

REPORT OF  
ASSOCIATION EXAMINATION

OF

RED MOUNTAIN CASUALTY INSURANCE COMPANY,  
INC.

BIRMINGHAM, ALABAMA

AS OF

DECEMBER 31, 2006

PARTICIPATION:

SOUTHEASTERN ZONE  
ALABAMA

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EXAMINER'S AFFIDAVIT

STATE OF ALABAMA  
COUNTY OF Jefferson

Mary B. Packard, being first duly sworn, upon her oath

deposes and says:

That she is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

That an examination was made of the affairs and financial condition of Red Mountain Casualty Insurance Company, Inc., for the period of January 1, 2003 through December 31, 2006.

That the following 28 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama.

And that the statements, exhibits, and data therein contained are true and correct to the best of her knowledge and belief.

Mary B. Packard  
Examiner-in-Charge

Subscribed and sworn to before the undersigned authority this 28<sup>th</sup> day of September, 2007

Tonia M. King  
(Signature of Notary Public)

TONIA M. KING Notary Public  
(Print Name)

in and for the State of Alabama.

My Commission expires 6-20-08.



BOB RILEY  
GOVERNOR

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DEPARTMENT OF INSURANCE  
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DENISE B. AZAR  
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JIMMY W. GUNN

September 28, 2007

Honorable Mary Jo Hudson, Director,  
Chairman, Examination Oversight Task Force  
Ohio Department of Insurance  
2100 Stella Court  
Columbus, Ohio 43215-1067

Honorable Julie McPeak, Executive Director, Secretary, Southeastern Zone  
Kentucky Office of Insurance  
Post Office Box 517  
Frankfort, Kentucky 40602-0517

Honorable Walter Bell, Commissioner  
Alabama Department of Insurance  
201 Monroe Street, Suite 1700  
Montgomery, Alabama 36104

Dear Directors and Commissioner:

Pursuant to your authorizations and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners (NAIC), an examination has been made of the affairs and financial condition of

**RED MOUNTAIN CASUALTY INSURANCE COMPANY, INC.**

at its home office located at 100 Brookwood Place, Birmingham, Alabama 35209, as of December 31, 2006. The Report of Examination is submitted herewith. Where the description "Company" or "RMCI" appears herein without qualification, it will be understood to indicate Red Mountain Casualty Insurance Company, Inc.

## SCOPE OF EXAMINATION

The Company was last examined for the five-year period ended December 31, 2002 by examiners from Alabama. The current examination covers the intervening period from the date of the last examination through December 31, 2006 and was conducted by examiners from Alabama, representing the Southeastern Zone, NAIC. The examination was conducted concurrently with the examination of affiliated companies, The Medical Assurance Company, Inc. (TMAC), and Woodbrook Casualty Insurance, Inc. (WCI), both of Birmingham, Alabama and NCRIC, Inc. (NCRIC) of Washington, D.C. Where deemed appropriate, transactions subsequent to 2006 were reviewed.

The examination was made in accordance with the statutory requirements of the Alabama Insurance Code and the Alabama Insurance Department's regulations and bulletins; in accordance with the applicable guidelines and procedures promulgated by the NAIC; and in accordance with generally accepted examination standards and practices in connection with the verification of assets and determination of liabilities.

The examination included an inspection of corporate records, test checks of recorded income and disbursement items for selected periods, and a general review of records and files pertaining to operations, administrative practices and compliance with statutes and regulations. Assets were verified and valued and all known liabilities were established or estimated as of December 31, 2006 as shown in the Financial Statements contained herein. However, the discussion of assets and liabilities contained in this report is confined to those items where a change was made by the examiners, or which indicated violation of the Alabama Insurance Code and the Insurance Department's rules and regulations or other insurance laws or rules, or which are deemed to require comments or recommendations.

A Company office copy of the filed Annual Statement for the year 2006 was compared with or reconciled to account balances with respect to ledger items.

The market conduct review consisted of a review of the Company's plan of operation, territory, policy forms and underwriting practices, dividends to policyholders, advertising, claims payments, policyholder complaints and compliance with agents' licensing requirements.

The Company's accounts were examined by Ernst and Young, LLP, certified public accountants (E&Y), for the years of 2003, 2004, 2005 and 2006. The Company does not maintain an internal audit department; however, its ultimate

parent, ProAssurance Corporation (PRA), does maintain an internal audit department which services the parent and its subsidiaries.

A signed letter of representation was obtained during the course of the examination. In this letter, management attests to having valid title to all assets, except as disclosed in the Annual Statement, and to the nonexistence of unrecorded liabilities as of December 31, 2006.

## ORGANIZATION AND HISTORY

The Company (formerly known as ProNational Casualty Company and as PICOM Insurance Company of Illinois) was incorporated on December 5, 1994 under the provisions of the Illinois Insurance Code. On January 5, 1995, the Illinois Director of Insurance issued a Certificate of Authority to transact all lines of business enumerated in Class 2 except (k) and 3, Section 4 of the Illinois Insurance Code. Paid in capital of \$12,400,000 consisted of 1,000,000 shares of \$1 par value common stock and \$11,400,000 of contributed surplus. Authorized stock of the Company was as follows:

- 8,000,000 shares authorized – common stock
- 1,000,000 shares issued and outstanding common stock
- 2,000,000 shares authorized – preferred stock
- 0 shares issued and outstanding preferred stock

ProNational Casualty Company was a wholly-owned subsidiary of ProNational Insurance Company (ProNational) (formerly known as PICOM Insurance Company), Okemos, Michigan. ProNational was incorporated on June 27, 1980 under the laws of Michigan as Physicians Insurance Company of Michigan.

