

**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 - **Health Care Industry Liability Reciprocal Insurance Company, A Risk Retention Group**, as of December 31, 2007

**ORDER**

An Examination of **Health Care Industry Liability Reciprocal Insurance Company, A Risk Retention Group**, as of December 31, 2007 has been conducted by the District of Columbia Department of Insurance, Securities and Banking ("the Department").

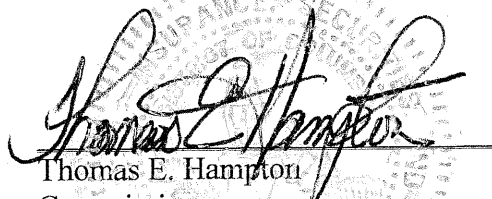
It is hereby ordered on this 30th day of June, 2009, that the attached financial condition examination report be adopted and filed as an official record of this Department.

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.

  
Thomas E. Hampton  
Commissioner

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



REPORT ON EXAMINATION

HEALTH CARE INDUSTRY LIABILITY  
RECIPROCAL INSURANCE COMPANY, A RISK  
RETENTION GROUP

AS OF

DECEMBER 31, 2007

NAIC NUMBER 11832

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Washington, D.C.  
March 11, 2009

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

**Health Care Industry Liability Reciprocal Insurance Company, A Risk  
Retention Group**

hereinafter referred to as the “Company” or “HealthCap RRG.”

**SCOPE OF EXAMINATION**

This full-scope examination, covering the period from October 31, 2003 through December 31, 2007, including any material transactions and/or events noted occurring subsequent to December 31, 2007, 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 2003 through 2007. We placed substantial reliance on the audited financial statements for calendar years 2003 through 2006, and consequently performed only minimal testing for those periods. We concentrated our examination efforts on the year ended December 31, 2007. We

obtained and reviewed the working papers prepared by the independent public accounting firm related to the audit for the year ended December 31, 2007. We placed 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:**

HealthCap RRG was organized as a risk retention group, and as an assessable reciprocal insurance company under the insurance laws of the District of Columbia to provide professional and general liability coverage to long-term care facilities. The attorney-in-fact for the reciprocal is a District of Columbia corporation whose full name is HCILRIC Attorney-In-Fact, Inc.

The Company commenced operations as of October 31, 2003 and writes nursing home general and professional liability coverage on either a claims-made or an occurrence basis to long-term care facilities.

As a reciprocal risk retention group domiciled in the District of Columbia, HealthCap RRG is required to maintain not less than \$500,000 of unencumbered surplus. The Company received \$1,100,000 of initial surplus from the Health Care Industry Liability Insurance Program ("HealthCap Bermuda"), a Bermuda domiciled group liability insurance program that is owned by its policyholders.

#### **Membership:**

HealthCap RRG is owned by its subscribers/policyholders who are members of the Health Care Risk Management Association, which consists of approximately 700 long-term care facilities. As a reciprocal insurer, HealthCap RRG does not issue stock or other certificates of ownership. Each subscriber is automatically a voting member of HealthCap RRG. As an assessable reciprocal insurer, HealthCap RRG may charge a supplemental premium to current and former subscribers in the event that a deficiency develops.

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

The Company did not declare or pay any dividends or other distributions during the period under examination.

## MANAGEMENT

The Company's bylaws established a Board of Directors, as well as a Subscribers' Advisory Committee whose duties are to advise the Board. Since inception, a single body of directors has served in both functions. The directors are elected by the full membership of subscribers. The following persons were serving as the Company's directors as of December 31, 2007:

<u>Name and State of Residence</u>	<u>Principal Occupation</u>
Lester R. Stauske (Chairman) Michigan	Former President/CEO Martin Luther Memorial Home
Timothy Boyle South Dakota	President/CEO Care Centre Management Company, Inc.
Tim Chesney Ohio	Administrator Jilltin Management
Richard D. Duros Illinois	CEO/CFO Barton Healthcare
Scott Ganton Michigan	Owner Ganton's Edgewood
Jeff Schade Michigan	President/CEO The Peplinski Group
Ronald J. Wilson Illinois	CFO RFMS, Inc.

The following persons were serving as the officers of HCILRIC Attorney-in-Fact as of December 31, 2007. These same persons also acted as the officers of HealthCap RRG, as of December 31, 2007:

<u>Name</u>	<u>Title</u>
Peter M. Feeney	President
J. Marc Feeney	Secretary

### Committees:

The Company has no additional committees other than the Subscribers' Advisory Committee described above.

