

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



**FINANCIAL EXAMINATION
OF
WESTERN PROFESSIONAL INSURANCE COMPANY
SEATTLE, WASHINGTON**

**NAIC CODE 10942
DECEMBER 31, 2006**

Order No. 08-35
Western Professional Insurance Company
Exhibit A

Participating State:
Washington

SALUTATION

Seattle, Washington
April 21, 2008

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building-Capitol Campus
302 Sid Snyder Avenue SW, Suite 200
Olympia, WA 98504

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

The Honorable Morris Chavez, Superintendent
New Mexico Insurance Division
NAIC Secretary, Western Zone
PO Drawer 1269
Santa Fe, NM 87504-1269

Dear Commissioners and Superintendent:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an Association examination was made of the corporate affairs and financial records of

Western Professional Insurance Company

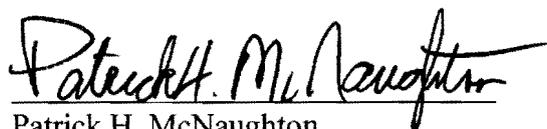
of

Seattle, Washington

hereinafter referred to as "WPIC" or "the Company," at the location of its home office, 1730 Minor Avenue Suite 1800, Seattle, Washington 98101. This report is respectfully submitted showing the condition of the Company as of December 31, 2006.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Western Professional Insurance Company of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2006.



Patrick H. McNaughton
Chief Examiner

4-21-08

Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2002 through December 31, 2006 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2006 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review.

1. State Investment Statutes

A review of short-term investments in Schedule DA-Part 1, indicated that one security, Northern Institutional Diversified Asset Portfolio exceeded the 4% limitation on securities of one institution by \$250,801. RCW 48.13.030(1) limits the investment in any one person or institution to 4% of the insurer's assets. The examiners verified during the field work that the company divested the excess in 2007. No examination adjustment was determined necessary.

Pursuant to RCW 48.13.030(1), the Company is instructed to limit its investment in the securities of any one entity aggregating an amount not exceeding four percent of its admitted assets.

2. Supplemental Schedules to the Annual Audit Report

SSAP No. 62, paragraph 72, requires reinsurance interrogatories to be included with the annual Certified Public Accountant (CPA) audit report for the period ended December 31, 2006. The

Company did not include the supplemental reinsurance interrogatories in the 2006 annual audit report.

Pursuant to RCW 48.05.073, the Company is instructed to include supplemental reinsurance interrogatories in all future annual CPA audit reports in accordance with SSAP 62, paragraph 72.

3. Investments Schedules

The Company owned a Canadian security, Chevron Capital Corporation, that was not identified as a foreign security in Schedule D - Part 1.

The Company is instructed to comply with RCW 48.05.073, RCW 48.05.250, and WAC 284-07-050(2) in filing its NAIC Annual Statements in accordance with the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions to correctly identify all foreign securities.

COMMENTS AND RECOMMENDATIONS

1. Control Over Claim Expense Payments

The Company does not keep a copy of every bill inside the claim file that was sent by the Company's lawyers; instead, all those bills and requests for payments are routed to the accounting department after the adjuster approves them. Several duplicate expense payments were found during the examination of claims.

It is recommended that the Company improve controls over processing loss adjustment expense payments. At a minimum, the adjuster should verify if the payment has been made in the claim system to eliminate duplicate payments.

2. Documentation Standards Manual

The Company does not have a documentation standards manual. Also, numerous internal controls, processes and procedures within the Information System (IS) Department are not documented or the documentation is outdated.

It is recommended that the Company establish and maintain a current document standards manual that documents its internal controls, procedures, processes, and policies for the IS System and IS Department.

3. Alternative Recovery Site

The Company does not have an alternative recovery site in the event the IS facility needs to be relocated.

It is recommended that the Company prepare formal written procedures for the relocation of the IS facility to a specific alternative recovery site and that the procedures be tested regularly to ensure that IS operations can be restored in a timely manner.