An Assumption Reinsurance Agreement, effective as of December 31, 1997, between ProNational and the Company was approved by the Director of the Illinois Insurance Department on November 4, 1997. All of the Company's liabilities and obligations arising under its policies were ceded to ProNational. From that time, the Company did not write any new business until October 1, 2002.

The Company redomesticated and reincorporated as an Alabama corporation on September 9, 2002 pursuant to the laws of the State of Alabama. On September 13, 2002, the Company changed its name to Red Mountain Casualty Insurance Company, Inc.

On August 10, 2006, the Company became a wholly-owned subsidiary of Professionals Group, Inc. (PGI) through a stock dividend paid by ProNational to its parent, PGI, a Michigan holding corporation.

## **MANAGEMENT AND CONTROL**

### **Shareholder**

At December 31, 2006, the Company was a stock corporation with control vested in its stockholder. The Company was a wholly owned subsidiary of Professionals Group, Inc. (PGI), which was 100% owned by ProAssurance Corporation (PRA), a Delaware stock corporation. Effective May 16, 2007, PGI was merged into affiliate, PRA Professional Liability Group, Inc., a new holding company incorporated under the laws of the State of Delaware.

### **Board of Directors**

Directors are elected for one year terms by the shareholder. Directors serving at December 31, 2006 were as follows:

<b><u>Director</u></b>	<b><u>Residence</u></b>
Aubrey Derrill Crowe, M.D.*	Birmingham, Alabama
Victor Thomas Adamo	Birmingham, Alabama
Howard Harley Friedman	Timonium, Maryland
Paul Richard Butrus	Birmingham, Alabama
Edward Lewis Rand, Jr.	Birmingham, Alabama
Darryl Keith Thomas	Hoover, Alabama

\*Retired effective June 30, 2007. See "SUBSEQUENT EVENTS" for further detail.



## Committees

### *Executive Committee*

The Company established an Executive Committee in 2002. No minutes or any other evidence of these committee meetings were provided to the examiners as no meetings had been conducted.

Members of the Executive Committee at December 31, 2006 consisted of the following directors:

Aubrey Derrill Crowe, M.D.\*  
Victor Thomas Adamo  
Howard Harley Friedman  
Darryl Keith Thomas

\*Retired effective June 30, 2007. See "SUBSEQUENT EVENTS" for further detail.

### *Investment Committee*

Members of the investment committee at December 31, 2006 consisted of the following directors and officers:

Aubrey Derrill Crowe, M.D.\*  
Victor Thomas Adamo  
Howard Harley Friedman  
Darryl Keith Thomas  
Edward Lewis Rand, Jr.

\*Retired effective June 30, 2007. See "SUBSEQUENT EVENTS" for further detail.

## Officers

Officers are elected annually by the Board of Directors. Principal officers elected and serving at December 31, 2006 were:

<u>Officer</u>	<u>Title</u>
Aubrey Derrill Crowe, M.D.*	Chairman
Victor Thomas Adamo	Vice Chairman
Howard Harley Freidman	President/Chief Underwriting Officer
James Joseph Morello	Treasurer
Hayes Vance Whiteside	Senior Vice President
Desmond Patrick O'Doherty	Vice President
Kathryn Anne Neville	Secretary
Jeffrey Patton Lisenby	Assistant Secretary
Larry Keith Chamblee*	Assistant Treasurer
Darryl Keith Thomas	Chief Claims Officer/ Assistant Secretary/ Assistant Treasurer

\*Retired in 2007.

### Conflict of Interest Statements

The Conflict of Interest Statements filed for the four-year period covered by this examination were reviewed. All statements were signed as required.

### **CORPORATE RECORDS**

The Articles of Corporation and By-Laws were amended and restated in 2004. They were approved by the Board of Directors on July 1, 2004. The Articles were filed with the Judge of Probate, State of Alabama – Jefferson County on July 1, 2004. The By-laws were certified by the Company's Secretary on July 6, 2004 and were mailed to the Alabama Department of Insurance on July 11, 2004.

The documents were inspected during the course of the examination and appeared to provide for the operation of the Company in accordance with usual corporate practice and applicable statutes and regulations.

### **HOLDING COMPANY AND AFFILIATE MATTERS**

#### Holding Company

The Company is subject to the Alabama Insurance Holding Company Regulatory Act as defined in ALA. CODE § 27-29-1 (1975). In connection therewith, the Company is registered with the Alabama Department of Insurance as joint registrant of an Insurance Holding Company System. Appropriate filings required

under the Holding Company Act were made from time to time by the Company as joint registrant. A review of the Company's filings during the period under review did not disclose any omissions in them.