### Conflicts of Interest:

We reviewed the conflict of interest policy as well as the conflict of interest statements for the period under examination. There were no conflicts of interest reported. However, our review disclosed that signed conflict of interest statements were executed only by the Company's directors and only in 2006. The Company's conflicts of interest policy does not require officers and key employees to submit such disclosure, and updates are required on an as-needed basis rather than annually. However, the D.C. municipal regulations require annual conflict of interest statements to be completed by all directors, officers, and key employees. See the "Comments and Recommendations" section of this Report, under the caption "Conflicts of Interest", for further comments regarding this condition.

### Corporate Records:

We reviewed the minutes of the meetings of the board of directors for the period under examination. Based on our review, it appears that the minutes documented the board's review and approval of the Company's significant transactions and events. In addition, annual board meetings were held in Washington D.C. for each year under examination.

## **CAPTIVE MANAGER**

Chelsea Rhone, LLC ("Chelsea Rhone") is the administrator and captive manager of the Company. Chelsea Rhone provides captive management services in the areas of accounting, regulatory compliance, and records retention. In addition, Chelsea Rhone provides marketing, underwriting, claims management, risk management and administrative services to the Company and its policyholders, either directly or through subcontractors.

## **AFFILIATED PARTIES AND TRANSACTIONS**

The members of HealthCap RRG rely on the attorney-in-fact to manage the affairs of the reciprocal insurer. The attorney-in-fact for the reciprocal is a District of Columbia corporation whose full name is HCILRIC Attorney-In-Fact, Inc. The attorney-in-fact has the legal authority to act on behalf of the Company's subscribers/policyholders. As previously noted, the officers of the Company are also officers of the attorney-in-fact.

In addition, the Company and its captive manager, Chelsea Rhone, are under common management. The Company's president and secretary are also principals of Chelsea Rhone. Chelsea Rhone manages all of the insurance operations of the Company under the terms of a management services agreement. Chelsea Rhone subcontracts certain services to third party entities with expertise in areas such as risk management or claims administration. The Company pays to Chelsea Rhone a fixed fee of 15 percent of annual gross written premium less return premium. This fee relates to captive management, risk management, claims administration, underwriting and other policyholder services. The Company also pays via Chelsea Rhone an

additional fee of 7.5 percent to 10 percent of gross annual premium less return premium as commission to its independent agency representatives.

Additionally, the Company and its reinsurer, HealthCap Bermuda, are under common management. (See the “Reinsurance” section of this report for further comments regarding the Company’s reinsurance.) As previously noted, HealthCap Bermuda also provided the initial funding for the Company. The Company’s president and secretary are the principles of Chelsea Rhone, which is the program administrator for HealthCap Bermuda.

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

The Company is a named insured under an errors and omissions policy with maximum policy limits of liability of \$1,000,000. HealthCap Bermuda is the primary insured, with the Company and two additional insurance programs listed as named insureds. The Company’s officers, board of directors and subscribers advisory committee members are separately insured through a directors and officers liability policy with maximum policy limits of liability of \$5,000,000. The policies provide adequate coverage based on NAIC guidelines.

### **PENSION AND INSURANCE PLANS**

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

### **STATUTORY DEPOSITS**

As of December 31, 2007, the Company did not have any statutory deposits in the District of Columbia and was not required to maintain any such deposits. In addition, the Company was not required to maintain statutory deposits with any other jurisdictions.

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

As of December 31, 2007, the Company was licensed in the District of Columbia and was registered as a risk retention group in twenty-nine states. In 2007, HealthCap RRG reported gross written premium of \$38,090,688 in twenty-three states. Approximately 77 percent (\$29,166,723) of premiums were written on an occurrence basis, and the remaining 23 percent (\$8,923,965) were written on a claims-made basis.

HealthCap RRG provides general and professional liability insurance on either a claims made or occurrence basis to its members, who are also members of Health Cap Risk Management Association, a group of approximately 700 long-term care facilities. To be insured by HealthCap RRG, members must meet eligibility requirements in accordance with HealthCap RRG’s underwriting guidelines. These include an acceptable loss history, a successful operating history, adherence to strict risk management protocols and claim reporting procedures.



During our examination, we noted that although the Company provides general and professional liability (medical malpractice) insurance, in its 2007 Annual Statement filing the Company reported all business as “Medical Malpractice”. (The NAIC Annual Statement Instructions contain a description of the coverages for each line of business in the appendix. The general liability business for health care facilities should be categorized as “Other Liability”.) During the examination we discussed this issue with management and management indicated that the business was recorded in this manner because the Company’s underwriting and accounting practices contained no specific distinction or allocation between the general and professional liability rates or premiums and the premiums and losses related solely to the general liability coverage were minimal compared to those involving some element or allegation of professional liability. Management also indicated the Company’s actuary had determined there was no impact on the Company’s loss reserves from this reporting treatment. (An independent actuary engaged as part of our examination agreed with this determination.)

