

STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION
OF
WESTERN PROFESSIONAL INSURANCE COMPANY
SEATTLE, WASHINGTON

NAIC CODE 10942
December 31, 2011

Order No. 13-156
Western Professional Insurance Company
Exhibit A

SALUTATION

Seattle, Washington
April 1, 2013

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

Dear Commissioner Kreidler:

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

Western Professional Insurance Company

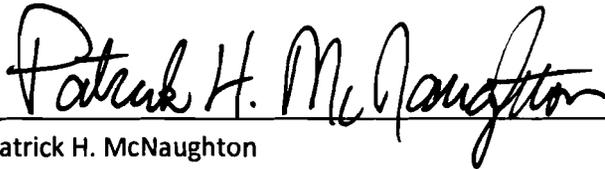
of

Seattle, Washington

hereinafter referred to as "WPIC," or the "Company" at the location of its home office, 1301 Second Avenue, Suite 2700, Seattle, Washington 98101. This report is respectfully submitted showing the financial condition and related corporate matters of WPIC as of December 31, 2011.

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, 2011.



Patrick H. McNaughton
Chief Examiner

5-9-13

Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2007 through December 31, 2011 and comprises a risk focused review of the books and records of the Company. The examination followed 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 through the end of fieldwork on April 1, 2013.

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 section 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.

This examination was performed in compliance with the 2011 NAIC FCEH which requires the examiner to consider the Company's risk management process, corporate governance structure, and control environment. The examiners utilized the information obtained during the examination to assess the Company's overall potential risks both currently and on an on-going basis, to allow the examiners to focus on the Company's greatest areas of risk, and to provide assurance on the Company's financial statements as of the examination date.

INSTRUCTIONS

The examiners reviewed the Company's filed 2011 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 outlined in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review:

1. Custodial Agreement

WPIC's custodial agreement with The Northern Trust Company did not contain several provisions which are required by RCW 48.13.480.

The Company is instructed to execute a revised or amended custodial agreement that complies with RCW 48.13.480.

2. Tax Allocation Agreement

WPIC is a party to the Tax Allocation Agreement, effective January 1, 1999, between Physicians Insurance A Mutual Company (PIAMC) and all its subsidiaries at that time, including Northwest Dental Insurance Company (NORDIC). However, NORDIC should not be a party to the agreement

since it was acquired by non-affiliated entities in 2007.

Also, Note No. 9 (F)(1) of the 2011 NAIC Annual Statement did not list Washington State Physicians Insurance Association, Inc., an inactive affiliate of PIAMC, as a party to the Tax Allocation Agreement.

The Company is instructed to comply with RCW 48.05.250 and RCW 48.31B.025(2)(c) by amending the Tax Allocation Agreement, effective January 1, 1999, reflecting current participants.

Also, the Company is instructed to follow the NAIC Annual Statement Instructions and the AP&P, as required by WAC 284-07-050(2) by listing all Tax Allocation Agreement participants in Note No. 9 (F)(1) of the NAIC Annual Statement.

3. Reinsurance Intermediary

The Company did not annually obtain financial statements of its reinsurance intermediary-broker as required by RCW 48.94.025(3).

The Company is instructed to comply with RCW 48.94.025(3) by annually obtaining a copy of statements of the financial condition of its reinsurance intermediary-broker with which it transacts business.

COMMENTS AND RECOMMENDATIONS

None

COMPANY PROFILE

Company History

WPIC is a wholly owned subsidiary of PIAMC that was incorporated as a stock insurance company on May 8, 1998, and was granted a certificate of authority by the OIC 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 a 100 percent quota share reinsurance agreement. In early 2004, WPIC discontinued writing new business, and it is currently in run off.

Capitalization

As of December 31, 2011, the Company had 300,000 shares of common capital stock issued and outstanding at a par value of \$10 per share. All issued and outstanding common stock shares of WPIC were owned by PIAMC. No dividends were declared or paid to stockholders during the examination period.

As of December 31, 2011, the Company's capitalization of \$13,085,307 consisted of \$3 million in common stock, gross paid in and contributed surplus of \$7 million, and unassigned funds in the amount of \$3,085,307.

