

**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 - **CARE Risk Retention Group, Inc.**, as of December 31, 2006

**ORDER**

An Examination of **CARE Risk Retention Group, Inc.**, as of December 31, 2006 has been conducted by the District of Columbia Department of Insurance, Securities and Banking (“the Department”).

It is hereby ordered on this 30<sup>th</sup> day of June, 2008, that the attached financial condition examination report be adopted and filed as an official record of this Department.

In addition, it is hereby ordered that the Company comply with the recommendations in the attached financial condition 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, 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.

A handwritten signature in black ink is written over a circular official seal. The seal contains the text "DEPARTMENT OF INSURANCE, SECURITIES AND BANKING" and "DISTRICT OF COLUMBIA".

Thomas E. Hampton  
Commissioner

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



REPORT ON EXAMINATION

CARE RISK RETENTION GROUP, INC.

AS OF

DECEMBER 31, 2006

NAIC NUMBER 11825

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Washington, D.C.  
January 7, 2008

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 Sir:

In accordance with Section 31-3931.14 of the District of Columbia Official Code, we have examined the financial condition and activities of

**CARE Risk Retention Group, Inc.**

hereinafter referred to as the “Company” or “CARE”, at the office of the Company’s captive manager, located at 1800 Second Street, Suite 909, Sarasota, Florida 34236.

**SCOPE OF EXAMINATION**

This full-scope examination, covering the period November 3, 2003 through December 31, 2006, including any material transactions and/or events noted occurring subsequent to December 31, 2006, was conducted by the District of Columbia Department of Insurance, Securities and Banking (“the Department”).

Our examination was conducted in accordance with examination procedures established by the Department and procedures recommended by the National Association of Insurance Commissioners (“NAIC”) and, accordingly, included such tests of the accounting records and such other examination 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 the calendar years 2004 through 2006. We placed substantial reliance on the audited financial statements for calendar years 2004 and 2005, and consequently performed only minimal testing for those periods. We concentrated our examination efforts on the year ended December 31, 2006. We

obtained and reviewed the working papers prepared by the independent public accounting firm related to the audit for the year ended December 31, 2006. We placed moderate reliance on the work of the auditor and directed our efforts, to the extent practical, to those areas not covered by the firm's workpapers.

### **STATUS OF PRIOR EXAMINATION FINDINGS**

This is the first examination of the Company.

### **HISTORY**

#### **General:**

CARE was incorporated as an association captive insurance company operating as a risk retention group under the captive insurance laws of the District of Columbia on November 3, 2003 and commenced operations on January 1, 2004. The Company is a stock insurance company capitalized by CARE Professional Liability Association, LLC ("CPLA"), a Kentucky based for-profit association. CARE writes medical professional liability policies for physicians and surgeons who are eligible members of CPLA.

#### **Membership:**

CPLA is the 100% owner of CARE with 1,000,000 shares of common stock at a par value of \$1.

#### **Dividends and Distributions:**

No dividends or other distributions to its member have been declared or paid since the Company was incorporated.

### **MANAGEMENT**

The following persons were serving as the Company's directors as of December 31, 2006:

<b><u>Name and State of Residence</u></b>	<b><u>Principal Occupation</u></b>
Daniel L. Hafendorfer, M.D. Kentucky	Physician, practitioner Haller, Hazlett & Adams
Robert Pope, M.D. Georgia	Vice President of Clinical Innovation Humana, Inc.

Michael T. Rogers  
Florida

President  
Risk Services, LLC

The following persons were serving as the Company's officers as of December 31, 2006:

<u>Name</u>	<u>Position</u>
Daniel L. Hafendorfer, M.D.	President
Robert Pope, M.D.	Vice-President
Michael T. Rogers	Treasurer
Heather Ross	Secretary

Committees:

As of December 31, 2006, the Company's board of directors had not established any committees.

Conflicts of Interest:

During the examination, our review of the conflict of interest statements signed by the Company's directors and officers for the period under examination disclosed that there were no conflicts of interest reported that would adversely impact the Company. Furthermore, no potential conflicts of interest were noted during our examination that were not already disclosed in the signed statements.

Corporate Records:

We reviewed the minutes of the meetings of the shareholder and board of directors for the period under examination. Based on our review, it appears that the minutes documented the shareholder's and the board's review and approval of the Company's significant transactions and events.

**CAPTIVE MANAGER**

Risk Services, LLC ("Risk Services") has been the Company's captive manager since inception, and provides captive management services including regulatory services and accounting services to the Company. In addition, Risk Services has its own legal counsel on staff that provides basic legal advice to CARE.

**AFFILIATED PARTIES AND TRANSACTIONS**

As indicated in the "Membership" section of this report, the Company is 100% owned by CARE Professional Liability Association, LLC ("CPLA").