The Company’s base policy has coverage limits of \$1,000,000 per occurrence with a \$3,000,000 annual aggregate. The Company also offers an excess policy with coverage up to \$5,000,000 per occurrence with a \$5,000,000 annual aggregate. Defense costs are covered in addition to policy limits. Deductibles apply to policies based on underwriting guidelines. Policies are written as of various effective dates and are subject to renewal annually.

Coverage is available to long-term care facilities through a select group of appointed agents. These agents are able to submit quotes for their clients, and are not permitted to broker business from other agents. The Company seeks to find one or two agencies, who meet strict marketing criteria, in each state where it operates. These criteria include a dedicated long-term care practice, a significant established book of long-term care business, support for state long-term care associations and health care risk management expertise within the agency. Currently, there are approximately 17 agencies, with approximately 43 producers, that have an active relationship with the Company.

The Company has no employees and its daily business operations are managed by Chelsea Rhone through various affiliated and unaffiliated service providers. Chelsea Rhone, the captive manager, is providing underwriting and accounting services from its primary location in Ann Arbor, Michigan. Hamlin & Burton Liability Management, Inc. provides claims management services.

## **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 November 1, 2003, the Company entered into a quota share reinsurance agreement with Universal Re-insurance Company Ltd. (“Universal Re”), an unauthorized reinsurer, and a protected cell Bermuda insurer. The protected cell account subject to this agreement is Health Care Industry Liability Insurance Program (“HealthCap Bermuda”). Between November 1, 2003 and December 31, 2005, the Company ceded 100 percent of all liability to Universal Re/HealthCap Bermuda. Effective January 1, 2006, the parties amended the agreement to a 90 percent quota share with 10 percent retained by the Company. There is no limit of liability under this agreement; however, coverage is applied to the Company’s losses net of the quota share and excess reinsurance treaties described below.

In conjunction with the aforementioned agreement, the Company entered into a Reinsurance Treaty Trust Agreement with Universal Re and Comerica Bank effective December 31, 2004. As an unauthorized reinsurer in the District of Columbia, Universal Re established a trust fund account that fully securitizes all balances ceded by the Company. The ceded balances include recoverables on paid losses, reported and unreported loss and loss adjustment expenses reserves and unearned premiums. As of December 31, 2007, the ceded balances on the books of the Company totaled \$74,514,066. The trust fund account at December 31, 2007 had a balance of \$77,514,069, which represents adequate funding to cover the unauthorized reinsurer balances at year end.

Effective May 1, 2007, the Company entered into an additional quota share reinsurance contract with Transatlantic Reinsurance Company (“Transatlantic”) and Platinum Underwriters Reinsurance, Inc (“Platinum”). Under the terms of the contract, the Company cedes 9.75 percent of losses up to the base policy limit of \$1 million. Transatlantic’s participation is 84.6 percent and Platinum’s participation is 15.4 percent of the ceded business. The reinsurers’ limit of liability under this contract is \$97,500 (9.75 percent of the first \$1,000,000) of each loss, each occurrence.

Effective May 1, 2007, the Company entered into an excess of loss reinsurance contract with Transatlantic, Platinum, and AXIS Reinsurance Company. Under the terms of the excess of loss contract, the Company cedes 90 percent of losses in the layer from \$1 million to \$3 million. The reinsurers’ limit of liability under this contract is \$1.8 million (90 percent of \$2 million) per loss occurrence.

Under the terms of the above reinsurance agreements, and for policies issued on or after May 1, 2007 at maximum limits offered by the Company, the Company's maximum annual retention in any one risk is \$470,750 (\$270,750 maximum retention on its primary policies plus \$200,000 retention on its excess policies). For policies issued between January 1, 2006 and April 30, 2007, the Company's maximum retention is 10 percent of policy limits. The Company ceded 100 percent of all liability to Universal Re/HealthCap Bermuda for policies issued prior to January 1, 2006.

The Company ceded \$34,558,690 of premiums during 2007. As of December 31, 2007, the Company reported "Amounts recoverable from reinsurers" totaling \$61,936,953 (representing estimated amounts recoverable on unpaid losses) and prepaid reinsurance premiums of \$18,794,230 (i.e., ceded unearned premiums). If the reinsurers were not able to meet their obligations under the treaties, the Company would be liable for any defaulted amounts that were not covered by the reinsurance trust fund account.

### **ACCOUNTS AND RECORDS**

The primary location of the Company's books and records is the office of its captive manager, Chelsea Rhone, in Ann Arbor, Michigan.

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.

However, we noted issues regarding unapproved changes to the Company's business plan. See the "Comments and Recommendations" section of this Report under the caption "Changes in Business Plan", for further comments regarding this condition. We also noted an issue regarding the Company's accounting treatment of premium taxes. See the "Comments and Recommendations" section of this Report under the caption "Premium Tax Accounting", for further comments regarding this condition.

