

REPORT OF EXAMINATION  
OF THE  
MEDICAL INSURANCE EXCHANGE OF CALIFORNIA  
AS OF  
DECEMBER 31, 2020

A handwritten signature in blue ink, appearing to read "P. DeLa", is positioned in the lower right quadrant of the page.

Filed on May 18, 2022

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Oakland, California  
May 5, 2022

Honorable Ricardo Lara  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

### MEDICAL INSURANCE EXCHANGE OF CALIFORNIA

(hereinafter also referred to as the Exchange). The Exchange's home office is located at 6250 Claremont Avenue, Oakland, California 94618.

#### SCOPE OF EXAMINATION

We have performed our multi-state examination of the Exchange. The previous examination of the Exchange was as of December 31, 2016. This examination covered the period from January 1, 2017 through December 31, 2020.

The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook (Handbook)*. The Handbook requires the planning and performance of the examination to evaluate the Exchange's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Exchange were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting

Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, an adjustment is identified, the impact of such adjustment will be documented separately following the Exchange's financial statements.

This examination report includes findings of fact and general information about the Exchange and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report but separately communicated to other regulators and/or the Exchange.

### COMPANY HISTORY

The Exchange is a reciprocal insurance exchange that was formed in 1975. The Exchange was licensed and began writing business in California on July 11, 1975. The Exchange was organized under the sponsorship of six medical societies of Northern California with surplus deposits from policyholders totaling \$5.1 million. All surplus deposits had been returned to its policyholders since December 31, 1987.

Effective December 31, 2018, Medical Underwriters of California (MUC), a subsidiary of the Exchange and an attorney-in-fact, merged with and into the Exchange, with the Exchange being the surviving entity. Under the merger agreement, all assets, liabilities, and employees were transferred from MUC to the Exchange. In December 2018, the Exchange formed MIEC Underwriters, LLC (MIECU), a single-member limited liability corporation, to replace MUC as its attorney-in-fact, effective January 1, 2019. On December 20, 2018, the California Department of Insurance consented to the merger pursuant to California Insurance Code Section 1215.5(b)(7). The Exchange's Certificate of Authority was amended to reflect the change.

## MANAGEMENT AND CONTROL

The Exchange is a member of an insurance holding company system. The following organizational table depicts the relationship of the Exchange within the holding company system as of December 31, 2020 (all ownership is 100%):

### **Medical Insurance Exchange of California (California)**

MIEC Underwriters, LLC (California)

MIEC Investment Company, Inc. (Nevada)

As of December 31, 2020, an eleven-member board of governors, who are elected for a three-year term, oversees the business and affairs of the Exchange. Each governor is a physician and a policyholder of the Exchange. The governors and principal officers serving at December 1, 2020 were as follows:

#### Board of Governors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Toni J. Brayer, MD Mill Valley, California	Self Employed Physician
Ronald V. Dorn III, MD Boise, Idaho	Physician St Luke's Cancer Institute
Scott A. Hoffinger, MD Moraga, California	Self Employed Physician
Robert J. Margolin, MD San Francisco, California	Self Employed Physician
Gary A. Okamoto, MD <sup>(a)</sup> Honolulu, Hawaii	Physician and Chief Medical Officer AlohaCare
Lamont D. Paxton, MD San Leandro, California	Physician Vascular Surgery Medical Group
Vinod K. Sawhney, MD San Leandro, California	Self Employed Physician

### Board of Governors (continued)

Cheryl A. Tanasovich, MD Greenbrae, California	Physician Greenbrae Dermatology
Jerry R. Tanner, DO Anchorage, Alaska	Physician Diabetes and Lipid Clinic of Alaska
Steven R. Una, MD Castro Valley, California	Self Employed Physician
Ann L. Vercoutere, MD Greenbrae, California	Self Employed Physician

*The following change in governors occurred subsequent to the examination date:*

*(a) Gary A. Okamoto MD retired from the Exchange's board in December 2021 without replacement.*

### Principal Officers

<u>Name</u>	<u>Title</u>
Andrew F. J. Firth	President and Chief Executive Officer
Denis J. Dillon	Chief Financial Officer, Secretary, and Treasurer
Janice M. Ginley	Vice President of Claims
Wesley J. Butler	Vice President of Underwriting