During the period under examination, CPLA was responsible for the collection and remittance of premiums, preparation of the bordereaux and oversight of claims. These services were provided without compensation to the Company pursuant to a Program Services Agreement (the "Agreement"), between the Company, CPLA, and a non-affiliated entity, Integrated Resource Specialists, Inc. ("IRSI"). Under this three-party agreement, IRSI was responsible for marketing, underwriting and policy issuance services. IRSI received up to a maximum of 16 percent of premiums written for each policy, depending on whether a policy was new or renewal, plus a profit commission.

During our examination, we noted that as of October 1, 2007, CPLA took over all functions previously performed for the Company by IRSI. However, the Department was not notified of this change until after it occurred. See the "Comments and Recommendations" section of this Report, under the caption "Underwriting Operations" for further comments regarding this condition.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company did not have fidelity bond coverage.

In addition, as noted above, both IRSI and CPLA had contracts with the Company to provide certain services to the Company. These contracts required that IRSI and CPLA maintain Fidelity Bond and other insurance coverage. However, IRSI and CPLA did not have all required coverage in place.

See the "Comments and Recommendations" section of this Report, under the caption "Fidelity Bond and Other Insurance Coverage" for further comments regarding the above conditions.

The Company is a named insured on a Directors and Officers policy maintained by CPLA, providing coverage in the amount of \$3,000,000.

### **PENSION AND INSURANCE PLANS**

The Company has no employees and therefore has no employee pension or insurance plans.

### **STATUTORY DEPOSITS**

The Company does not have any statutory deposits in the District of Columbia and is not required to maintain any such deposits. In addition, the Company did not have any other statutory deposits as of December 31, 2006.

## **TERRITORY AND PLAN OF OPERATION**

As of December 31, 2006, the Company was licensed in the District of Columbia, and was registered as a risk retention group in the following 27 states: Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Kentucky, Maine, Maryland, Michigan, Minnesota, Montana, Nevada, North Carolina, Ohio, Oklahoma, South Dakota, Texas, Vermont, Virginia and West Virginia.

During 2006, CARE wrote premiums of approximately \$16.8 million. Approximately 85 percent of the premiums were written in the following five (5) states: Florida (44 percent), Ohio (12 percent), Texas (11 percent), Kentucky (11 percent), and California (7 percent). As of December 31, 2006, the Company was not actively writing policies in the following states: Colorado, Connecticut, Hawaii, Idaho, Illinois, Maine, Minnesota, Montana, South Dakota, Vermont and Virginia.

CARE offers medical professional liability insurance on a claims asserted policy form, which differs from some claims made policies in that it covers only claims asserted by third parties during the policy period, rather than all incidents reported during the policy period. Policy limits up to \$1 million per occurrence/\$3 million annual policy aggregate are available. A \$15,000 deductible applies to most policies. A small number of policies have deductibles ranging from zero to \$50,000. Allocated loss adjustment expenses (ALAE) are included within the limits and within the \$15,000 deductible. Policies are offered on a first year through fifth year (fully mature) basis.

The Company had no employees and its daily business operations were managed by various affiliated and unaffiliated service providers. During the examination period and as of the date of this report, the Company's operations were located at the offices of its owner, CPLA, in Louisville, Kentucky, and at the offices of its captive manager, Risk Services, in Sarasota, Florida. Underwriting was conducted at the offices of the Company's program manager, IRSI, in Louisville, Kentucky, through the termination of their agreement with CARE on September 30, 2007. Claims were handled by a third party claims administrator located in Ohio.

During our examination, we noted that underwriting rates were not consistent with the business plan submitted to the Department. See the "Comments and Recommendations" section of this Report, under the caption "Underwriting Rates" for further comments regarding this condition.

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

This examination was a financial examination, and generally did not include market conduct procedures. An examination of the market conduct affairs of the Company has never been conducted. A market conduct examination would include detailed reviews of the Company's sales and advertising, agent licensing, timeliness of 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**

Effective January 1, 2004, CARE entered into a quota-share reinsurance agreement under which it ceded 90 percent of its premiums and losses and loss adjustment expenses. Under terms of the treaty, upon the Company's surplus reaching \$2 million, the quota share percentage would become 80 percent. This occurred during 2005. The reinsurance agreement is subject to a maximum recovery of 150 percent of reinsurance premium for each year and 125 percent reinsurance premium for any five year period.

Our review of the Company's ceded reinsurance contract did not disclose any unusual provisions.

During 2006, the Company ceded premiums of approximately \$13.5 million, and as of December 31, 2006, the Company reported estimated reinsurance recoverable on unpaid losses, and ceded unearned premiums, totaling \$14.3 million and \$6.5 million, respectively. If the reinsurer was not able to meet its obligations under the treaty, the Company would be liable for any defaulted amounts.