### Dividends to Stockholders

The Company paid the following dividends during the period covered by this examination:

<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
\$0	\$1,500,000	\$0	\$0

No extraordinary dividends were paid during this period.

### Management and Service Agreements

#### *2006 Management Agreement*

This agreement was entered into by ProAssurance Corporation (PRA) and its subsidiaries effective January 1, 2006. The agreement was for one year with automatic renewals for subsequent calendar years.

It was determined that by combining certain portions of the insurance operations, the companies could operate more effectively and efficiently. It was decided that The Medical Assurance Company, Inc. (TMAC) would be responsible for the coordination and delivery of the management services to be provided, including but not limited to the following:

- Accounting Services, Financial Statements and Tax Returns
- Underwriting Services
- Marketing and Sales
- Claims Administration
- Reinsurance
- Information Systems Services
- Administrative Services
- Legal Services
- Actuarial Service
- Risk Management

Services may be performed using the personnel of any of the companies party to the agreement or through the use of consultants, advisors, investment managers, and other third parties as reasonably required to perform the services referenced above. The direct or indirect expenses incurred shall be allocated as determined by the Expense Allocation Agreement that was entered into simultaneously with this agreement. TMAC should not charge any management fee, commission or override for performing the services set forth in the agreement.

### *2006 Expense Allocation Agreement*

The agreement is between ProAssurance Corporation (PRA) and its subsidiaries and was effective January 1, 2006 and amended in July 2007. The agreement will continue in-force unless amended or modified in writing by all of the companies involved.

The agreement defines the types of expenses involved (direct and indirect) and establishes the method of allocating these expenses.

Direct expenses are defined as those expenses arising from services performed by employees of the companies or outside vendors that can be identified as being applicable to one specific company. Direct expenses will be allocated to the company incurring the expenses.

Indirect expenses are defined as those expenses arising from services performed for the benefit of one or more companies, and cannot be identified as applicable to one company. These expenses will be allocated during each accounting period on a closely estimated basis and in a fair and reasonable method in conformity with customary insurance accounting practices. The method will be consistently applied.

All expenses will be settled on a quarterly basis.

### *2006 Consolidated Tax Allocation Agreement*

The agreement, dated August 1, 2006, is between PRA and its subsidiaries (Group). The agreement succeeds the Consolidated Tax Allocation Agreement dated September 1, 2005 between PRA and its subsidiaries and the Tax Sharing Agreement dated August 15, 2005 between Physicians Insurance Company of Wisconsin, Inc. and its subsidiaries. The agreement should continue until terminated by the mutual agreement of the members. Any amendments,

modifications, or supplements to this agreement shall be in writing and shall be executed by a duly appointed representative of each of the members.

A consolidated federal income tax return shall be filed under the terms of Section 1501, et seq. of the Internal Revenue Code of 1986, as amended, and the Treasury Regulations. Pursuant to Regulation Section 1.1552-1(c), PRA elects to allocate the consolidated tax liability of the Group among the members in accordance with the ratio of each member's taxable income to the consolidated taxable income. This calculation shall be made pursuant to Regulation Section 1.1552-1(a)(1). Each member would pay this amount on the date the liability was due had it not been consolidated, or soon thereafter. In lieu of actual payments, adjustments to the intercompany receivables or payables will be made if any exists.

If any member's losses or tax credits resulted in reduced taxes for the other members, then the member who experienced the loss would receive a reduction to its intercompany payable by the members experiencing the benefit. The payment would be calculated by allocating to each benefiting member an additional tax liability in an amount equal to 100 percent of the excess, if any, of the (1) separate return tax liability of each benefiting member for the taxable year over (2) the tax liability allocated to the benefiting members under this agreement. This additional tax liability shall be paid or adjustments made to the intercompany balances of the member experiencing the loss on the ratio of separate return tax benefit divided by the total tax benefit of all members who experienced a loss. If the tax credit exceeds the intercompany payable of the member who experienced the loss, then an actual cash payment will be made. The additional tax amount owed by each benefiting member or adjustment to intercompany balances should be made on the date this amount was due had it not be consolidated, or soon thereafter.

If any member owes another member an amount in addition to its liability, then the overpayment amount would be repaid or readjusted on the date or dates the amount would have been paid to the Internal Revenue Service (IRS) had the member filed a separate return, or as soon thereafter as possible.