### Management Agreements

Administrative Services Agreement: Effective January 1, 2000, the Exchange and its attorney-in-fact, Medical Underwriters of California (MUC) entered into an Administrative Services Agreement (Agreement), which was subsequently amended and approved by the California Department of Insurance (CDI) on September 22, 2010 pursuant to California Insurance Code (CIC) Section 1215.5(b)(4). Subject to supervision and direction by the Exchange's Board of Governors, MUC managed the daily operations of the Exchange and its subsidiary on a cost reimbursement basis. MUC was responsible for the production, underwriting, reserving, and claims handling of insurance for the

Exchange, as well as accounting, financial reporting, and providing adequate personnel and facilities to perform these services. Effective December 31, 2018, MUC was merged into the Exchange, and the Agreement was terminated. Effective with the merger, the Exchange assumed all the above services previously performed by MUC. During 2017 and 2018, the fees incurred by the Exchange for the services under this Agreement were \$16,723,226 and \$16,184,842, respectively.

Administrative Services Agreement: Effective January 1, 2019, the Exchange entered into an Administrative Services Agreement (Agreement) with MIEC Underwriters, LLC (MIECU), a single-member limited liability corporation wholly owned by the Exchange. MIECU serves as attorney-in-fact for the Exchange pursuant to the Agreement. Under supervision and direction of the Board of Governors, MIECU monitors the finances and the operations of the Exchange to such extent as to assure their conformity with the Agreement and duties as members' power of attorney. MIECU is also responsible for monitoring the procurement of the audit of the accounts and records of the Exchange and also for reviewing and ensuring that the Exchange maintains complete and accurate records of all policies written by the Exchange, in accordance with the law, good insurance practices and reasonable standards established by the Board. This Agreement was approved by the CDI on December 20, 2018 pursuant to CIC Section 1215.5(b)(4). During 2019 and 2020, the fees incurred by the Exchange for the services under this Agreement were \$18,338 and \$21,673, respectively.

Amended and Restated Tax Allocation Agreement: The Exchange is a party to an Amended and Restated Tax Allocation Agreement (Agreement) with its subsidiaries, MIEC Investment Company, Inc. (MIECICI) and MUC, effective September 1, 2013. The Agreement was filed and approved by the CDI on March 5, 2014 pursuant to CIC Section 1215.5(b)(4). The Agreement provides for the federal tax returns of the parties to be filed on a consolidated basis. Allocation is based on a separate company return basis with current credit given to a company for net losses or tax credits to the extent losses and/or credits result in an actual reduction to the consolidated group's tax liability. As a result of the merger MUC into the Exchange effective December 31, 2018, only MIECICI remains

as a participant in this agreement with the Exchange. The federal income tax incurred/(recovered) by the Exchange for 2017, 2018, 2019, and 2020 were (\$1,334,570), (\$881,373), \$267,152, and (\$1,257,569), respectively.

### TERRITORY AND PLAN OF OPERATION

As of December 31, 2020, the Exchange is licensed to transact liability insurance business in the states of Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, and Washington, but only writes business in Alaska, California, Hawaii, Idaho, and Washington. The Exchange specializes in underwriting medical professional liability (MPL) and legal defense coverage for physicians, group practices, blood banks, acupuncturists, and clinics.

Generally, the MPL policies are written on a claims-made basis at limits below \$5.0 million, but the Exchange can issue policies with limits up to \$10.0 million that are subject to specific underwriting and reinsurance restrictions. The Exchange also provides “Tail” coverage without additional premium in the event an individually insured physician dies or is permanently disabled, or in the event of retirement from practice at age 55 or older (for physicians insured for at least five consecutive years). For all other cancellations or non-renewals, unlimited length “Tail” coverage is contractually available for additional premium.

Direct premiums written during 2020 totaled \$46.4 million. The primary lines of business were medical professional liability – claims-made at \$42.9 million (92.5%) and medical professional liability – occurrence at \$2.7 million (5.7%). Direct premiums were written in California (43.3%), Hawaii (24.3%), Alaska (19.3%), Idaho (13.0%), and Washington (0.03%). The Exchange has regional offices in Anchorage, Alaska; Honolulu, Hawaii; and Boise, Idaho. The Exchange generates its business from state, county, and specialty medical societies’ sponsorship and trade journals, via direct solicitations, through the Exchange’s website and through a small number of brokers.