## **FINANCIAL STATEMENTS**

The following financial statements, prepared in accordance with generally accepted accounting principles in the United States (“GAAP”), reflect the financial condition of the Company as of December 31, 2007, 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, 2007</i>
Cash ( <b>Note 1</b> )	\$ <u>7,109,944</u>
Subtotals, cash and invested assets	\$ 7,109,944
Investment income due and accrued	55,283
Premiums and considerations:	
Uncollected premiums	2,376,852
Deferred premiums	15,498,203
Reinsurance:	
Other amounts receivable under reinsurance contracts	61,936,953
Current federal income taxes	57,279
Net deferred tax asset	175,000
Health care and other receivables	150,033
Aggregate write-ins for other than invested assets:	
Prepaid reinsurance premiums	18,794,230
Deferred acquisition costs	404,269
Commissions receivable	4,525,096
Total	\$ <u><u>111,083,142</u></u>

**LIABILITIES, SURPLUS AND OTHER FUNDS**

	<i>December 31, 2007</i>
Losses ( <b>Note 2 and Note 3</b> )	\$ 44,412,153
Loss adjustment expenses ( <b>Note 2 and Note 3</b> )	21,069,942
Commissions payable	4,139,629
Other expenses (excluding taxes, licenses and fees)	90,617
Taxes, licenses and fees (excluding federal and foreign income taxes)	630,605
Unearned premiums ( <b>Note 2</b> )	19,311,486
Ceded reinsurance premiums payable (net of ceding commission) ( <b>Note 2</b> )	16,225,945
Aggregate write-ins for liabilities ( <b>Note 2</b> ):	
Deferred commission income	815,275
Total liabilities	\$ 106,695,652
Gross paid in and contributed surplus	1,100,000
Unassigned funds (surplus)	3,287,490
Surplus as regards policyholders	\$ 4,387,490
Total	<u>\$ 111,083,142</u>

## STATEMENT OF INCOME

	<i>2007</i>
UNDERWRITING INCOME	
Premiums earned	\$ 3,515,048
DEDUCTIONS	
Losses incurred	\$ 1,624,380
Loss expenses incurred	874,666
Other underwriting expenses incurred	(517,080)
Total underwriting deductions	\$ 1,981,966
Net underwriting income	\$ 1,533,082
INVESTMENT INCOME	
Net investment income earned	\$ 194,155
Net income, before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	\$ 1,727,237
Federal and foreign income taxes incurred	580,000
Net income	<u>\$ 1,147,237</u>

## **SURPLUS ACCOUNT**

Surplus as regards policyholders, January 1, 2003	\$ 0
Initial paid in surplus	1,100,000
Net loss, 2003	(14,442)
Surplus adjustments: Paid in	1,250
Net change in surplus as regards policyholders, 2003	1,086,808
Surplus as regards policyholders, December 31, 2003	\$ 1,086,808
Net income, 2004	265,389
Surplus adjustments: Paid in	(1,250)
Net change in surplus as regards policyholders, 2004	264,139
Surplus as regards policyholders, December 31, 2004	\$ 1,350,947
Net income, 2005	844,393
Net change in surplus as regards policyholders, 2005	844,393
Surplus as regards policyholders, December 31, 2005	\$ 2,195,340
Net income, 2006	1,044,913
Net change in surplus as regards policyholders, 2006	1,044,913
Surplus as regards policyholders, December 31, 2006	\$ 3,240,253
Net income, 2007	1,147,237
Net change in surplus as regards policyholders, 2007	1,147,237
Surplus as regards policyholders, December 31, 2007	\$ 4,387,490

## **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 is as follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Assets	\$ 111,083,142	\$ 84,499,230	\$ 61,811,761	\$ 36,814,685	\$ 3,251,025
Liabilities	106,695,652	81,258,977	59,616,421	35,463,738	2,164,217
Surplus	4,387,490	3,240,253	2,195,340	1,350,947	1,086,809
Gross written premium	38,090,688	35,327,496	30,551,264	21,257,250	0
Net earned premium	3,515,048	1,769,410	0	0	0
Net investment income	194,155	110,177	42,738	14,857	0
Net income	\$ 1,147,237	\$ 1,044,913	\$ 844,393	\$ 265,389	\$ (14,442)

Amounts in the preceding financial statements for the years ended December 31, 2003 through 2006 were taken from the Company's Annual Statements as filed with the Department. Amounts for the year ended December 31, 2007 are amounts per examination.