During our examination, we noted certain policies that had been written by the Company for classes of business that were specifically excluded under the Company's reinsurance agreement. We also noted two policies that were written for three-year periods, which is a violation of the reinsurance agreement. In addition, we noted exceptions granted by the reinsurer to certain terms of the treaty were not well-documented by the Company. See the "Comments and Recommendations" section of this report, under the caption "Reinsurance", for further comments regarding these conditions.

### **ACCOUNTS AND RECORDS**

During the period under examination, the primary locations of the Company's accounting and corporate records was at the office of its captive manager, Risk Services, Sarasota, Florida; at the offices of its owner, CPLA, in Louisville, Kentucky; at the offices of its program manager, IRSI, in Louisville, Kentucky; and at the offices of its claims administrator, in Ohio.

The Company's general accounting records consisted of an automated general ledger and various subsidiary ledgers. Our examination did not disclose any significant issues with these records.

## FINANCIAL STATEMENTS

The following financial statements were prepared in accordance with accounting practices generally accepted in the United States (“GAAP”), and reflect the financial condition of the Company as of December 31, 2006, 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

	<i>December 31, 2006</i>
Bonds	\$ 1,793,360
Commons stocks	152,988
Cash (\$ 6,649,692), cash equivalents (\$ 0) and short-term investments (\$ 1,060,264)	<u>7,709,956</u>
Subtotals, cash and invested assets	\$ 9,656,304
Investment income due and accrued	52,287
Premiums and considerations: Uncollected premiums and agents' balances in the course of collection	1,385,382
Reinsurance: Amounts recoverable from reinsurers	300,671
Other amounts receivable under reinsurance contracts ( <b>NOTE 1</b> )	14,336,021
Net deferred tax asset	212,194
Aggregate write-ins for other than invested assets: Prepaid expenses	163,014
Deferred policy acquisition costs	1,247,526
Deferred reinsurance expense (ceded unearned premiums)	6,520,568
Total	<u>\$ 33,873,967</u>

**LIABILITIES, SURPLUS AND OTHER FUNDS**

	<i>December 31, 2006</i>
Losses ( <b>NOTE 1</b> )	\$ 10,128,129
Loss adjustment expenses ( <b>NOTE 1</b> )	7,332,560
Commissions payable, contingent commissions and other similar charges	365,036
Other expenses (excluding taxes, licenses and fees)	62,196
Taxes, licenses and fees (excluding federal and foreign income taxes)	228,740
Current federal and foreign income taxes (including \$0 on realized capital gains (losses))	161,434
Unearned premiums (after deducting unearned premiums for ceded reinsurance of \$0 and including warranty reserves of \$0)	8,150,710
Ceded reinsurance premiums payable (net of ceding commission)	2,587,723
Aggregate write-ins for liabilities	<u>1,236,725</u>
Total Liabilities	\$ 30,253,253
Common capital stock	1,000,000
Gross paid in and contributed surplus	1,910,529
Unassigned funds (surplus)	<u>710,185</u>
Surplus as regards policyholders	\$ 3,620,714
Totals	<u>\$ 33,873,967</u>

**STATEMENT OF INCOME**

	<i>2006</i>
UNDERWRITING INCOME	
Premiums earned	\$ 3,085,265
DEDUCTIONS	
Losses incurred	\$ 1,184,536
Loss expenses incurred	818,772
Other underwriting expenses incurred	589,796
Total underwriting deductions	\$ 2,593,104
Net underwriting gain	\$ 492,161
INVESTMENT INCOME	
Net investment income earned	\$ 245,143
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	\$ 737,304
Federal and foreign income taxes incurred	\$ 259,403
Net income	\$ 477,901

## CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2003	\$ 1,000,000
Net income, 2004	\$ 26,263
Net change in surplus as regards policyholders, 2004	<u>1,026,263</u>
Surplus as regards policyholders, December 31, 2004	\$ 1,026,263
Net income, 2005	205,240
Paid in capital	500,000
Surplus adjustments: Paid in	555,337
Net change in surplus as regards policyholders, 2005	<u>1,260,577</u>
Surplus as regards policyholders, December 31, 2005	\$ 2,286,840
Net income, 2006	477,901
Change in net unrealized capital gains or (losses) less capital gains tax of \$402	781
Surplus adjustments: Paid in	855,192
Net change in surplus as regards policyholders, 2006	<u>1,333,874</u>
Surplus as regards policyholders, December 31, 2006	\$ 3,620,714

## 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 periods since inception are as follows:

	2006	2005	2004 (NOTE 2)
Assets	33,873,967	19,991,455	3,395,685
Liabilities	30,253,253	17,704,615	2,369,422
Capital and surplus	3,620,714	2,286,840	1,026,263
Gross written premium	16,849,111	13,011,173	6,759,429
Net earned premium	3,085,265	1,642,334	290,259
Net investment income	245,143	63,380	11,170
Net income	477,901	205,240	26,263

**Note:** Amounts in the preceding financial statements for the years ended December 31, 2004 and 2005 were taken from the Company's Annual Statements as filed with the Department. The amounts for the year ended December 31, 2006 are amounts per examination.