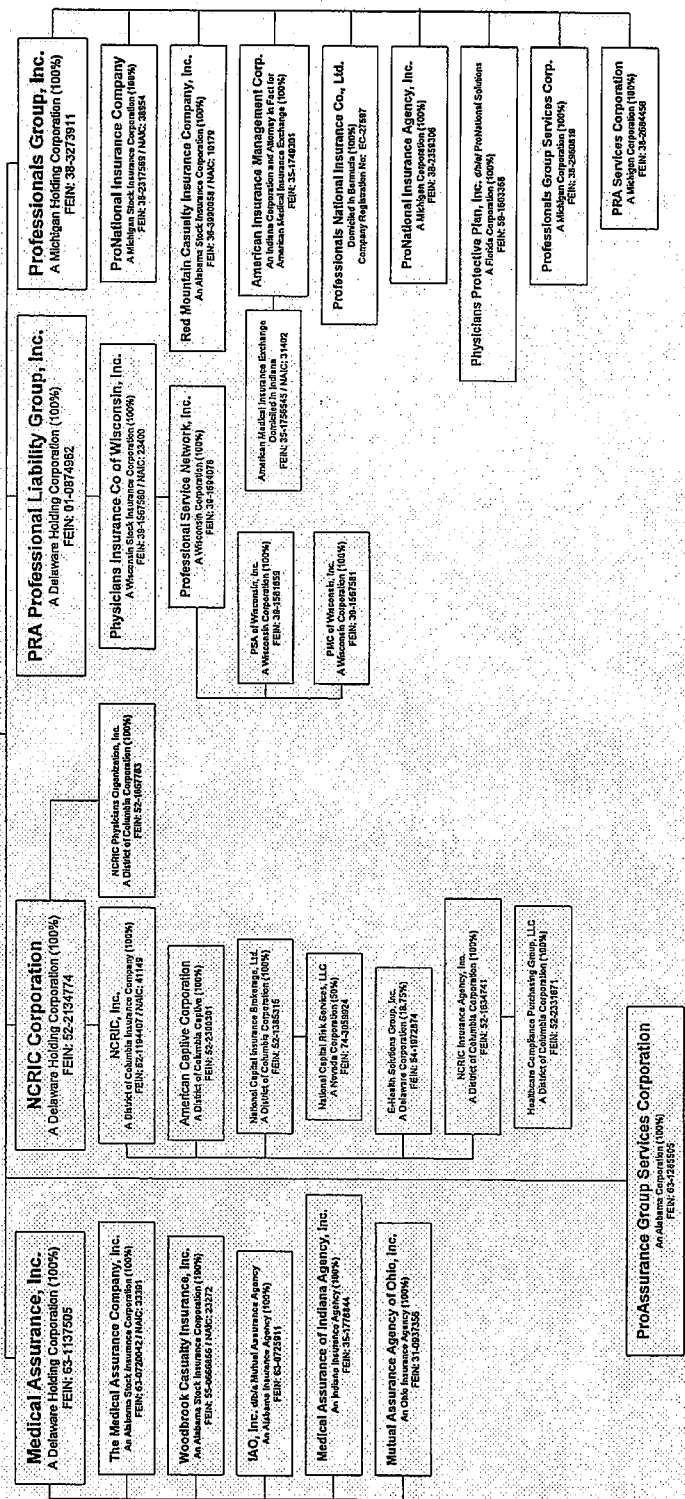
If any member owes another member an amount less than its liability, then the member would pay or adjust the intercompany balance of the member due the payment on the date or dates the amount would have been required by the IRS had the member filed a separate return, or as soon thereafter as possible.

Subsequent changes in a member's tax liability and the reimbursement payment shall be considered an intercompany liability or receivable and not a dividend or surplus contribution, until the adjustment is made.

## Organizational Chart

The following chart presents the identities of and interrelationships among all affiliated persons within the Insurance Holding Company System as of December 31, 2006.

**ProAssurance Corporation**  
A Delaware Holding Corporation / FEIN: 63-1261493



As of December 31, 2006

## FIDELITY BOND AND OTHER INSURANCE

The Company was a named insured on a financial institution bond issued by The Cincinnati Insurance Company of Cincinnati, Ohio, which met the suggested minimum requirements of the NAIC Financial Condition Examiners Handbook. The bond covered forgery or alteration, securities, trading loss, computer system fraud and extortion.

In addition to the fidelity bond, the Company maintained the following coverages to protect the Company against hazards to which it may be exposed:

- Corporate Accident Liability
- Publicly Traded Blue Chip Liability
- Commercial Automobile Liability
- Commercial Excess and Umbrella Liability
- International Blanket Accident Liability
- International Commercial Liability
- International General Liability
- International Workers' Compensation Liability
- Property Insurance Liability
- Workers' Compensation Liability
- Pension Retirement Liability
- Directors and Officers Liability
- Errors and Omissions Liability

The coverages and limits carried by the Company were reviewed during the course of the examination and appeared to adequately protect the Company's interest at the examination date.

## EMPLOYEE AND AGENT WELFARE

The Company had no employees or agents. All services were provided to the Company by employees of ProAssurance Group Services Corporation. Expenses were allocated in accordance with the Expense Allocation Agreement that is discussed under "HOLDING COMPANY AND AFFILIATE MATTERS" section of this report under the caption "Management and Service Agreements."