## REINSURANCE

### Assumed

The Exchange's assumed reinsurance is in runoff with the last treaty year effective 2013 and has no current book of assumed business.

### Ceded

The following is a summary of the Exchange's ceded reinsurance agreements in-force as of December 31, 2020:

Type of Contract	Line of Business	Reinsurer's Name	Exchange's Retention	Reinsurer's Limit
Excess of Loss Reinsurance Agreement	Healthcare providers liability policies and hospital general liability and professional liability policies	<u>Authorized:</u> Renaissance Reinsurance U.S. Inc. (21.5%) Trans Re. (19%) Markel Global Reinsurance Company (7.5%) Safety National Casualty Corporation (6.5%) SCOR Reinsurance Company (6.5%) Partner Reinsurance Company of the US (5.0%) Lloyds Syndicates (5.0%)  <u>Certified:</u> Hannover Ruck SE (24.0%)  <u>Unauthorized:</u> Peak Reinsurance Company Limited (5.0%)	\$2.0 million	\$4.0 million excess of \$2.0 million of the sum of contractual loss and/or loss adjustment and defense cost expenses; and/or  \$4.0 million excess of \$2.0 million where two or more Original Insureds and/or Policies and/or claimants are involved in the same Occurrence; and/or  \$4.0 million excess of \$6.0 million in respect of Extra Contractual Obligations and/or loss in excess of the original policy limit; and/or  \$4.0 million excess of \$10.0 million for an Awards Made claim.
Quota Share Reinsurance Agreement Continuous Contract	DataGuard, including multimedia liability, security and privacy liability, privacy regulatory defense and penalties, etc.	<u>Authorized:</u> Houston Casualty Company	10%	90%

## ACCOUNTS AND RECORDS

As a result of Principal Financial Group's acquisition of the trust and custody business from Wells Fargo Bank, effective February 22, 2022, Principal Bank became the custodial bank for the Exchange. The Exchange did not execute a new custodial agreement with Principal Bank to reflect the change. California Insurance Code (CIC) Section 1104.9(c) mandates that securities shall not be deposited in or with a qualified custodian, qualified depository, or qualified subcustodian except as authorized by an agreement between the insurer and the qualified custodian, if the agreement is satisfactory to and has been approved by the Commissioner. It is recommended that the Exchange enter into a new custodial agreement with Principal Bank and submit the custodial agreement to the California Department of Insurance for approval in accordance with CIC Section 1104.9(c).

## FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Exchange with the California Department of Insurance for the period ending December 31, 2020. The accompanying comments to the amounts in the financial statements should be considered an integral part of the financial statements. No adjustments were made to the financial statements as a result of the examination.

Statement of Financial Condition as of December 31, 2020

Underwriting and Investment Exhibit for the Year Ended December 31, 2020

Reconciliation of Surplus as Regards Policyholders from December 31, 2016 through December 31, 2020

Statement of Financial Condition  
as of December 31, 2020

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 317,365,051	\$	\$ 317,365,051	
Common stocks	71,029,446	183,139	70,846,307	
Real estate properties occupied by the company	2,127,935		2,127,935	
Cash and cash equivalents	27,361,089		27,361,089	
Other invested assets	25,000	25,000		
Investment income due and accrued	1,856,690		1,856,690	
Uncollected premiums and agents' balances in the course of collection	864,036	562,563	301,473	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,045		1,045	
Amounts recoverable from reinsurers	39,797		39,797	
Funds held by or deposited with reinsured companies	4,957		4,957	
Net deferred tax asset	2,339,251		2,339,251	
Electronic data processing equipment and software	129,915	68,913	61,002	
Furniture and equipment	144,980	144,980		
Receivables from parent, subsidiaries and affiliates	529		529	
Aggregate write-ins for other than invested assets	<u>1,838,606</u>	<u>1,597,737</u>	<u>240,869</u>	
Total assets	<u>\$ 425,128,327</u>	<u>\$ 2,582,332</u>	<u>\$ 422,545,995</u>	
 <u>Liabilities, Surplus and Other Funds</u>				<u>Notes</u>
Losses			\$ 87,561,221	(1)
Loss adjustment expenses			58,264,601	(1)
Commissions payable, contingent commissions and other similar charges			31,582	
Other expenses			3,322,604	
Taxes, licenses and fees			(6,085)	
Current federal and foreign income taxes			393,035	
Borrowed money			1,500,000	
Unearned premiums			27,625,700	
Advance premiums			2,239,416	
Policyholders dividends declared and unpaid			17,246,854	
Ceded reinsurance premiums payable			3,221,715	
Amounts withheld or retained by company for account of others			5,185,885	
Provision for reinsurance			33,000	
Aggregate write-ins for liabilities			<u>18,618,691</u>	
Total liabilities			225,238,219	
Unassigned funds (surplus)	<u>\$ 197,307,776</u>			
Surplus as regards policyholders			<u>197,307,776</u>	
Total liabilities, surplus, and other funds			<u>\$ 422,545,995</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2020