## **NOTES TO FINANCIAL STATEMENTS**

### **NOTE 1 – Loss and Loss Adjustment Expense Reserves:**

The Company reported “Losses” and “Loss adjustment expense” reserves totaling \$10,128,129 and \$7,332,560, respectively. These reserves represent management’s best estimate of the amounts necessary to pay all claims and related expenses that have been incurred but are still unpaid as of December 31, 2006.

Reserve credits taken as of December 31, 2006 for cessions to the Company’s reinsurer totaled approximately \$14.3 million. These amounts are reported as “Other amounts receivable under reinsurance contracts” on the Company’s assets page. If the reinsurer was unable to meet its obligations under the reinsurance treaty, the Company would be liable for any defaulted amounts. The Company’s net loss reserves total approximately \$3.1 million.

The methodologies utilized by the Company to compute reserves, and the adequacy of the loss and loss adjustment expenses reserves as of December 31, 2006, were reviewed as part of our examination. As part of our review, we relied on the Company’s independent actuary, who concluded that the reserves on the Company’s books appeared to be sufficient. In addition, as part of our review, we engaged an independent actuary to review the methods employed, assumptions relied upon, and conclusions reached by the Company’s independent actuary. The independent actuary utilized in our examination concluded that the loss reserves reported by the Company as of December 31, 2006 appeared sufficient. However, our actuary also noted a number of 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.

### **NOTE 2 – Comparative Financial Position of the Company:**

In the “Comparative Financial Position of the Company” table, 2004 liabilities were reported net of reinsurance, and 2005 and 2006 liabilities were reported gross of reinsurance in accordance with GAAP, as required by the Department.

## COMMENTS AND RECOMMENDATIONS

### Underwriting Operations:

As of October 1, 2007, CPLA took over all functions previously performed for the Company by IRSI. However, the Department was not notified of this change until after it occurred. Substantive changes in the Company's operations are considered changes to the Company's business plan, which require prior approval of the Department. **We recommend that changes to the Company's business plan be submitted to the Department for review and approval prior to implementation. Any questions regarding what may or may not constitute a change in business plan should be clarified with the Department prior to implementation.**

### Fidelity Bond and Other Insurance Coverage:

As of the time of our examination, the Company did not have a fidelity bond. In order to ensure maximum protection for the Company's policyholders, it is the Department's position that insurers maintain fidelity bond coverage. In this regard, the National Association of Insurance Commissioners' Financial Condition Examiners' Handbook ("the Handbook") includes suggested minimum amounts of fidelity insurance. The suggested amounts are based on the Company's admitted assets and premiums written, and for the Company, would be between \$300,000 and \$350,000 based on the Company's recent financial position and results of operations.

In addition, as noted above, both IRSI and CPLA had contracts with the Company to provide certain services to the Company during and subsequent to the examination period. The contract between the Company and IRSI required that IRSI maintain a Fidelity Bond in the total amount of \$50,000. In addition, the contract required IRSI to obtain and maintain an errors and omissions insurance policy with limits of not less than \$1 million. However, as of December 31, 2006, IRSI did not have these policies in place. The contract between CARE and CPLA required that CPLA maintain a Fidelity Bond in the total amount of \$2,000,000. However, as of the date of this report, CPLA did not have this policy in place.

**We recommend the Company obtain and maintain the minimum fidelity bond coverage specified in the Handbook. We also recommend that the Company ensure all of its service providers obtain appropriate fidelity bond and other insurance coverage as required by the service agreements between the Company and the service providers.**

### Underwriting Rates:

The Company's application and business plan on file with the Department include specific rates, based on an actuarial rate study, to be charged by the Company. However, during our examination, we noted that the Company was not using these rates, and had not submitted revised rates to the Department. Changes to information filed with the Company's application

are required to be filed with the Department. In addition, substantive changes to information in the application and to the Company's business plan, which would include changes in rates, require prior approval of the Department.

During our examination, we discussed this condition with the Company. Management acknowledged that the Company was not utilizing rates it had filed with the Department, and explained that the Company utilizes rates provided by its reinsurer. The rates are updated continuously (usually monthly) based upon on-going pricing studies and actuarial analyses performed by the reinsurer. Based on our review of this on-going process, it appears that the rates being used by the Company are well-supported by actual loss data and actuarial analyses. In addition, the Company's reinsurer, which is assuming 80 percent of the Company's losses, has significant involvement in developing these rates and supports the use of the rates. However, we also noted that the Company could not readily provide a record of the historical rates in place during our examination period and we therefore could not determine that rates charged to policyholders were the rates that were in place at the time the policy was written.