## SPECIAL DEPOSITS

The Company maintained the following deposits with the respective statutory authorities at December 31, 2006, as required or permitted by law:

<u>States and Territories</u>	<u>Book Value</u>	<u>Fair Value</u>
Alabama	\$ 2,627,264	\$ 2,591,404
Arkansas	101,271	101,097
Louisiana	100,000	100,000
Michigan	99,992	99,750
New Mexico	101,283	100,914
Oklahoma	110,969	111,006
<b>TOTAL</b>	<b>\$ 3,140,779</b>	<b>\$ 3,104,171</b>

## FINANCIAL CONDITIONS/GROWTH OF THE COMPANY

	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital &amp; Surplus</u>	<u>Premiums Earned</u>
2006*	\$ 55,485,391	\$ 33,018,395	\$ 21,466,996	\$0
2005	66,190,187	46,805,907	19,384,280	0
2004	49,853,342	33,342,131	16,511,211	0
2003	34,693,106	17,908,191	16,784,915	0
2002*	17,951,539	2,122,134	15,829,405	0

**\*Per Examination**



As of December 31, 2006, the Company's book of business consisted of 360 physicians and dentist policies written in the following states:

Arkansas	Illinois	Ohio
Arizona	Kentucky	Oklahoma
Colorado	Maryland	Tennessee
District of Columbia	Michigan	Texas
Delaware	Missouri	Utah
Florida	Mississippi	Virginia
Georgia	New Jersey	Washington
Iowa	North Carolina	

The Company marketed its products through brokers outside of the State of Alabama.

### **Policy Forms and Underwriting**

The Company is a surplus lines insurer, licensed in Alabama and offers surplus lines for professional liability insurance in states other than Alabama. As a result, there were no form filings in Alabama for the period under review.

### **Dividends to Policyholders**

There were no dividends paid to policyholders during the period covered by this examination.

### **Advertising**

As an excess and surplus lines writer, the Company utilizes a small number of surplus lines brokers to generate business from retail agents who are unable to place particular risks in the standard marketplace due to the characteristics of these risks. The Company does not attempt to advertise for business directly with retail agents or potential policyholders.

### **Claims Review**

There were no claims incurred, paid or settled in the State of Alabama for the examination period under review.

## Policyholder Complaints

During the examination period, the Company had one complaint registered with the ALDOI. The Company was not notified of the complaint.

## Compliance with Agents' Licensing Requirements

The Company is a surplus lines carrier and did not write or issue any policies in the State of Alabama for the period under review. The Company had no licensed or appointed agents in the State of Alabama and utilized the services of brokers and program managers in all other states.

## **PRIVACY STANDARDS**

The examiners reviewed the Company's privacy procedures and found the following:

1. The Company provides new employees with a copy of the Employee Handbook which contains the Code of Ethics. The Company's policy on Confidential Information in general as well as its requirements under HIPAA are included in the Code of Ethics. The employees are required to sign an acknowledgement form after they have received and reviewed the document.
2. The Company has safeguards in its data systems to prevent unauthorized access to nonpublic and personal information stored there.
3. The Company sends an initial privacy notice with every new policy and at renewal.
4. The Company does not disclose any nonpublic information on its policyholders unless required by law. This includes personal health or financial information. For this reason, the Company does not need to provide opt-out statements to its policyholders.

Overall, the examiners determined that the Company was following the privacy procedures and standards contained in ALA. ADMIN. CODE 482-1-122 (2001).

## REINSURANCE

### Assumed Reinsurance

The Company had no assumed reinsurance business, as of December 31, 2006.

### Ceded Reinsurance

The Company and ProNational signed a 100% Quota Share Reinsurance agreement effective October 1, 2002 in which the Company will cede 100% of its gross liability on risk under all policies covered. In addition, the Company has a reinsurance arrangement with Podiatry Insurance Company of America (PICA). The Company has agreed to write high-risk podiatrists on an excess and surplus lines basis for PICA. PICA performs the initial underwriting of an account, and the Company has final underwriting approval on all risks. PICA and the Company participate 50/50 in the risk. This program began in mid-2006.

The review of the Companies' reinsurance treaties disclosed no unusual provisions, except for the Company's program involving nursing homes. This program is not considered insurance for statutory accounting purposes, but is booked using deposit accounting in accordance with SSAP No. 75. The coverage is not considered to be insurance because there is no transfer of risk. The Company issues a policy for the reimbursement of claims on a policy which is fully funded to the policy limits.

## ACCOUNTS AND RECORDS

The Company's principal accounting records were maintained primarily on electronic data processing (EDP) equipment. The Company uses a system to maintain files on claims and underwriting, including premiums. This system interfaces with the Company's general ledger system as needed.

The Company was audited annually by the independent certified public accounting firm of Ernst & Young, LLP (E&Y), Birmingham, Alabama. E&Y conducted all of the Company's audits for the four-year period under examination.

The actuarial firm of Tillinghast-Towers Perrin, Atlanta, Georgia, was retained by the Company throughout the examination period and prepared the 2006 Statutory Loss Reserve Opinion and the Statement of Actuarial Opinion. The reserve calculations were verified by Mr. James D. Hurley, ACAS, MAAA, a qualified actuary.

The Company has not completed its Corporate Level Business Continuity Plan. Without a plan, senior management's ability to efficiently respond to contingencies could be impaired.

The Company has seven individuals with access to the production data. Project Managers should not have access to production data. No one should have access to production data all day every day. Access should be limited, and tracking of the use of superuser accounts should be performed and audited.

Prior to the initial appointment of an agency, the Senior VP of Sales conducts a complete review of the potential agency, including a review of the Dunn & Bradstreet report on the respective agency. For the Company, the premium is paid to the Company net of commission by the broker. If the Company binds the policy and the insured does not pay the premium, the broker is responsible for making the Company whole. The initial reviews are not documented as the materials are reviewed and the decision is made to either appoint the agency or not. If the agency is appointed, the materials may or may not be kept in the agency file.