4. Chairman and Vice Chairman of the Board

Review of Bylaws for the period under examination found that the Article 3.5, Chairman and Vice Chairman of the Board, requires that the shareholder, at the same meeting at which the shareholder elects the directors of the corporation, shall elect the Chairman and Vice Chairman of the Board of Directors from among those elected as directors. It was noted that no Chairman or Vice Chairman of the Board was nominated as of December 31, 2006.

It is recommended that the Company's shareholder nominate a Chairman and Vice Chairman of the Board from among elected directors.

COMPANY PROFILE

Company History

WPIC is a wholly owned subsidiary of Physicians Insurance A Mutual Company (PIAMC) which owns 100% of the issued and outstanding shares of stock. WPIC was incorporated as a stock insurance company on May 8, 1998, and was granted a certificate of authority by the Washington State Office of the Insurance Commissioner on October 22, 1998.

In 1999, the Company began underwriting comprehensive professional liability insurance policies for hospitals and clinics, as well as employer stop loss and provider excess of loss insurance policies. All business underwritten by WPIC is ceded to PIAMC under an inter-company 100% quota share reinsurance agreement. In early 2004, WPIC discontinued writing comprehensive professional liability insurance policies for hospitals and clinics based on the loss ratios experienced. The majority of these policies expired in March 2004.

Capitalization

As of December 31, 2006, the Company had 300,000 shares of common capital stock issued and outstanding at a par value of \$10 per share.

Dividends to Stockholders

WPIC did not declare or pay any dividends to stockholders during the examination period.

Territory and Plan of Operation

WPIC is licensed to transact business in the states of Washington, Idaho, Montana and Oregon and primarily wrote medical malpractice insurance to hospitals, stop loss insurance and business office insurance. The Company substantially ceased writing all business in 2004.

Growth of Company

The Company's growth, as reported in its filed NAIC Annual Statements, is illustrated below:

Year	Admitted Assets	Liabilities	Capital & Surplus
2006	\$12,331,942	\$877,719	\$11,454,223
2005	12,989,005	1,970,868	11,018,137
2004	20,413,348	9,693,291	10,720,057
2003	15,939,201	5,334,840	10,604,361
2002	15,615,298	5,183,332	10,431,966

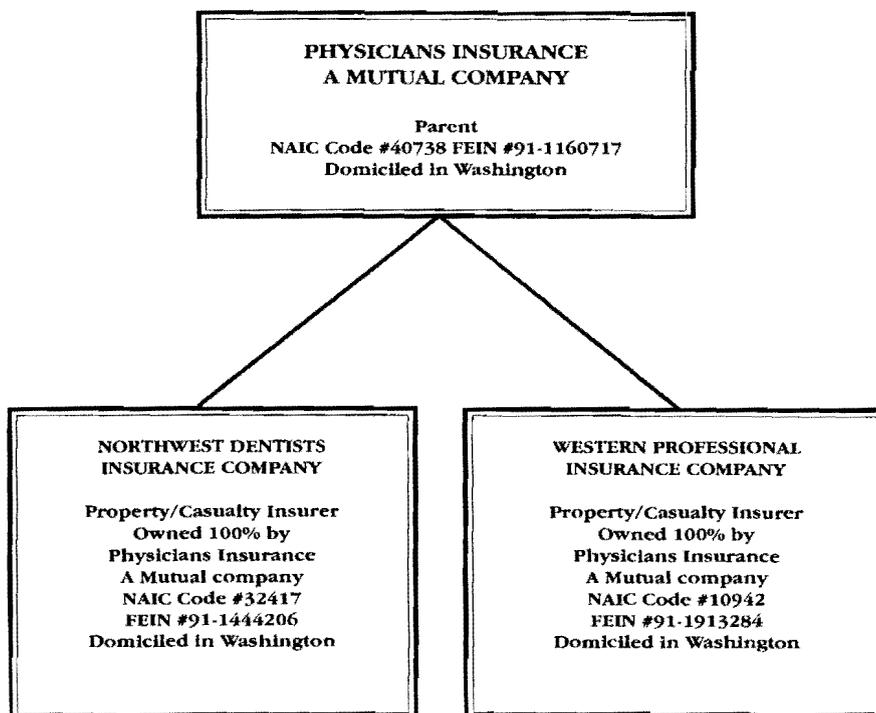
Year	Premiums Earned	Net Underwriting Gain (Loss)	Net Investment Gains (Losses)	Net Income
2006	\$0	\$152,764	\$532,909	\$438,991
2005	0	(118,937)	437,430	243,014
2004	58,661	(209,863)	376,468	132,272
2003	97,076	(258,153)	377,604	69,337
2002	14,248	(387,880)	449,286	49,849