Statement of Income

Underwriting Income

Premiums earned		\$ 42,183,611
Deductions:		
Losses incurred	\$ 20,710,134	
Loss adjustment expenses incurred	21,022,500	
Other underwriting expenses incurred	<u>9,605,196</u>	
Total underwriting deductions		<u>51,337,830</u>
Net underwriting loss		(9,154,219)

Investment Income

Net investment income earned	\$ 9,578,600	
Net realized capital gains	<u>8,513,736</u>	
Net investment gain		18,092,336

Other Income

Net loss from agents' or premium balances charged off	\$ (163)	
Aggregate write-ins for miscellaneous income	<u>4,950</u>	
Total other income		<u>4,787</u>
Net income before dividends to policyholders, after capital gains tax, and before all other federal and foreign income taxes		8,942,904
Dividends to policyholders		<u>4,500,000</u>
Net income after dividends to policyholders, after capital gains tax, and before all other federal and foreign income taxes		4,442,904
Federal and foreign income taxes incurred/(recovered)		<u>(1,295,936)</u>
Net income		<u>\$ 5,738,840</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2019		\$ 186,573,365
Net income	\$ 5,738,840	
Change in net unrealized capital gains	6,923,762	
Change in net deferred income tax	290,561	
Change in nonadmitted assets	621,946	
Change in provision for reinsurance	(33,000)	
Aggregate write-ins for losses in surplus	<u>(2,807,698)</u>	
Change in surplus as regards policyholders for the year		<u>10,734,411</u>
Surplus as regards policyholders, December 31, 2020		<u>\$ 197,307,776</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2016 through December 31, 2020

Surplus as regards policyholders, December 31, 2016			\$ 177,539,919
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 17,218,888	\$	
Change in net unrealized capital gains	4,035,285		
Change in net deferred income tax		4,463,028	
Change in nonadmitted assets	11,015,950		
Change in provision in reinsurance		33,000	
Aggregate write-ins for losses in surplus		<u>8,006,238</u>	
Total gains and losses in surplus	<u>\$ 32,270,123</u>	<u>\$ 12,502,266</u>	
Net increase in surplus as regards policyholders			<u>19,767,857</u>
Surplus as regards policyholders, December 31, 2020			<u>\$ 197,307,776</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance reviewed the Actuarial Report as of December 31, 2020 prepared by the Exchange's independent actuary and concurred with the actuary's conclusion that the Exchange's loss and loss adjustment expense reserves as of December 31, 2020 were reasonable and have been accepted for purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Accounts and Records – Custodial Agreement (Page 8): It is recommended that the Exchange enter into a new custodial agreement with Principal Bank and submit the custodial agreement to the California Department of Insurance for approval in accordance to California Insurance Code Section 1104.9(c).

### Previous Report of Examination

Management Agreements (Page 5): It was recommended that the Exchange appropriately disclose all management and tax allocation agreements in accordance with California Insurance Code Section 1215.4(b)(3). The Exchange has complied with the recommendation.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Exchange's officers and employees during the course of this examination.

Respectfully submitted,

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Mei Gu, CFE  
Examiner-In-Charge  
Senior Insurance Examiner  
Department of Insurance  
State of California

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Li Lim, CFE  
Senior Insurance Examiner, Supervisor  
Department of Insurance  
State of California