### **Record Retention Compliance**

The examiners determined that the Company's record retention policy did not require that the Company maintain all records in accordance with ALA. ADMIN. CODE 482-1-118-.03 (1999), which states: "Every insurer, which term shall include every domestic insurer, foreign insurer, health care services corporation, health maintenance organization, prepaid dental plan, managing general agent or any other legal entity regulated by the Insurance Code and licensed to do business in this state shall maintain its books, records, documents and other business records in order that the insurer's financial condition may be readily ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years." These items included: petty cash records, audits or adjustments, vendor W-9 forms, payroll records, files for commissions, bonuses, incentives, awards, employee personnel records, affirmative action and EEO files, requests for reasonable accommodation under ADA, records related to FLMA leave, job descriptions, job advertisements, applications and resumes, service requests, and risk management files.

## FINANCIAL STATEMENTS INDEX

The Financial Statements included in this report were prepared on the basis of the Company's records and the valuations and determinations made during the course of the examination for the year 2006. Amounts shown in the comparative statements for the year 2003, 2004, 2005 and 2006 were compiled from Company copies of filed Annual Statements. The statements are presented in the following order:

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Capital and Surplus.....	22

**THE NOTES TO THE FINANCIAL STATEMENTS ARE AN  
INTREGAL PART THEREOF.**

**Red Mountain Casualty Insurance Company, Inc.**  
**Statement of Assets, Liabilities, Surplus and Other Funds**  
**For the Year Ended December 31, 2006**

	<u>Assets</u>	<u>Nonadmitted</u> <u>Assets</u>	<u>Net Admitted</u> <u>Assets</u>
Bonds (Note 1)	\$ 33,526,488	\$ -	\$ 33,526,488
Cash, cash equivalents and short-term investments	20,138,040	-	20,138,040
Subtotal, cash and invested assets	\$ 53,664,528	\$ -	\$ 53,664,528
Investment income due and accrued	310,325	-	310,325
Premium considerations:			
Uncollected premiums and agents' balances in the course of collection	86,747	73	86,674
Reinsurance:			
Amounts recoverable from reinsurers	89,267	-	89,267
Current federal and foreign income tax recoverable	21,802	-	21,802
Net deferred tax asset	65,367	38,707	26,660
Furniture and equipment, including health care delivery assets	560	560	-
Receivable from parent, subsidiaries and affiliates	10,000		10,000
Fee program receivables	276,135		276,135
Employee travel advances	2,082	2,082	-
Prepaid other taxes and fees	5,155	5,155	-
<b>TOTAL</b>	<u>\$ 54,531,968</u>	<u>\$ 46,577</u>	<u>\$ 54,485,391</u>

**THE NOTES TO THE FINANCIAL STATEMENTS ARE AN  
INTREGRAL PART THEREOF.**



**Red Mountain Casualty Insurance Company, Inc.**  
**Statement of Assets, Liabilities, Surplus and Other Funds (Continued)**  
**For the Year Ended December 31, 2006**

<u>LIABILITIES</u>	<u>2006</u>
Loss adjustment expenses	\$ 1,205,001
Commissions payable, contingent commissions and other similar charges	17,955
Other expenses	759,274
Taxes, licenses and fees	32,791
Current federal and foreign income taxes	-
Advance premiums	332,723
Ceded reinsurance premiums payable	296,563
Funds held by company under reinsurance treaties	25,197,228
Amounts withheld or retained by company for account of others	4,427,887
Provision for reinsurance	434,000
Payable to parent, subsidiaries and affiliates	314,973
<b>TOTAL LIABILITIES</b>	<b>\$ 33,018,395</b>
<u>CAPITAL AND SURPLUS</u>	
Common capital stock	\$ 3,000,000
Gross paid in and contributed surplus	12,466,528
Unassigned funds (surplus) (Note 2)	6,000,468
<b>TOTAL CAPITAL AND SURPLUS</b>	<b>\$ 21,466,996</b>
<b>TOTAL LIABILITIES, CAPITAL AND SURPLUS</b>	<b>\$ 54,485,391</b>

**THE NOTES TO THE FINANCIAL STATEMENTS ARE AN  
INTREGRAL PART THEREOF.**

**Red Mountain Casualty Insurance Company, Inc.**  
**Statement of Income**  
**For the Years Ended December 31, 2006, 2005, 2004 and 2003**