Subsequent to the date of this Report, the Company formally submitted, to the Department, its procedure for updating its rates. The Company requested approval from the Department to be allowed to make pricing changes based on the procedures submitted, without having to submit revised rates to the Department each time the rates are changed. The procedure appears to ensure adequate pricing for the Company's policies. **We recommend that the Company obtain pre-approval from the Department for any future changes to these procedures. In addition, we recommend that the Company ensure that all revisions to documents previously filed with the department be submitted to the Department. We also recommend that future substantive or material changes to the Company's business plan be submitted to the Department for review and approval prior to implementation. Any questions regarding what may or may not constitute a change in business plan should be clarified with the Department prior to implementation. Additionally, we recommend that the Company maintain readily available historical records of all rates in place at all times.**

#### Reinsurance:

1. During our examination, we noted over 30 policies that had been written by the Company for classes of business that were specifically excluded under the Company's reinsurance agreement. We also noted two policies that were written for three-year periods, which is a violation of the reinsurance agreement. As a result, these policies written by the Company were potentially not covered by the Company's reinsurance.

During our examination, we brought these policies to the attention of the Company and the Company immediately began working with its reinsurer to ensure these policies would be covered by the reinsurance agreement. On December 20, 2007, the Company executed an addendum to its reinsurance agreement which provided coverage for the policies in question. The reinsurer agreed to provide the coverage without additional reinsurance premium; however terms of the reinsurance agreement regarding the payment of profit commission were modified.

2. During our examination, we noted certain policies written by the Company that were covered under its reinsurance agreement based on exceptions granted by the Company's reinsurer on the specific policies. However, the exceptions and approval granted by the reinsurer for these policies were not clearly documented by the Company in its underwriting files.

**We recommend that the Company ensure all policies written are in compliance with the terms of its reinsurance agreement. In cases where exceptions are granted by the reinsurer, we recommend that the Company clearly document the exceptions and the reinsurer's approval in the underwriting files.**

#### Loss Reserves:

The Company reported "Losses" and "Loss adjustment expense" reserves totaling \$10,128,129 and \$7,332,560, respectively. The methodologies utilized by the Company to compute reserves, and the adequacy of the loss and loss adjustment expenses reserves as of December 31, 2006, were reviewed as part of our examination. As part of our review, we relied on the Company's independent actuary, who concluded that the Company's reserves appeared to be sufficient. In addition, as part of our review, we engaged an independent actuary to review the methods employed, assumptions relied upon, and conclusions reached by the Company's independent actuary. Although our actuary agreed that the loss reserves reported by the Company as of December 31, 2006 appeared sufficient, our actuary noted the following:

1. For purposes of estimating loss reserves, there is no tracking by the Company, the Company's actuary, or by the Company's reinsurer of the various underwriting credits applied by the Company to various policies. These credits and the changes in them from year to year could have an effect on the calculation of the Company's estimated losses. **We recommend that the Company ensure underwriting credits are appropriately considered in the development of its loss reserves.**
2. One of the factors utilized by the Company's actuary to estimate loss reserves is a target loss ratio. However, when estimating loss reserves, the Company's actuary is not verifying that the underwriting rates being used are the same rates that were developed based on the expected loss ratio. **We recommend that the Company ensure that its actuary, in the estimation of loss reserves, verify the rates in use are the same rates that have been developed based on the Company's target loss ratio.**
3. As previously indicated, the Company's rates are updated continuously based upon ongoing pricing studies and actuarial analyses performed by the Company's reinsurer. We noted that the reinsurer has included an automatic inflation factor in the development of the Company's rates. However, it is not clear if the Company's actuary is taking this inflation factor in to account in the actuary's loss cost studies. The impact of the inflation factor could result in a lower loss ratio, thereby resulting in lower reserve estimates. **We recommend that the Company ensure that its actuary consider the inflation factor**

**in the development of future loss cost studies and that consideration of the inflation factor be described in the actuarial analysis.**

## CONCLUSION

Our examination disclosed that as of December 31, 2006 the Company had:

Admitted Assets	\$	33,873,967
Liabilities and Reserves		30,253,253
Common Capital Stock		1,000,000
Gross Paid in and Contributed Surplus		1,910,529
Unassigned Funds (Surplus)		710,185
Total Surplus		3,620,714
Total Liabilities, Capital and Surplus	\$	33,873,967

Based on our examination, the accompanying balance sheet properly presents the financial position of the Company at December 31, 2006, and the accompanying statement of income properly presents the results of operations for the period then ended.

Chapter 39 (“CAPTIVE INSURANCE COMPANIES”) of Title 31 (“Insurance and Securities”) of the D.C. Official Code specifies 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.

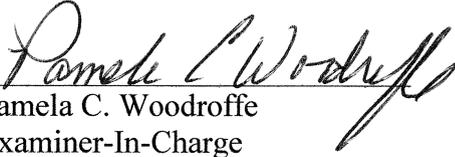
**SIGNATURES**

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:

Christina M. Bonney, Collins Consulting, Inc.  
Terry Corlett, AFE, CIE, FLMI, Collins Consulting, Inc.  
John G. Gantz, Collins Consulting, Inc.