## **NOTES TO FINANCIAL STATEMENTS**

### **NOTE 1 – Cash:**

As of December 31, 2007, the Company reported a “Cash” balance of \$7,109,944. This amount included a certificate of deposit that secured a \$1,100,000 irrevocable letter of credit (LOC) issued to the Insurance Commissioner of the District of Columbia on behalf of the Company. Because the LOC is secured by assets of the Company, the LOC is not separately recorded as an asset of the Company.

The Company maintains cash balances at various financial institutions. Accounts at each financial institution are insured by the Federal Deposit Insurance Corporation (“FDIC”). In the normal course of business, the Company may have deposits that exceed the FDIC insured limits. During our examination, we discussed with management the potential risk to the Company from maintaining balances in excess of the FDIC insured limits in a single institution. Management agreed potential risk existed and indicated steps would be taken to mitigate this risk in the future.

### **NOTE 2 – Examination Reclassifications:**

Pursuant to Section 31-3931.13 of the DC Official Code, the Company is required to report its financial condition on the basis of generally accepted accounting principles (“GAAP”). Under the basis of GAAP, certain liabilities, including “Losses”, “Loss adjustment expenses”, “Unearned premiums”, and “Ceded reinsurance premiums payable” are reported gross of reinsurance. However, the Company reported these liabilities net of the applicable reinsurance balances, and reported the reinsurance balances as “Write-in” liabilities. For purposes of our examination, we reclassified the reinsurance balances to the appropriate liability lines. In addition, we discussed with management the future accounting treatment for these liabilities and management agreed to report these liabilities gross of reinsurance in future financial filings. All adjustments made as a result of our examination had no impact on surplus. Reclassifying adjustments were made as follows:

- a) Ceded loss reserves totaling \$42,035,652, initially reported by the Company under “Aggregate write-ins for liabilities”, was reclassified to “Losses”.
- b) Ceded loss adjustment expense reserves totaling \$19,901,301, initially reported by the Company under “Aggregate write-ins for liabilities”, was reclassified to “Loss adjustment expenses”.
- c) Ceded unearned premium reserves totaling \$17,531,197, initially reported by the Company under “Aggregate write-ins for liabilities”, was reclassified to “Unearned premiums”.

- d) Ceded reinsurance premiums payable totaling \$4,525,096, initially reported by the Company under “Aggregate write-ins for liabilities”, was reclassified to “Ceded reinsurance premiums payable”.

The above adjustments are depicted in the following chart:

<b>DESCRIPTION</b>	<b>Per Company</b>	<b>Examination Adjustment</b>	<b>Note</b>	<b>Per Examination</b>	<b>Surplus Increase (Decrease)</b>
<u>Liabilities</u>					
Losses	\$ 2,376,501	\$ 42,035,652	(a)	\$ 44,412,153	-
Loss adjustment expenses	1,168,641	19,901,301	(b)	21,069,942	-
Unearned premiums	1,780,289	17,531,197	(c)	19,311,486	-
Ceded reinsurance premiums payable	11,700,849	4,525,096	(d)	16,225,945	-
Aggregate write-ins for liabilities	84,808,521	(42,035,652) (19,901,301) (17,531,197) (4,525,096)	(a) (b) (c) (d)	815,275	-
<u>Surplus</u>					
Surplus as regards policyholders, December 31, 2007	\$ 4,387,490	-	-	\$ 4,387,490	-

### **NOTE 3– Loss and Loss Adjustment Expense Reserves:**

The Company reported gross “Losses” and “Loss adjustment expenses” reserves totaling \$44,412,153 and \$21,069,942, respectively. No adjustments were made to these reported amounts as a result of our examination. 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, 2007. The Company does not utilize a discount rate to reduce its loss reserves.

Reserve credits taken as of December 31, 2007 for loss reserve cessions to the Company’s reinsurers totaled \$61,936,953, which was reported as “Other amounts receivable under reinsurance contracts” in the Company’s assets and secured by the previously-mentioned reinsurance trust fund account. If the reinsurers are unable to meet their obligations under the reinsurance treaty, the Company would be liable for any defaulted amounts that were not covered by the reinsurance trust fund account. The Company’s net undiscounted loss reserves totaled \$3,545,142 as of December 31, 2007.

The methodologies utilized by the Company to compute reserves, and the adequacy of the loss and loss adjustment expenses reserves as of December 31, 2007, 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 of the Company's reserves, 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 methods employed, assumptions relied upon, and conclusions reached by the Company's independent actuary appeared sufficient.