	2006	2005	2004	2003
<b><u>Underwriting income</u></b>				
Premiums earned	\$ -	\$ -	\$ -	\$ -
<b><u>Deductions:</u></b>				
Loss expenses incurred	637,001	49,167	232,253	721,736
Other underwriting expenses incurred	(360,592)	(494,167)	(652,327)	(1,757,282)
Total underwriting deductions	<u>\$ 276,409</u>	<u>\$ (445,000)</u>	<u>\$ (420,074)</u>	<u>\$ (1,035,546)</u>
Net underwriting gain (loss)	<u>\$ (276,409)</u>	<u>\$ 445,000</u>	<u>\$ 420,074</u>	<u>\$ 1,035,546</u>
<b><u>Investment income</u></b>				
Net investment income earned	\$ 1,903,237	\$ 2,045,232	\$ 1,122,732	\$ 641,623
Net realized capital gains (losses)	(132,495)	(30,108)	14,359	4,441
Net investment gain (loss)	<u>\$ 1,770,742</u>	<u>\$ 2,015,124</u>	<u>\$ 1,137,091</u>	<u>\$ 646,064</u>
<b><u>Other income</u></b>				
Fee income	\$ 2,040,972	\$ 1,630,257	\$ 299,061	\$ -
Client risk survey income	(3,000)	11,500	9,500	1,250
Miscellaneous other income	4,284	(12,519)	(3,386)	37,824
Total other income	<u>2,042,256</u>	<u>1,629,238</u>	<u>305,175</u>	<u>39,074</u>
Net income before federal and foreign income taxes	<u>\$ 3,536,589</u>	<u>\$ 4,089,362</u>	<u>\$ 1,862,340</u>	<u>\$ 1,720,684</u>
Federal and foreign income taxes incurred	<u>1,037,415</u>	<u>1,243,548</u>	<u>629,085</u>	<u>757,383</u>
<b>NET INCOME</b>	<b><u>\$ 2,499,174</u></b>	<b><u>\$ 2,845,814</u></b>	<b><u>\$ 1,233,255</u></b>	<b><u>\$ 963,301</u></b>
<b><u>Capital and Surplus Account</u></b>				
Surplus as regards policyholders, prior year	\$ 19,384,280	\$ 16,511,211	\$ 16,784,915	\$ 15,829,405
Net income	2,499,174	2,845,814	1,233,255	963,301
Change in net deferred income tax	53,097	(27,847)	10,314	29,803
Change in nonadmitted assets	(35,555)	55,102	(17,273)	(37,594)
Change in provision for reinsurance	(434,000)	-	-	-
Dividends to stockholders	-	-	(1,500,000)	-
Capital changes: Transferred from surplus	-	-	-	2,000,000
Capital changes: Transferred to capital	-	-	-	(2,000,000)
Change in surplus as regards policyholders	<u>\$ 2,082,716</u>	<u>\$ 2,873,069</u>	<u>\$ (273,704)</u>	<u>\$ 955,510</u>
Surplus as regards policyholders, December 31, current year	<u>\$ 21,466,996</u>	<u>\$ 19,384,280</u>	<u>\$ 16,511,211</u>	<u>\$ 16,784,915</u>

**THE NOTES TO THE FINANCIAL STATEMENTS ARE AN  
INTREGRAL PART THEREOF.**

## NOTES TO THE FINANCIAL STATEMENTS

### Note 1 – Bonds

\$33,526,488

The above captioned amount is the same as reported by the Company in its 2006 Annual Statement.

It was noted that the Company had an investment with subprime exposure. The fair value and par value of the investment totaled \$593,002 and \$591,872, respectively. Standard & Poors rated the bond AA+.

### Note 2 - Unassigned funds (Surplus)

\$6,000,468

The above captioned amount is the same as reported by the Company in its 2006 Annual Statement.

The following schedule presents a reconciliation of the unassigned funds per the Company's filed statement to this examination's findings:

Unassigned funds (surplus) per Company		\$6,000,468
Examination increase/(decrease) to assets:	<u>-0-</u>	
Total increase/(decrease) to assets		<u>0</u>
Examination (increase)/decrease to liabilities:	<u>-0-</u>	
Total (increase)/decrease to liabilities		<u>0</u>
Unassigned funds (surplus) per Examination		\$6,000,468

## CONTINGENT LIABILITIES AND PENDING LITIGATION

The review of contingent liabilities and pending litigation included an inspection of representation made by management regarding the Company, a review of a report to the examiners on pending litigation made by Company's counsel, and a general review of the Company's records and files conducted during the course of the examination including a review of claims. These reviews did not disclose any items that would have a material effect on the Company's financial condition in the event of an adverse outcome.

## SUBSEQUENT EVENTS

The following two agreements were effective subsequent to the exam period:

## *Management and Service Agreement*

This agreement effective January 1, 2007 was signed and entered into by ProAssurance Corporation (PRA) and its subsidiaries on August 1, 2006. The companies determined that by combining certain portions of its insurance operations, they could operate more effectively and efficiently.

It was determined that The Medical Assurance Company, Inc. (TMAC) would be responsible for the coordination and delivery of the management services to be provided, including but not limited to the following:

- accounts receivable and accounts payable
- investment management
- preparation and filing of financial statements and tax returns
- reviewing applications for policies of insurance
- making decisions on coverage
- following-up with applicants for additional information
- working with reinsurers to arrange appropriate reinsurance for each Company
- selling and promoting the policies of insurance issued by each Company
- invoicing policies\*
- mailing applications to insured's\*
- collecting premiums\*
- marketing policies to prospective\*
- reviewing, processing, investigating, adjusting and settling or resisting all claims in accordance with each Company's policy and procedures
- establishing loss reserves for each claim as deemed necessary in accordance with each Company's policy and procedures
- providing all information systems service requirements
- preparing business plans
- actuarial services
- assisting in the arrangement of appropriate insurance for insurance company operations
- payroll administration
- benefit administration
- employee relations
- regulatory and financial compliance
- facilities operations

- legal services
- coordination of loss prevention services
- furnishing assistance and professional consultation to insured's
- developing and conducting training programs
- maintaining CME accreditation

TMAC can use the employees of the companies, consultants, advisors, investment managers or third-parties at any time to perform any of the aforementioned services. The companies involved will make all of its resources available to TMAC and TMAC will do the same. Direct and indirect expenses will be allocated as determined by the Expense Allocation Agreement that was signed simultaneously with this agreement. TMAC should not charge any management fee, commission or override for performing the services outlined in the agreement.

