment expenses" reserves totaling \$104,239,000 and \$42,652,000, respectively. The methodologies utilized by the Company to compute these reserves, and the adequacy of the loss and loss adjustment expense reserves as of December 31, 2005 were reviewed as part of our examination by an independent actuary engaged as part of our examination. Although this independent actuary engaged as part of our examination concluded that these reserves appeared to be sufficient, the actuary noted that in determining certain reserve selections, heavy reliance is placed on industry based increased limit factor relationships, and heavy reliance is placed on loss development patterns from other than the jurisdictions where the business was written. **As the Company's business matures, we recommend that the Company place reliance on state specific increased limits factor relationships and on state specific loss development patterns.**

#### Additional Comments and Recommendations

During our examination, in addition to the above Comments and Recommendations, we made other suggestions and recommendations to the Company with regard to record keeping and other procedures relating to its operations. These additional suggestions and recommendations were not deemed significant for purposes of our Report on Examination, and are not included in our Report on Examination.

## CONCLUSION

Our examination disclosed that as of December 31, 2005, the Company had:

Admitted assets	<u>\$ 259,628,167</u>
Liabilities	<u>\$ 212,544,635</u>
Common capital stock	\$ 1,000,000
Gross paid in and contributed surplus	50,434,666
Unassigned funds (surplus)	(4,351,134)
Surplus as regards policyholders	<u>\$ 47,083,532</u>
Total liabilities, capital and surplus	<u>\$ 259,628,167</u>

Based on our examination, the accompanying balance sheet properly presents the statutory financial position of the Company as of December 31, 2005, and the accompanying statement of income properly presents the statutory results of operations for the period then ended. The supporting financial statements properly present the information prescribed by the District of Columbia Official Code and the National Association of Insurance Commissioners.

Chapters 20 (“RISK-BASED CAPITAL”) and 25 (“FIRE, CASUALTY AND MARINE INSURANCE”) of Title 31 (“Insurance and Securities”) of the District of Columbia Official Code specify the level of capital and surplus required for the Company. We concluded that the Company’s capital and surplus funds exceeded the minimum requirements during the period under examination.

**SIGNATURES**

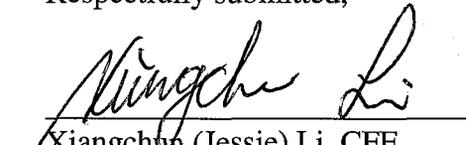
In addition to the undersigned, the following examiners representing the District of Columbia Department of Insurance, Securities and Banking participated in certain phases of this examination:

Chidinma Ukairo, District of Columbia Department of Insurance,  
Securities and Banking  
Joseph A. Rome, CFE, CIE, INS Consultants, Inc.

The electronic data processing review and computer assisted data analysis was performed by Lisa Peterson, CFE, AES, CISA, from Eide Bailly, LLP.

The actuarial portion of this examination was completed by Dave Macesic, ACAS, MAAA, and Jim Neidermyer, FCAS, MAAA, from INS Consultants, Inc.

Respectfully submitted,



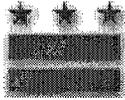
Xiangchun (Jessie) Li, CFE  
Examiner-In-Charge  
District of Columbia Department of  
Insurance, Securities and Banking

Under the Supervision of,



Nathaniel Kevin Brown, CFE  
Supervising Examiner  
District of Columbia Department of  
Insurance, Securities and Banking

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



Thomas E. Hampton  
Commissioner

October 4, 2006

Howard H. Friedman  
President  
NCRIC, Inc.  
1115 30<sup>th</sup> Street N.W.,  
Washington, DC 20007

Dear Mr. Friedman:

Pursuant to the provisions of Section 31-1404 of the D.C. Official Code, enclosed is a draft copy of the Report on Examination of the affairs and financial condition of **NCRIC, Inc.** as of December 31, 2005.

Please call our attention to any errors or omissions. In addition, if this Report on Examination contains a section entitled "Comments and Recommendations" that discloses certain areas requiring action, the Company shall submit a statement covering the corrective measures which will be taken. If the Company's position on any of these points is contrary to the Examiner's findings, an explanation should be submitted covering each contested comment and/or recommendation.

If there are no errors or omissions to be brought to our attention, and there are no "Comments and Recommendations" requiring a response, please submit a statement that the Company accepts the Report.

All of your comments concerning these matters must be in writing and shall be furnished to this Department within **thirty (30) days from the date of this letter (November 3, 2006)**.