Affiliated Companies

The following companies are all within the holding company group and have been included in the filed registration statement under the provisions of the Washington Insurer Holding Company Act pursuant to Chapter 48.31B RCW.

Physicians Insurance A Mutual Company (PIAMC) is the parent company which primarily underwrites professional liability insurance to physicians. Northwest Dentists Insurance Company (NORDIC) is a wholly owned subsidiary of PIAMC. NORDIC was organized in 1989 to provide comprehensive professional liability insurance to dentists.

The following organization chart shows the affiliated insurance companies:



Intercompany Contracts

The following intercompany contracts were in-force as of December 31, 2006:

- Management agreement including a power of attorney between WPIC and PIAMC dated June 23, 1998. Expense reimbursement transactions are documented and covered under this agreement and it clarifies matters related to the operational management of WPIC by PIAMC.
- Quota share reinsurance agreement between WPIC and PIAMC dated June 16, 1998. Under this agreement, WPIC cedes 100% of its premium and losses to PIAMC.
- Tax allocation agreement dated January 1, 1999. PIAMC files a consolidated federal income tax return with its affiliated companies, NORDIC, WPIC, Association Insurance Services, Inc., and PHYSIS Corporation. The method of allocation among the affiliated companies is subject to a written agreement approved by the Board of Directors. This agreement calls for allocation of taxes based upon separate return calculations with current credit for net losses. Intercompany tax balances are settled annually in the first quarter.

MANAGEMENT AND CONTROL

Ownership

WPIC is a wholly owned subsidiary of PIAMC.

Board of Directors (BOD)

(See Comment and Recommendation No. 4)

Directors as of December 31, 2006:

Stewart M. Cogan	Director
James W. Pritchett, MD	Director
Richard W. Seaman, MD	Director

Officers

Officers as of December 31, 2006:

<u>Name</u>	<u>Position Held</u>
Mary-Lou A. Misrahy	President, CEO
Kristin L. Kenny	Treasurer
Gary L. Morse	Senior Vice President; Secretary
Terry B. Evans	Vice President
Paul A. Buckner	Vice President
Rodney A. Pierson	Senior Vice President, CFO
Richard L. Nauman	Senior Vice President
John C. Hastie	Vice President
Bruce W. Schafer	Senior Vice President
Robert J. Nickles	Vice President
David R. Williams	Vice President
Leslie I. Mallonee	Senior Vice President

Committees

The Bylaws provide for an executive committee and other standing committees. Furthermore, the designated committees of the parent company operate as combined committees with the affiliated companies. All committees of the parent met regularly, kept written records of its meetings, and made regular reports to the respective affiliated BOD.

Conflict of Interest

The Company requires the annual completion of a conflict of interest statement by officers, directors, and key employees. All are required to disclose to the corporate counsel relevant outside interests, memberships, associations, and affiliations.

Fidelity Bond and Other Insurance

WPIC is a named insured on a financial institution fidelity bond insurance policy purchased by its parent, PIAMC. The aggregate amount of coverage meets the recommended guidelines of the NAIC to cover the exposure risk of the parent and its affiliates.

Officers', Employees', and Agents' Welfare and Pension Plans

PIAMC is the employer for all affiliated companies. All employees are covered by a qualified 401(K) Plan and Money Purchase Plan.