## **COMMENTS AND RECOMMENDATIONS**

### **Conflict of Interest Policy:**

As indicated in the “Conflicts of Interest” section of this Report, the Company’s conflict of interest policy requires members of the board of directors to disclose conflicts of interest on an as-needed basis. However, the D.C. Municipal Regulations (DCMR), section 26-3712, requires annual conflict of interest disclosures from officers, directors and key employees. **We recommend that the Company amend its conflict of interest policy to comply with the above-mentioned section of the DCMR.**

### **Changes in Business Plan:**

Changes to information filed with the Company's application are required to be submitted to 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 noted the following:

#### **1. Underwriting Rates and Files:**

The Company has made changes to its rates during the examination period, and also subsequent to the date of our examination. However, the Company had not submitted these revised rates to the Department. During our examination, we discussed this condition with Management. Management acknowledged that the Company's rates had been updated and the Department had not been notified.

#### **2. Reinsurance Broker Agreement:**

In November 2006, the Company entered in to a reinsurance broker agreement. However, the agreement was never submitted to the Department.

**We recommend that the Company obtain pre-approval from the Department for any future changes to its rates. In addition, we recommend that the Company ensure that all revisions or additions 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.**

### **Premium Tax Accounting:**

The Company invoices policyholders directly, at the beginning of each policy period, for applicable policy premiums. This amount of policy premium is recorded in the Company’s books as direct premium written. In addition, the Company invoices policyholders an additional amount

for estimated state premium taxes. The estimated amount of premium taxes is calculated based on the direct premium, multiplied by the applicable premium tax rate in each jurisdiction. This amount of estimated premium tax is not recorded as part of the Company's premiums written. Rather, the collected amount is held on the Company's balance sheet as a liability until paid to the various states. No income or expense flows through the financial statement related to state premium taxes. The result of this accounting treatment is an understatement of gross written premiums. **We recommend that the Company properly classify all amounts billed to policyholders as gross written premium. The District of Columbia premium taxes should be calculated based upon the gross premiums written.**

## **CONCLUSION**

Our examination disclosed that as of December 31, 2007 the Company had:

Admitted Assets	\$ 111,083,142
Liabilities and Reserves	106,695,652
Gross Paid in and Contributed Surplus	1,100,000
Unassigned Funds (Surplus)	3,287,490
Total Surplus	4,387,490
Total Liabilities and Surplus	\$ 111,083,142

Based on our examination, the accompanying balance sheet properly presents the financial position of the Company at December 31, 2007, 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 surplus required for the Company. We concluded that the Company’s surplus funds exceeded the minimum requirements during the period under examination.


## SIGNATURES

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


George Brown, CFE, CIE, AGI Services

The actuarial portion of this examination was completed by J. Doug Moulton, ACAS, MAAA, AGI Services.

Respectfully submitted,

  
\_\_\_\_\_  
Jean R. Adams, CFE  
Examiner-In-Charge  
AGI Services

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**

June 8, 2009

Peter M. Feeney  
President  
Health Care Industry Liability Reciprocal Insurance Company, A Risk Retention Group  
c/o Chelsea Rhone L.L.C.  
201 S. Main Street, Suite 201  
Ann Arbor, Michigan 48104

Dear Mr. Feeney:

Pursuant to the provisions of Section 31-1404 of the D.C. Official Code, enclosed is a draft copy of the Report on Examination ("Report") of the affairs and financial condition of **Health Care Industry Liability Reciprocal Insurance Company, A Risk Retention Group**, as of December 31, 2007.

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

The response must be in writing and shall be furnished to this Department by **June 22, 2009**. In addition to a hard-copy response, please also furnish the response electronically via e-mail to me, in a Microsoft "Word" format, to [sean.o'donnell@dc.gov](mailto:sean.o'donnell@dc.gov).

Sincerely,

A handwritten signature in black ink, appearing to read "P. Sean O'Donnell", is written over the typed name.

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

Enclosure



## HEALTHCAP RRG

The Health Care Industry Liability Reciprocal Insurance Company, a Risk Retention Group

201 SOUTH MAIN STREET, SUITE 200  
ANN ARBOR, MICHIGAN 48104

RECEIVED  
2009 JUN 26 12:45 PM  
TELEPHONE: 734.996.2700  
FAX: 734.996.1261

P. Sean O'Donnell  
Director of Financial Examination  
Risk Finance Bureau  
DC-DISB  
810 First Street NE  
Washington, DC 20002

Re: Health Care Industry Liability Reciprocal Insurance Company, a risk retention group ("Health Cap RRG")

Dear Mr. O'Donnell

This letter is in response to the Report of Examination you sent to us in draft form on June 8<sup>th</sup>. Thank you for the chance to comment.

With respect to drafting issues which we see in the document, we have simply added corrections and/or comments to a redlined copy of the draft report itself, which we attach hereto and incorporate herein by reference.

With respect to the Comments and Recommendations section, I will attempt to respond to or comment on items in the order they appear in that section of the Report:

Conflict of Interest Policy: Agree. Health Cap RRG has changed its policy on Conflict of Interest Statements to comply with DCMR 26-3712 and has obtained updated statements from all officers and directors.