The actuarial portion of this examination was completed by N. Terry Godbold, ACAS, MAAA, FCA, President & Senior Actuary, Godbold, Malpere & Co.

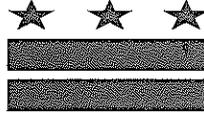
Respectfully submitted,

  
Pamela C. Woodroffe  
Examiner-In-Charge  
Collins Consulting, Inc.

Under the Supervision of,

  
Xiangchun (Jessie) Li, 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**

May 22, 2008

Daniel L. Hafendorfer, M.D.  
President  
CARE Risk Retention Group, Inc.  
C/o Risk Services, LLC  
5101 Wisconsin Avenue, Suite 500  
Washington, D.C. 20016

Dear Dr. Hafendorfer:

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 **CARE Risk Retention Group, Inc.**, as of December 31, 2006.

Please submit, to my attention, a written response calling 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 (June 23, 2008)**.

Please be advised that the Risk Finance Bureau may recommend to the Commissioner that the Company be fined for certain conditions disclosed in the "Comments and Recommendations" section of the Report, under the captions "Underwriting Operations", and "Underwriting Rates".

Sincerely,

A handwritten signature in black ink that reads "P. Sean O'Donnell". The signature is written in a cursive, flowing style.

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

Enclosure

# CARE Risk Retention Group, Inc.

607 14th Street, N.W., Suite 900, Washington, DC, 20005

June 20, 2008

P. Sean O'Donnell  
Director of Financial Examination  
Risk Finance Bureau  
Department of Insurance, Securities and Banking  
1400 L Street, N.W., Suite 400  
Washington, D.C. 20005

**Re: CARE Risk Retention Group, Inc. ("CARE")**  
**NAIC Company Code: 11825; NAIC Group Code: 0000; FEIN: 52-2395338**

Dear Mr. O'Donnell:

The following responses are submitted with respect to the comments and recommendations contained in the Report on Examination of the Company for the period January 1, 2003 through December 31, 2006 forwarded by the Risk Finance Bureau on May 22, 2008:

1. Underwriting Operations:

*As of October 1, 2007, CPLA took over all functions previously performed for the Company by IRSI. However, the Department was not notified of this change until after it occurred. Substantive changes in the Company's operations are considered changes to the Company's business plan, which require prior approval of the Department. We recommend that changes to the Company's business plan be submitted to the Department for review and approval prior to implementation. Any questions regarding what may or may not constitute a change in business plan should be clarified with the Department prior to implementation.*

**RESPONSE:** CPLA assumed the duties previously provided by IRSI in order to protect the Company from potential violations of the Company's underwriting guidelines. Prior approval of the decision was not practically possible due to the unknown outcome of the negotiations which were not formally concluded until the official transfer of duties on December 15, 2007. The Company will in future ensure that it obtains preapproval from the Department for any future changes to business plan.

2. Fidelity Bond and Other Insurance Coverage:

*As of the time of our examination, the Company did not have a fidelity bond. In order to ensure maximum protection for the Company's policyholders, it is the Department's position that insurers maintain fidelity bond coverage. In this regard, the National Association of Insurance Commissioners' Financial Condition Examiners' Handbook ("the Handbook") includes suggested minimum amounts of fidelity insurance. The suggested amounts are based on the Company's admitted assets and premiums written, and for the Company, would be between \$300,000 and \$350,000 based on the Company's recent financial position and results of operations.*

*In addition, as noted above, both IRSI and CPLA had contracts with the Company to provide certain services to the Company during and subsequent to the examination period. The contract between the Company and IRSI required that IRSI maintain a Fidelity Bond in the total amount of \$50,000. In addition, the contract required IRSI to obtain and maintain an errors and omissions insurance policy with limits of not less than \$1 million. However, as of December 31, 2006, IRSI did not have these policies in place. The contract between CARE and CPLA required that CPLA maintain a Fidelity Bond in the total amount of \$2,000,000. However, as of the date of this report, CPLA did not have this policy in place.*

***We recommend the Company obtain and maintain the minimum fidelity bond coverage specified in the Handbook. We also recommend that the Company ensure all of its service providers obtain appropriate fidelity bond and other insurance coverage as required by the service agreements between the Company and the service providers.***

RESPONSE: CARE outsources all functions and has no employees; therefore, fidelity bond coverage could have no practical effect as there are no employees to cover. Its current service providers, CPLA and Risk Services, LLC have fidelity bonds coverage of \$2M and \$10M respectively. CPLA fidelity bond coverage inceptioned January 24, 2008. The Company will in future ensure that all coverage required by the service agreements between the Company and its service providers is maintained in accordance with the terms of said agreements; however for reasons noted above we respectfully suggest that securing such coverage for CARE does not provide any additional protections and thus is unnecessary.