A new Management Annual Incentive Plan was put into place for senior management in 2006. Officers and other key employees designated by the Compensation Committee are eligible to participate in the Management Annual Incentive Plan.

CORPORATE RECORDS

Corporate records were reviewed for the period under examination. There have been no amendments or restatements to the Articles of Incorporation for this period.

WPIC's Bylaws were amended on February 12, 2003, when the BOD amended the paragraph that specifies terms of service of the directors. The Bylaws were restated on October 26, 2005 when the BOD approved restructuring of the BOD and reduced the number of directors to three.

UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

All business underwritten by the Company is ceded to PIAMC under a 100% quota share reinsurance agreement. The Company's reserves for losses and loss adjustment expenses were reviewed together with PIAMC's reserves for losses and loss adjustment expenses as of December 31, 2006 by OIC actuaries and determined to be within a reasonable range.

REINSURANCE

The Company has a quota share agreement with its parent, PIAMC, in which 100% of its business risk is ceded. The reinsurance agreement was reviewed and found to be in compliance with Washington State reinsurance statutes. The reinsurers are properly classified in Schedule F of the 2006 NAIC Annual Statement. The Company has controls in place to monitor its reinsurance program.

STATUTORY DEPOSITS

The Company maintained the statutory deposit as of December 31, 2006 in the state of Washington with a fair value of \$1,007,915. The Company's auditors confirmed directly with the Company's authorized custodians the securities held by the state of Washington.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a Statutory Accounting Principles (SAP) accrual basis. The Company is audited annually by the certified public accounting firm of Deloitte & Touche, LLP. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no material exceptions were noted.

Management is sufficiently knowledgeable of the information system (IS) process. Systems development, acquisition and maintenance controls were evaluated to gain assurance that appropriate internal controls are in place.

Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the controls exercised to maintain the confidentiality, integrity and availability of data. Sufficient internal controls are in place and monitored by the Company. The Company's IS Department has the ability to recover from an incident or disaster and has documented these procedures in a detailed, business continuity and disaster recovery plan. However, documentation for the Company's IS system, procedures, policies and internal controls are lacking or are outdated. (See Comment and Recommendation No. 2)

Except for an alternative recovery site, the Company has a very detailed and well written disaster recovery plan for the restoration of the IS and an equally formal, written business continuity plan that addresses the continuation of all significant business activities, including financial functions, telecommunication services and data processing services, in the event of a disruption of normal business activities, as recommended by NAIC Guidelines. (See Comment and Recommendation No. 3)

SUBSEQUENT EVENTS

There were no material events adversely impacting the Company between the examination date and the last day of our fieldwork.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

The Company remedied all prior examination instructions and implemented the recommendations.

FINANCIAL STATEMENTS

Statement of Assets, Liabilities, Surplus and Other Funds
Statement of Income and Capital and Surplus Account
Reconciliation of Surplus

WESTERN PROFESSIONAL INSURANCE COMPANY
ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
AS OF DECEMBER 31, 2006

Assets	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION
Bonds	\$10,478,868	\$0	\$10,478,868
Cash and short-term investments	1,129,193		1,129,193
Subtotal, cash and invested assets	11,608,061	0	11,608,061
Investment income due and accrued	115,457		115,457
Amount recoverable from reinsurers	549,364		549,364
Net deferred tax asset	4,284		4,284
Guaranty funds receivable or on deposit	32,475		32,475
Aggregate write-ins for other than invested assets	22,301		22,301
Total Assets	\$12,331,942	\$0	\$12,331,942
Liabilities, Surplus and other Funds			
Other expenses	\$48,823	\$0	\$48,823
Current federal and foreign income taxes	156,455		156,455
Ceded reinsurance premiums payable	102,686		102,686
Payable to parent, subsidiaries and affiliates	352,047		352,047
Payable for securities	217,708		217,708
Total Liabilities	877,719	0	877,719
Common capital stock	3,000,000		3,000,000
Gross paid in and contributed surplus	7,000,000		7,000,000
Unassigned funds (surplus)	1,454,223		1,454,223
Surplus as regards policyholders	11,454,223		11,454,223
Total Liabilities, Surplus and other Funds	\$12,331,942	\$0	\$12,331,942