Sincerely,

Philip Barlow  
Associate Commissioner for Insurance

Enclosure



NCRIC, Inc.  
A ProAssurance Company

800/613-3615  
202/969-1866  
Fax 202/969-1881  
www.ProAssurance.com

October 16, 2006

Mr. Philip Barlow  
Associate Commissioner for Insurance  
Department of Insurance, Securities and Banking  
810 First Street, NE, #701  
Washington, DC 20002

RE: Report on Examination of NCRIC, Inc. for the two years ended December 31, 2005

Dear Associate Commissioner Barlow:

In connection with the above referenced report, we are submitting our responses to the recommendations contain therein. As used in this letter; DISB refers to the District of Columbia Department of Insurance, Securities and Banking and Company refers to NCRIC, Inc.

The following are the Company's responses to the Recommendations contained in the Report.

Documentation of Accounting and Claims Handling Policies and Procedures:

Recommendation

The DISB recommends that the Company ensure that policies and procedures utilized to process its accounting and claims transactions are formally documented.

Response

The Company's accounting and claim functions have been centralized and are now being processed on one system out of ProAssurance group's home office in Birmingham, Alabama. The Company is in the process of completing its plan to document the significant policies and procedures within the Company.

Information Systems General Controls:

Monitoring of Administrator Level Access

Recommendation

To improve control over its data processing operations, the DISB recommends that the Company generate system activity reports that track user activity by users with

“administrator” access, and that these reports be reviewed for unauthorized activities by management not having administrator level authority.

#### Response

Prior to the Company’s merger with ProAssurance, the Company had a small information systems department and in order to protect the Company in the event of an employee leaving or becoming unavailable, additional persons were cross trained and were assigned administrator privileges. Currently, the Company’s system is no longer utilized and functions now run on the ProAssurance system in which administrator functions are subdivided within the system. The ProAssurance system is a Sarbanes-Oxley compliant system. ProAssurance will investigate the need for a mechanism that generates system activity reports that track user activity by users with “administrator” access or other mechanism or control which will allow the Company to monitor for or prevent unauthorized activities.

#### Outside Service Provider

#### Recommendation

The DISB recommends that the Company periodically (e.g., annually) review the procedures and controls in place at the Cananwill service center. Such a review could be performed by an independent auditor (i.e. “SAS 70” review), or could be performed by the Company’s internal auditor.

#### Response

The Company will periodically (e.g. annually) review the procedures and controls in place at its current service center. This review will be performed by either an independent auditor (i.e. “SAS 70” review), or by the Company’s internal auditor. In addition, the Company will evaluate performing the services provided by the service center internally in the future.

#### Pledged Assets:

#### Recommendation

The DISB recommends that the Company disclose pledged assets in its Annual Statements in accordance with the NAIC Annual Statement Instructions.

Response

The Company will make appropriate disclosures concerning pledged assets in its Annual Statements in accordance with the NAIC Annual Statement Instructions and guidelines.

Loss Reserves:

Recommendation

As the Company's business matures, the DISB recommends that that the Company place reliance on state specific increased limits factor relationships and on state specific loss development patterns.

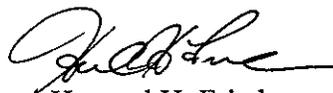
Response

As the Company's business matures, and loss data becomes more credible, the Company will assign greater weight to the actual experience on state specific increased limits factor relationships and on state specific loss development patterns.

We thank the Department for its willingness to honor the Company's request for an accelerated financial exam and appreciate the Department's efforts in conjunction with this exam. We also want to specifically thank Sean O'Donnell, Kevin Brown and Jessie Li for their professionalism and efforts on this exam.

We are available to address any questions and provide additional information if needed.

Sincerely,



Howard H. Friedman  
President

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



**Thomas E. Hampton**  
**Commissioner**

October 19, 2006

Howard H. Friedman  
President  
NCRIC, Inc.  
1115 30<sup>th</sup> Street N.W.,  
Washington, DC 20007

Dear Mr. Friedman:

We are in receipt of your response, dated October 16, 2006, which addresses the corrective actions taken by NCRIC, Inc. to comply with the recommendations made in the Report on Examination as of December 31, 2005, dated August 1, 2006.

Your response adequately addresses the recommendations made in the Report. During our next examination of the Company, we will review the implementation of the corrective actions taken.

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, and will be forwarded electronically to each Commissioner whose name is set forth on Page 1 of the Report, as well as to each of the participating zone examiners, to the National Association of Insurance Commissioners, and to each state in which the Company is licensed, according to your Annual Statement.

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 here at the Department.

Howard H. Friedman  
NCRIC, Inc.  
October 19, 2006  
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Please contact me at 202-442-7785 if you have any questions.

Sincerely,

A handwritten signature in black ink that reads "P. Sean O'Donnell". The signature is fluid and cursive, with a long horizontal stroke at the end.

P. Sean O'Donnell  
Chief Financial Examiner

Enclosures