Territory and Plan of Operations

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

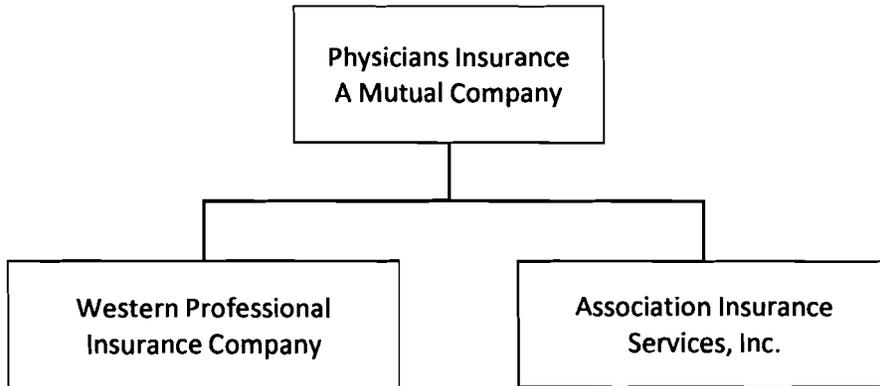
The following reflects the Company’s growth as reported in its filed NAIC Annual Statements for the five year period under examination:

| <u>Year</u> | <u>Admitted Assets</u> | <u>Liabilities</u> | <u>Capital & Surplus</u> | | |
|-------------|------------------------|--------------------|------------------------------|--|--|
| 2011 | \$13,209,960 | \$124,653 | \$13,085,307 | | |
| 2010 | 12,855,806 | 96,909 | 12,758,897 | | |
| 2009 | 12,561,056 | 137,848 | 12,423,208 | | |
| 2008 | 12,360,323 | 252,281 | 12,108,042 | | |
| 2007 | 11,959,266 | 175,321 | 11,783,945 | | |

| <u>Year</u> | <u>Premium Earned</u> | <u>Net Underwriting Gain (Loss)</u> | <u>Net Investment Gain (Loss)</u> | <u>Net Income</u> |
|-------------|-----------------------|-------------------------------------|-----------------------------------|-------------------|
| 2011 | \$0 | (\$73,651) | \$477,795 | \$326,410 |
| 2010 | 0 | (81,656) | 474,416 | 335,689 |
| 2009 | 0 | (79,280) | 448,637 | 319,829 |
| 2008 | 0 | (73,090) | 460,148 | 323,718 |
| 2007 | 80,253 | (45,617) | 465,108 | 329,722 |

Affiliated Companies

The following abbreviated organization chart, taken from WPIC’s filed 2011 NAIC Annual Statement, shows the active affiliates:



Intercompany Agreements

As of December 31, 2011, the Company had the following intercompany agreements:

- Tax Allocation Agreement, effective January 1, 1999. This agreement allows the filing of consolidated federal income tax returns for PIAMC, WPIC, Association Insurance Services, Inc., PHYSIS Corporation, Washington State Physicians Insurance Association, Inc., and NORDIC. (See Instruction No. 2.)
- Management Agreement Including a Power of Attorney, dated June 23, 1998, and with Amendment Number 1 effective January 1, 2007, between WPIC and PIAMC.
- Quota Share Reinsurance Agreement, dated June 16, 1998, with Amendment Number 1 effective January 1, 2007, between WPIC and PIAMC.

MANAGEMENT AND CONTROL

Board of Directors (BOD)

Directors as of December 31, 2011:

| | |
|------------------------|----------|
| James P. Campbell, MD | Chairman |
| John R. Huddleston, MD | |
| Sheila Rege, MD | |

Officers

Officers as of December 31, 2011:

| | |
|---------------------|---------------------------------------|
| Mary-Lou A. Misrahy | President and Chief Executive Officer |
| Kristin L. Kenny | Treasurer |
| Gary L. Morse | Secretary |

Conflict of Interest

The Company requires the annual completion of a conflict of interest statement by its officers and directors. All are required to disclose to the corporate counsel relevant outside interests, memberships, associations, and affiliations. No exceptions were noted.

Fidelity Bond and Other Insurance

PIAMC, which owns 100 percent of the outstanding stock of each of its affiliates and performs substantially all services to its subsidiaries, maintains financial institution bond coverage that meets the amount suggested by NAIC guidelines. Also, PIAMC is the named insured on corporate insurance coverages to cover risks in the normal course of business.

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

The Company does not have any direct employees, so it does not have any obligations for retirement plans, deferred compensation, post employment benefits, compensated absences or other post retirement benefit plans.

CORPORATE RECORDS

The Company's Articles of Incorporation, Bylaws, Certificates of Authority and meeting minutes of the BOD and its committees were reviewed for the period under examination. All BOD meetings were conducted with a quorum present. Investment purchases, transfers, and disposals were ratified by the BOD and noted in the minutes.

UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

All business underwritten by the Company is ceded to PIAMC under a 100 percent quota share reinsurance agreement. The Company's reserves for losses and loss adjustment expenses were reviewed together with PIAMC reserves for losses and loss adjustment expenses as of December 31, 2011 by the OIC actuaries and determined to be within a reasonable range. Therefore, the Company's reserves for losses and loss adjustment expense were accepted as reasonable and no adjustments were proposed to the amounts reported in the Company's 2011 NAIC Annual Statement.

REINSURANCE

The Company has a quota share agreement with its parent, PIAMC, in which 100 percent of its insurance risks are ceded. The reinsurance agreement was reviewed and found to be in compliance with Washington State reinsurance statutes.

STATUTORY DEPOSITS

The Company maintained the following statutory deposits as of December 31, 2011:

| <u>State</u> | <u>Type</u> | <u>Book Value</u> | <u>Fair Value</u> |
|--------------|-------------|-------------------|-------------------|
| Washington | Bond | \$1,007,508 | \$1,096,367 |

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a Statutory Accounting Principles (SAP) basis and is audited annually by the certified public accounting firms of Deloitte & Touche LLP for years ended prior to December 31, 2010 and by Ernst & Young LLP subsequently. 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 significant weaknesses were noted.

The Company's Information Technology (IT) environment was reviewed during the planning and testing phase of the examination, focusing on the following Control Objectives for Information and related Technology (COBIT) Framework domains:

- Plan and Organize
- Acquire and Implement

- Deliver and Support
- Monitor and Evaluate

The IT system and controls were evaluated to gain an understanding of the IT general control risks and assess the effectiveness of these controls to determine if appropriate mitigating and internal controls have been implemented. Appropriate mitigating and internal controls have been implemented to reduce residual risk to appropriate levels. The Company has an effective Business Continuity Plan and Disaster Recovery Plan, which have been tested on a regular basis and includes the availability of an alternate site.

SUBSEQUENT EVENTS

There were no material events impacting the Company between the examination date and the last day of our field work on April 1, 2013.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

All previous report instructions and recommendations were satisfactorily addressed.

FINANCIAL STATEMENTS

The following financial statements show the financial condition of Western Professional Insurance Company as of December 31, 2011:

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

Western Professional Insurance Company
Assets, Liabilities, Surplus and Other Funds
December 31, 2011

| | <u>Balance Per Company</u> | <u>Examination Adjustments</u> | <u>Balance Per Examination</u> |
|--|--------------------------------|------------------------------------|------------------------------------|
| Assets | | | |
| Bonds | \$12,848,813 | \$0 | \$12,848,813 |
| Cash, cash equivalents, and short-term investments | 194,744 | | 194,744 |
| Subtotals, cash and invested assets | <u>13,043,557</u> | <u>0</u> | <u>13,043,557</u> |
| Investment income due and accrued | 138,710 | | 138,710 |
| Amounts recoverable from reinsurers | 22,693 | | 22,693 |
| Aggregate write-ins for other than invested assets | 5,000 | | 5,000 |
| Total Assets | <u>\$13,209,960</u> | <u>\$0</u> | <u>\$13,209,960</u> |
| Liabilities, Surplus and Other Funds | | | |
| Losses | \$0 | \$0 | \$0 |
| Other expenses | 124 | | 124 |
| Current federal and foreign income taxes | 94,079 | | 94,079 |
| Payable to parent, subsidiaries and affiliates | 30,450 | | 30,450 |
| Total Liabilities | <u>124,653</u> | <u>0</u> | <u>124,653</u> |
| Common capital stock | 3,000,000 | | 3,000,000 |
| Gross paid in and contributed surplus | 7,000,000 | | 7,000,000 |
| Unassigned funds (surplus) | 3,085,307 | | 3,085,307 |
| Surplus as regards policyholders | <u>13,085,307</u> | <u>0</u> | <u>13,085,307</u> |
| Total Liabilities, Surplus and Other Funds | <u>\$13,209,960</u> | <u>\$0</u> | <u>\$13,209,960</u> |