\* Services provided for insurance companies only.

### *Expense Allocation Agreement*

The agreement, effective January 1, 2007, was by and between ProAssurance Corporation (PRA) and its subsidiaries. This agreement was amended in July 2007.

The companies determined that it would be more efficient and effective if certain operational services were combined and provided by the employees and managers of The Medical Assurance Company, Inc. (TMAC).

This agreement defines the types of expenses involved (direct and indirect) and establishes the method of allocation for these expenses. Direct expenses are defined as those expenses arising from services performed by employees of the companies or outside vendors that can be identified as being applicable to one specific company. Whereas indirect expenses are defined as those expenses arising from services performed by employees of the companies or vendors for the benefit of one or more companies and cannot be identified as applicable to one company.

Direct expenses will be allocated to the company incurring the expenses. Indirect expenses will be allocated during each accounting period on a closely estimated basis. Indirect expenses will be allocated in a fair and reasonable method in conformity with customary insurance accounting practices and the method will be consistently applied.

These expenses (indirect and direct) will be settled on a quarterly basis. This agreement will continue in-force unless amended or modified in writing by all of the companies involved.

### *Retirement of Chief Executive Officer*

Aubrey Derrill Crowe, M.D. retired as Chief Executive Officer (CEO) of ProAssurance Corporation effective June 30, 2007. Dr. Crowe will continue to serve as Chairman of the Board in a non-executive capacity. William Stancil Starnes was named the new CEO effective July 1, 2007.

### *Reinsurance Intermediary*

ProAssurance Corporation entered into a new reinsurance intermediary agreement, on July 13, 2007, effective October 1, 2007, authorizing Towers Perrin Forster & Crosby, Inc. to solicit, negotiate, and procure reinsurance for the ProAssurance group of companies. The agreement appears to meet all statutory requirements.

## COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

A review was conducted during the current examination with regard to the Company's compliance with the recommendations made in the previous examination report. This review indicated that the Company complied with the prior recommendations.

## IMPORTANT POINTS, COMMENTS AND RECOMMENDATIONS

### Accounts and Records – Page 17

It is recommended that the Company complete and maintain a Corporate Level Business Continuity Plan.

It is recommended that the Company put in place a procedure whereby the system administrators keep a log of changes that are made using the superuser account and additionally a second login should be used for normal job duties. The Company should review the list of employees with superuser access and limit to those with an absolute need. Secondary accounts should be created for those remaining on the list for use only when production data must be accessed. This will allow for tracking of all changes made to production data through the maintaining and reviewing a log of such changes.

**It is recommended** that management maintain documentation of the initial review of the financial condition and controls of outside agents or others who handle premiums.

**It is recommended** that the Company amend its record retention policy to maintain all records for not less than 5 years in accordance with the requirements of ALA. ADMIN. CODE 482-1-118-.03 (1999).

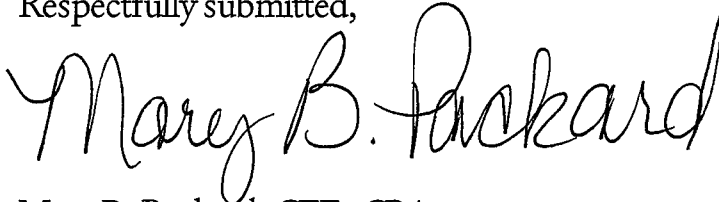
## CONCLUSION

Acknowledgment is hereby made of the courteous cooperation extended by the officers and employees of the Company during the course of this examination.

The customary insurance examination procedures, as recommended by the NAIC have been followed to the extent appropriate in connection with the verification and valuation of assets and determination of liabilities set forth in this report.

In addition to the undersigned, Lori Wright; Juliette Glenn; Charles Turner; Mora Perkins; Toni Bean; Janice Palmer, CPA, CFE, CPCU; Randall D. Ross, ACAS, MAAA, Consulting Actuary; Jenny Jeffers, CISA, AES and Joe Detrick, AFE, AES, CPA, CISA, Consulting Information Technology Specialists, all represented the Alabama Department of Insurance. David L. Daulton, CFE; Ed Fossa; Tim Oglesby and Nancy Ukairo represented the District of Columbia Department of Insurance, Securities and Banking.

Respectfully submitted,



Mary B. Packard, CFE, CPA  
Examiner-in-Charge  
Department of Insurance  
State of Alabama Department of Insurance  
Southeastern Zone, NAIC