Changes to Business Plan:

1. *Underwriting Rates and Files.* Respectfully disagree. Health Cap RRG submitted premium projections and actuarial information as part of its 2003 Business Plan. But it did not submit comprehensive rating information. We believe, given the market upheaval at the time the RRG was formed and further given the RRG's wide variety of jurisdictions, all the different facilities, bed-types and coverages offered by the program, any specific rating information would have been overwhelming (and not very meaningful) to DISB. Health Cap RRG has employed actuaries and performed rate reviews on a county-by-county basis in all of its active states not less than annually since inception and has on occasion voluntarily provided those rate studies to DISB. We did not think those studies were required or that they had to be filed or approved.



## HEALTHCAP RRG

The Health Care Industry Liability Reciprocal Insurance Company, a Risk Retention Group

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ANN ARBOR, MICHIGAN 48104

TELEPHONE: 734.996.2700  
FAX: 734.996.1261

We would respectfully request that this comment and recommendation be removed from the report. Rate adjustments have been made in the context of the entire LTC liability marketplace and should not be considered a material change to the Business Plan of the RRG, which always intended to be an active and competitive participant in that market.

Having said all that, it does appear that we have not notified DISB that we brought in a 2nd pricing actuary (AVR Consulting) to assist us and Demotech, Inc. (our original actuary) in this process. We should have informed DC of this addition.

But we feel it is unrealistic to expect DISB to respond in a timely and meaningful manner to requests for rate changes in over 30 states for a market segment that varies significantly from region-to-region and venue-to-venue. We could submit a written statement indicating that rates are developed in consultation with qualified pricing actuaries consistent with industry practice and within the context of our normal rate reviews. We could also compile all the rate studies for all years and reconstruct our rating history for DISB to review. We would prefer that such information not become part of the public record for the obvious competitive reasons, but it can be pulled together if needed.

2. *Reinsurance Broker Agreement.* Agree. Health Cap RRG has submitted its reinsurance broker agreement to DISB and will submit any new agreements or material changes to such agreements in the future.

Premium Tax Accounting: Agree in part and respectfully disagree in part. District of Columbia premium taxes are already getting the accounting treatment indicated in the Notes and Recommendations, so we agree that such treatment should continue (i.e., DC premium taxes are already recorded as part of the Health Cap RRG's premiums written and are not an additional charge. Both income and expense flow through the RRG's financial statement.)

However, as a risk retention group, HealthCap RRG is required to file premium taxes on the same basis as surplus lines carriers in most states. The Health Cap RRG's current treatment of premium taxes is consistent with the policies and regulations of each state in which it operates.

During our last exam phone conference (March 11, 2009), we explained these factors to DISB and the examiners. Both seemed to express satisfaction with this arrangement and asked for some evidence of the individual states policies and practices on surplus lines-type treatment of these taxes. We provided information and tax forms from seven of our key states all of which was consistent with our treatment and thought the issue was settled (with our treatment of individual state premium taxes remaining



HEALTHCAP RRG

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unchanged so long as District of Columbia premium taxes continue to be treated as in the proposed recommendation).

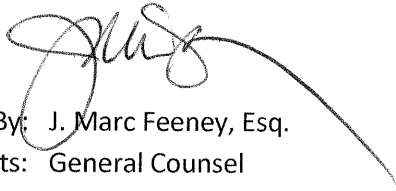
We hope this issue has been resolved to the satisfaction of the DISB and request that the recommendation be removed from the final report.

**In sum, we question whether the Health Cap RRG should be required to obtain pre-approval from the DISB for any future changes to its rates. However, we do agree with the general recommendation that Health Cap RRG ensure that all revisions or additions to documents previously filed with the DISB be submitted to the DISB for approval. We also agree with the general recommendation that future substantive or material changes to our business plan be submitted to the DISB for review and approval prior to implementation and that any questions regarding what may or may not constitute a change in business plan should be clarified with the Department prior to implementation.**

Respectfully submitted,

**Health Cap RRG**

**Health Care Industry Liability Reciprocal Insurance Company,  
A Risk Retention Group**



By: J. Marc Feeney, Esq.  
Its: General Counsel

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



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

June 30, 2009

Peter M. Feeney  
President  
Health Care Industry Liability Reciprocal Insurance Company, A Risk Retention Group  
c/o Chelsea Rhone L.L.C.  
201 S. Main Street, Suite 201  
Ann Arbor, Michigan 48104

Dear Mr. Feeney:

We are in receipt of a June 24, 2009 response, from J. Marc Feeney, General Counsel, Health Care Industry Liability Reciprocal Insurance Company, A Risk Retention Group ("HealthCap" or "Company"), which addresses the corrective actions taken or to be taken by HealthCap to comply with the recommendations made in the Report on Examination as of December 31, 2007. The response adequately addresses the recommendations made in the Report, except for the following:

**Changes in Business Plan:**

- A. We recommended that the Company obtain pre-approval from the Department for any future changes to its rates. In addition, we recommend that the Company ensure that all revisions or additions 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.**

**Company Response:**

The response indicates the following:

Respectfully disagree. Health Cap RRG submitted premium projections and actuarial information as part of its 2003 Business Plan. But it did not submit comprehensive rating information. We believe, given the market upheaval at the

time the RRG was formed and further given the RRG's wide variety of jurisdictions, all the different facilities, bed-types and coverages offered by the program, any specific rating information would have been overwhelming (and not very meaningful) to DISB. Health Cap RRG has employed actuaries and performed rate reviews on a county-by-county basis in all of its active states not less than annually since inception and has on occasion voluntarily provided those rate studies to DISB. We did not think those studies were required or that they had to be filed or approved.

We would respectfully request that this comment and recommendation be removed from the report. Rate adjustments have been made in the context of the entire LTC liability marketplace and should not be considered a material change to the Business Plan of the RRG, which always intended to be an active and competitive participant in that market.

Having said all that, it does appear that we have not notified DISB that we brought in a 2nd pricing actuary (AVR Consulting) to assist us and Demotech, Inc. (our original actuary) in this process. We should have informed DC of this addition.

But we feel it is unrealistic to expect DISB to respond in a timely and meaningful manner to requests for rate changes in over 30 states for a market segment that varies significantly from region-to-region and venue-to-venue. We could submit a written statement indicating that rates are developed in consultation with qualified pricing actuaries consistent with industry practice and within the context of our normal rate reviews. We could also compile all the rate studies for all years and reconstruct our rating history for DISB to review. We would prefer not to do so and that such information not become part of the public record for the obvious competitive reasons, but it can be pulled together if needed.

In sum, we are not sure that Health Cap RRG should be required to obtain pre-approval from the DISB for any future changes to its rates. However, we do agree with the general recommendation that Health Cap RRG ensure that all revisions or additions to documents previously filed with the DISB be submitted to the DISB for approval. We also agree with the general recommendation that future substantive or material changes to our business plan be submitted to the DISB for review and approval prior to implementation and that any questions regarding what may or may not constitute a change in business plan should be clarified with the Department prior to implementation.

**Department Response:**

As indicated in the Report, 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. It is important for the Department to know the

Company has developed rates using a meaningful methodology, and is not deviating from those rates. As has been offered by the Company in its response, please submit to the Department a written statement indicating an overview of how rates are developed. Going forward, upon a change in rates, the Company shall notify the Department of the change, and submit documentation of the new rates to the Department. Upon confirmation by the Company that the Department has received the updated rates, the Company may immediately begin to implement the new rates. The Department will follow-up with any questions. The Company shall also maintain a rating history for the Department to review during future financial examinations of the Company.

**Premium Tax Accounting:**

**We recommended that the Company properly classify all amounts billed to policyholders as gross written premium. The District of Columbia premium taxes should be calculated based upon the gross premiums written.**

**Company Response:**

The response indicates the following:

Agree in part and respectfully disagree in part. District of Columbia premium taxes are already getting the accounting treatment indicated in the Notes and Recommendations, so we agree that such treatment should continue (i.e., DC premium taxes are already recorded as part of the Health Cap RRG's premiums written and are not an additional charge. Both income and expense flow through the RRG's financial statement.)

However, as a risk retention group, HealthCap RRG is required to file premium taxes on the same basis as surplus lines carriers in most states. The Health Cap RRG's current treatment of premium taxes is consistent with the policies and regulations of each state in which it operates.

During our last exam phone conference (March 11, 2009), we explained these factors to DISB and the examiners. Both seemed to express satisfaction with this arrangement and asked for some evidence of the individual states policies and practices on surplus lines-type treatment of these taxes. We provided information and tax forms from seven of our key states all of which was consistent with our treatment and thought the issue was settled (with our treatment of individual state premium taxes remaining unchanged so long as District of Columbia premium taxes continue to be treated as in the proposed recommendation).

We hope this issue has been resolved to the satisfaction of the DISB and request that the recommendation be removed from the final report.

**Department Response:**

Please note, as indicated in the Report recommendation, all amounts billed to policyholders shall be recorded as gross written premium, and the District of Columbia premium taxes should be calculated based upon the gross premiums.

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,

A handwritten signature in black ink, reading "P. Sean O'Donnell". The signature is fluid and cursive, with the first name "P. Sean" and last name "O'Donnell" clearly distinguishable.

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

Enclosures