### ***3. Underwriting Rates:***

*The Company's application and business plan on file with the Department include specific rates, based on an actuarial rate study, to be charged by the Company. However, during our examination, we noted that the Company was not using these rates, and had not submitted revised rates to the Department. Changes to information filed with the Company's application are required to be filed with the Department. In addition, substantive changes to information in the application and to the Company's business plan, which would include changes in rates, require prior approval of the Department.*

*During our examination, we discussed this condition with the Company. Management acknowledged that the Company was not utilizing rates it had filed with the Department, and explained that the Company utilizes rates provided by its reinsurer. The rates are updated continuously (usually monthly) based upon on-going pricing studies and actuarial analyses performed by the reinsurer. Based on our review of this on-going process, it appears that the rates being used by the Company are well-supported by actual loss data and actuarial analyses. In addition, the Company's reinsurer, which is assuming 80 percent of the Company's losses, has significant involvement in developing these rates and supports the use of the rates. However, we also noted that the Company could not readily provide a record of the historical rates in place during our examination period and we therefore could not determine that rates charged to policyholders were the rates that were in place at the time the policy was written.*

*Subsequent to the date of this Report, the Company formally submitted, to the Department, its procedure for updating its rates. The Company requested approval from the Department to be allowed to make pricing changes based on the procedures submitted, without having to submit*

*revised rates to the Department each time the rates are changes. The procedure appears to ensure adequate pricing for the Company's policies. We recommend that the Company obtain preapproval from the Department for any future changes to these procedures. In addition, we recommend that the Company ensure that all revisions to documents previously filed with the department be submitted to the Department. We also recommend that future substantive or material changes to the Company's business plan be submitted to the Department for review and approval prior to implementation. Any questions regarding what may or may not constitute a change in business plan should be clarified with the Department prior to implementation. Additionally, we recommend that the Company maintains readily available historical records of all rates in place at all times.*

**RESPONSE:** The Company will in future ensure that it obtains preapproval from the Department for any future changes to its procedures and will make every effort to provide the Department with all revisions and changes in a timely manner. As was indicated in a letter submitted to the department on February 11, 2008, CARE has requested approval to provide the most current Imagine raters and the underlying loss costs provided by Milliman, Inc. that are used in the raters for all states in which CARE does business. CARE also intends to annually provide updated raters and underlying rate tables for all states that CARE writes business in so that the rates filed with the department are as current as possible under the current rater system.

4. Reinsurance:

*During our examination, we noted over 30 policies that had been written by the Company for classes of business that were specifically excluded under the Company's reinsurance agreement. We also noted two policies that were written for three-year periods, which is a violation of the reinsurance agreement. As a result, these policies written by the Company were potentially not covered by the Company's reinsurance.*

*During our examination, we brought these policies to the attention of the Company and the Company immediately began working with its reinsurer to ensure these policies would be covered by the reinsurance agreement. On December 20, 2007, the Company executed an addendum to its reinsurance agreement which provided coverage for the policies in question. The reinsurer agreed to provide the coverage without additional reinsurance premium; however terms of the reinsurance agreement regarding the payment of profit commission were modified.*

*During our examination, we noted certain policies written by the Company that were covered under its reinsurance agreement based on exceptions granted by the Company's reinsurer on the specific policies. However, the exceptions and approval granted by the reinsurer for these policies were not clearly documented by the Company in its underwriting files.*

*We recommend that the Company ensure all policies written are in compliance with the terms of its reinsurance agreement. In cases where exceptions are granted by the reinsurer, we recommend that the Company clearly document the exceptions and the reinsurer's approval in the underwriting files.*

**RESPONSE:** The Company will in future ensure that all policies written are in compliance with the terms of its underwriting guidelines and its reinsurance agreement and that any exceptions thereto granted by the reinsurer shall be fully documented.

5. Loss Reserves:

*The Company reported "Losses" and "Loss adjustment expense" reserves totaling \$10,128,129 and \$7,332,560, respectively. The methodologies utilized by the Company to compute reserves and the adequacy of the loss and loss adjustment expense reserves as of December 31, 2006, were reviewed as part of our examination. As part of our review, we relied on the Company's independent actuary, who concluded that the Company's reserves appeared to be sufficient. In addition, as part of our review, we engaged an independent actuary to review the methods employed, assumptions relied upon, and conclusions reached by the Company's independent actuary. Although our actuary agreed that the loss reserves reported by the Company as of December 31, 2006 appeared sufficient, our actuary noted the following:*

- 1. For purposes of estimating loss reserves, there is no tracking by the Company, the Company's actuary, or by the Company's reinsurer of the various underwriting credits applied by the Company to various policies. These credits and the changes in them from year to year could have an effect on the calculation of the Company's estimated losses. We recommend that the Company ensure underwriting credits are appropriately considered in the development of its loss reserves.*

**RESPONSE:** The Company will in future ensure that all underwriting credits are appropriately considered in the development of its loss reserves.