**WESTERN PROFESSIONAL INSURANCE COMPANY
STATEMENT OF INCOME AND CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2006**

STATEMENT OF INCOME	BALANCE PER COMPANY	EXAMINATION ADJUSTMENT	BALANCE PER EXAMINATION
Underwriting Income			
Premiums earned	\$0	\$0	\$0
Deductions			
Loss expenses incurred	(186,009)		(186,009)
Other underwriting expenses incurred	33,245		33,245
Total underwriting deductions	(152,764)		(152,764)
Net underwriting gain or (loss)	152,764		152,764
Investment Income			
Net investment income earned	432,899		432,899
Net realized capital gains or (losses)	10		10
Net investment gain or (loss)	432,909		432,909
Other Income			
Net (loss) from agents' or premiums balances charged off	(297)		(297)
Aggregate write-ins for misc income	10,065		10,065
Total other income	9,768	0	(297)
Net income before dividends to policyholders but before federal and foreign income taxes	595,441		595,441
Dividends to policyholders			
Net income, after dividends to policyholders but before federal and foreign income taxes	595,441		595,441
Federal and foreign income taxes incurred	156,450		156,450
Net income	\$438,991	\$0	\$438,991

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31 prior year	\$11,018,137	\$0	\$11,018,137
Gains and (Losses) in Surplus			
Net income	438,991		438,991
Change in net unrealized capital gain/losses			0
Change in net unrealized foreign exchange capital gain			0
Change in net deferred income tax	(11,065)		(11,065)
Change in nonadmitted assets	8,160		8,160
Change in surplus as regards policyholders	436,086	0	436,086
Surplus as regards policyholders, December 31 current year	\$11,454,223	\$0	\$11,454,223

**WESTERN PROFESSIONAL INSURANCE COMPANY
RECONCILIATION OF SURPLUS
FOR YEAR ENDED AS OF DECEMBER 31,**

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Capital and surplus, December 31, previous year	<u>\$11,018,137</u>	<u>\$10,720,056</u>	<u>\$10,604,361</u>	<u>\$10,431,966</u>	<u>\$10,472,506</u>
Net income	438,991	243,014	132,272	69,337	49,849
Change in net unrealized capital gains or (losses)					
Change in net unrealized foreign exchange capital gains or (loss)					
Change in net deferred income tax	(11,065)	(1,416)	(18,630)	153,677	(131,394)
Change in nonadmitted assets	<u>8,160</u>	<u>56,483</u>	<u>2,053</u>	<u>(50,619)</u>	<u>41,005</u>
Change in surplus as regards policyholders for the year	<u>436,086</u>	<u>298,081</u>	<u>115,696</u>	<u>172,395</u>	<u>(40,540)</u>
Surplus as regards policyholders, December 31, current year	<u><u>\$11,454,223</u></u>	<u><u>\$11,018,137</u></u>	<u><u>\$10,720,056</u></u>	<u><u>\$10,604,361</u></u>	<u><u>\$10,431,966</u></u>

NOTES TO THE FINANCIAL STATEMENTS

1. The Company has no special consents, permitted practices or orders from the state of Washington.

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examination team by the officers of Western Professional Insurance Company during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Timoteo L Navaja, CFE, CIE, Property and Casualty Field Supervisor; D. Lee Barclay, FCAS, MAAA, Senior Actuary; John R. Jacobson, AFE, CISA, AES, Automated Examination Specialist; Susan Campbell, CPA, FLMI, CFE, Reinsurance Specialist; Orlando Gabriel, AFE, Financial Examiner; and Albert Karau, Jr., CPA, AFE, FLMI, Financial Examiner; all from the Washington State Office of Insurance Commissioner who participated in the examination and the preparation of this report.

Respectfully submitted,

Constantine Arustamian

Constantine Arustamian, CPA, CFE
Examiner in Charge
State of Washington