Western Professional Insurance Company
Statement of Income and Capital and Surplus Account
For the Year Ended December 31, 2011

| | <u>Balance Per Company</u> | <u>Examination Adjustments</u> | <u>Balance Per Examination</u> |
|---|--------------------------------|------------------------------------|------------------------------------|
| Underwriting Income | | | |
| Premiums earned | \$0 | \$0 | \$0 |
| Deductions | | | |
| Losses incurred | 0 | | 0 |
| Loss adjustment expenses incurred | 0 | | 0 |
| Other underwriting expenses incurred | 73,651 | | 73,651 |
| Total underwriting deductions | <u>73,651</u> | <u>0</u> | <u>73,651</u> |
| Net underwriting gain or (loss) | <u>(73,651)</u> | <u>0</u> | <u>(73,651)</u> |
| Investment Income | | | |
| Net investment income earned | 446,066 | | 446,066 |
| Net realized capital gains or (losses) | 31,729 | | 31,729 |
| Net investment gain or (loss) | <u>477,795</u> | <u>0</u> | <u>477,795</u> |
| Other Income | | | |
| Net gain (loss) from agents' or premium balances charged off | 0 | | 0 |
| Finance and service charges not included in premiums | 0 | | 0 |
| Aggregate write-ins for miscellaneous | 0 | | 0 |
| Total other income | <u>0</u> | <u>0</u> | <u>0</u> |
| Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes | | | |
| | 404,144 | | 404,144 |
| Federal and foreign income taxes incurred | 77,734 | | 77,734 |
| Net income | <u>\$326,410</u> | <u>\$0</u> | <u>\$326,410</u> |
| Capital and Surplus Account | | | |
| Surplus as regards policyholders, December 31 prior year | <u>\$12,758,897</u> | <u>\$0</u> | <u>\$12,758,897</u> |
| Gains and (losses) in surplus | | | |
| Net income | 326,410 | | 326,410 |
| Change in surplus as regards policyholders for the year | 326,410 | 0 | 326,410 |
| Surplus as regards policyholders, December 31 current year | <u>\$13,085,307</u> | <u>\$0</u> | <u>\$13,085,307</u> |

**Western Professional Insurance Company
Five Year Reconciliation of Surplus
For the Years Ended December 31,**

| | <u>2011</u> | <u>2010</u> | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|---|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| Capital and Surplus, December 31, prior year | <u>\$12,758,897</u> | <u>\$12,423,208</u> | <u>\$12,108,042</u> | <u>\$11,783,945</u> | <u>\$11,454,223</u> |
| Net income or (loss) | 326,410 | 335,689 | 319,829 | 323,718 | 329,722 |
| Changes in net deferred income tax | | | (4,663) | (3,894) | (3,718) |
| Change in nonadmitted assets | | | | 4,273 | 3,718 |
| Change in surplus as regards policyholders for the year | <u>326,410</u> | <u>335,689</u> | <u>315,166</u> | <u>324,097</u> | <u>329,722</u> |
| Capital and Surplus, December 31, current year | <u><u>\$13,085,307</u></u> | <u><u>\$12,758,897</u></u> | <u><u>\$12,423,208</u></u> | <u><u>\$12,108,042</u></u> | <u><u>\$11,783,945</u></u> |

NOTES TO THE FINANCIAL STATEMENTS

Special Consent

The Company holds a special consent, issued by the state of Washington, with an effective date of January 1, 2011, and subsequently renewed effective January 1, 2012, that allows the Company to own and purchase mutual funds if certain statutory requirements have been met. WPIC is allowed to acquire and hold a single entity's NAIC non-exempt listed mutual funds totaling not more than four percent of WPIC's admitted assets. As of December 31, 2011, WPIC's mutual fund investments represented 1.34 percent of its admitted assets. One of WPIC's mutual fund investments exceeded the one percent of assets limitation that would have been imposed by RCW 48.13.240(3) without the special consent.

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

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Western Professional Insurance Company and its affiliates during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; John Jacobson, AFE, CISA, AES, Automated Examination Specialist; Susan Campbell, CPA, FLMI, CFE, Reinsurance Specialist; D. Lee Barclay, FCAS, MAAA, Senior Actuary; Timothy F. Hays, CPA, JD, Investment Specialist; Eric Slavich, ACAS, MAAA, Actuary; Tarik Subbagh, MSBA, CPA, CFE, Property and Casualty Field Supervising Examiner; Edsel R. Dino, AFE, Financial Examiner; and James R. Gill, CPA, MBA, Financial Examiner; all from the Washington State Office of the Insurance Commissioner, participated in the examination and in the preparation of this report.

Respectfully submitted,



Randy Fong, CFE
Examiner-in-Charge
State of Washington