- 2. One of the factors utilized by the Company's actuary to estimate loss reserve is a target loss ratio. However, when estimating loss reserves, the Company's actuary is not verifying that the underwriting rates being used are the same rates that were developed based on the expected loss ratio. We recommend that the Company ensure that its actuary, in the estimation of loss reserves, verify the rates in use are the same rates that have been developed based on the Company's target loss ratio.*

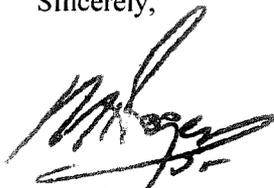
**RESPONSE:** The Company will in future ensure that the actuary, in estimation of loss reserves, verifies the rates in use are the same rates that have been developed based on the Company's target loss ratio.

- 3. As previously indicated, the Company's rates are updated continuously based upon ongoing pricing studies and actuarial analyses performed by the Company's reinsurer. We noted that the reinsurer has included an automatic inflation factor in the development of the Company's rates. However, it is not clear if the Company's actuary is taking this inflation factor in to account in the actuary's loss cost studies. The impact of the inflation factor could result in a lower loss ratio, thereby resulting in lower reserve estimates. We recommend that the Company ensure that its actuary consider the inflation factor in the development of future loss cost studies and that consideration of the inflation factor be described in the actuarial analysis.*

**RESPONSE:** The Company has confirmed that the actuary is taking the rate inflation factor into account. Specifically, the purpose of the rate inflation factor is to increase premium rates at the same rate as the expected loss trend, thereby maintaining a constant expected loss ratio. The Company will in future ensure that the actuary continues to consider the inflation factor and that consideration of the inflation factor is described in the actuarial analysis.

Thank you. Should you have any further questions, please don't hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "M. Rogers". The signature is stylized and written over a horizontal line.

Michael T. Rogers  
President

**Risk Services, LLC**

As Managers for

**CARE Risk Retention Group, Inc.**

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



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

June 30, 2008

Daniel L. Hafendorfer, M.D.  
President  
CARE Risk Retention Group, Inc.  
C/o Risk Services, LLC  
2233 Wisconsin Avenue, N.W.  
Suite 310  
Washington, DC 20007

Dear Dr. Hafendorfer:

We are in receipt of a response dated June 20, 2008, from Michael T. Rogers, President of Risk Services, LLC, as Managers for CARE Risk Retention Group, Inc. (“CARE” or “Company”), which addresses the corrective actions taken or to be taken by CARE to comply with the recommendations made in the Report on Examination as of December 31, 2006. The response adequately addresses the recommendations made in the Report. With regard to one of the recommendations, we have the following comments:

**Fidelity Bond and Other Insurance Coverage:**

**We recommended the Company obtain and maintain the minimum fidelity bond coverage specified in the National Association of Insurance Commissioners’ Financial Condition Examiners’ Handbook (“the Handbook”). We also recommended that the Company ensure all of its service providers obtain appropriate fidelity bond and other insurance coverage as required by the service agreements between the Company and the service providers.**

The response indicates CARE outsources all functions and has no employees; therefore, fidelity bond coverage could have no practical effect as there are no employees to cover. Its current service providers, CPLA and Risk Services, LLC have fidelity bonds coverage of \$2M and \$10M respectively. CPLA fidelity bond coverage inceptioned January 28, 2008. The Company will in future ensure that all coverage required by the service agreements between the company and its service providers is maintained in accordance with the terms of said agreements; however for reasons noted above we respectfully suggest that securing such coverage for CARE does not provide any additional protections and thus is unnecessary.

Daniel L. Hafendorfer, M.D.  
CARE Risk Retention Group, Inc.  
June 30, 2008  
Page 2 of 2

To ensure maximum protection for the Company and its policyholders, it is the Department's position that insurers maintain fidelity bond coverage. In the case of CARE, although there are no employees, fidelity bond coverage would protect the Company against any losses of cash, investments or other covered property due to dishonest acts of officers or directors of the Company who may have access to these assets and have the ability to authorize wire transfers, write checks, or to buy, sell or transfer investments or other property.

However, based on the response that Management of the Company has determined that fidelity bond coverage for CARE does not provide any additional protections and thus is unnecessary, the Department will not at this time require the Company to obtain such coverage. Management of the Company should continue to evaluate any future need for fidelity bond coverage.

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 the National Association of Insurance Commissioners, and to each state in which the Company is registered.

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 202-442-7785 if you have any questions.

Sincerely,



P. Sean O'Donnell  
Director of Financial Examination  
Risk Finance Bureau

Enclosures