

REPORT OF EXAMINATION

OF

**PROASSURANCE SPECIALTY INSURANCE COMPANY, INC.**

**BIRMINGHAM, ALABAMA**

AS OF

DECEMBER 31, 2010

**PARTICIPATION:**

**SOUTHEASTERN ZONE  
ALABAMA**

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**EXAMINER'S AFFIDAVIT**

**STATE OF ALABAMA  
COUNTY OF JEFFERSON**

Mary B. Packard, CPA, CFE, being duly sworn, states as follows:

1. I have authority to represent Alabama in the examination of ProAssurance Specialty Insurance Company, Inc.
2. Alabama is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
3. I have reviewed the examination workpapers and examination report, and the examination of ProAssurance Specialty Insurance Company, Inc. was performed in a manner consistent with the standards and procedures required by the State of Alabama.

The affiant says nothing further.

Mary B. Packard

Examiner-in-Charge

Subscribed and sworn before me by Mary B. Packard on this  
30<sup>th</sup> day of March.

(SEAL)

[Signature]

(Signature of Notary Public)

My commission expires 4/28/13.



ROBERT BENTLEY  
GOVERNOR

JIM L. RIDLING  
COMMISSIONER

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
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DEPUTY COMMISSIONER  
CHARLES M. ANGELL (acting)  
CHIEF OF STAFF  
RAGAN INGRAM  
CHIEF EXAMINER  
RICHARD L. FORD  
STATE FIRE MARSHAL  
EDWARD S. PAULK  
GENERAL COUNSEL  
REYN NORMAN

March 30, 2012

Honorable Jim L. Ridling, Commissioner  
Alabama Department of Insurance  
201 Monroe Street, Suite 502  
Montgomery, Alabama 36104

Dear Commissioner Ridling:

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

**PROASSURANCE SPECIALTY INSURANCE COMPANY, INC.**

at its home office located at 100 Brookwood Place, Birmingham, Alabama 35209, as of December 31, 2010. The Report of Examination is submitted herewith. Where the description "Company" or "PRA Specialty" appears herein without qualification, it will be understood to indicate ProAssurance Specialty Insurance Company, Inc.

## SCOPE OF EXAMINATION

The Company was last examined for the four-year period ended December 31, 2006, by examiners from Alabama, representing the Southeastern Zone, NAIC and by examiners from the District of Columbia, representing the Northeast Zone, NAIC. The current examination was conducted as a coordinated examination with ProAssurance Indemnity Company, Inc. (PRA Indemnity) of Birmingham, Alabama; ProAssurance Casualty Company (PRA Casualty) of Okemos, Michigan; ProAssurance Wisconsin Insurance Company (PRA Wisconsin) of Madison, Wisconsin; and ProAssurance National Capital Insurance Company (PRA National Capital) of the District of Columbia. Where deemed appropriate, transactions subsequent to 2010 were reviewed.

The examination was conducted in accordance with applicable statutory requirements of the *Code of Alabama, 1975*, as amended, the Alabama Insurance Department regulations, bulletins and directives and in accordance with the procedures and guidelines promulgated by the NAIC, as deemed appropriate, and in accordance with generally accepted examination standards and practices. The examination was conducted in accordance with the NAIC *Financial Condition Examiners Handbook*. The examination was planned and performed to evaluate the financial condition of the companies as of December 31, 2010, and to identify prospective risks by obtaining information about the companies, including the corporate governance of holding company, ProAssurance Corporation (PRA Corp.), by identifying and assessing inherent risks within the companies and by evaluating system controls and procedures used to mitigate those risks. The examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with statutory accounting principles and annual statement instructions.

The Company's annual statements for each year under examination (2007 through 2010) were compared with or reconciled to the corresponding general ledger account balances.

An examination of PRA Corp.'s information systems (IS) was conducted prior to the financial examination. The scope of this examination was developed using Exhibit C of the NAIC 2010 Financial Condition Examiner's Handbook and ISACA Cobit 4.1 domains: (1) Monitor & Evaluate, (2) Plan & Organize, (3) Acquire & Implement, and (4) Deliver & Support. The objectives of the examination included (a) identify IT inherent and prospective risks, (b) analyze mitigating controls, (c) determine residual IT Risks, (d) identify non-compliance

with regulatory criteria, and (e) provide regulatory and corporate management follow-up recommendations. See “**ACCOUNTS AND RECORDS**” on page 21 for further discussion of the IS examination.

A market conduct examination was performed concurrently with the financial examination. The examination included reviews of PRA Specialty’s territory and plan of operation, management and operations, claims, complaint handling, marketing and sales, agents’ licensing, underwriting and rating, and privacy standards. See “**MARKET CONDUCT ACTIVITIES**” on page 18 for further discussion of the market conduct examination.

PRA Corp., ultimate parent, maintains an Internal Audit (IA) Department, which is charged with performing the internal audit function for all companies within the holding company system. The IA Department is subject to oversight by PRA Corp.’s Audit Committee which is comprised of all outside directors. Reports generated by the IA Department were made available to the examiners and were used in the examination as deemed appropriate. In addition, the IA Department is responsible for the testing and documentation of all processes, the risks for each, and all mitigating controls over those risks as required by Sarbanes-Oxley (SOX) 404. The examiners reviewed the processes tested and requested the workpapers for specific ones which had been identified as significant to the key activities and sub-activities being examined. The workpapers were provided and were utilized where deemed appropriate.

Ernst & Young, LLP was the Company’s certified public accountants (CPAs) for the four years under examination. The examiners reviewed the CPAs’ workpapers for all years, copies of which were incorporated into the examination as deemed appropriate.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attested to having valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2010.

## **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. (Red Mountain).

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.

On May 7, 2007, the Company's then immediate parent, PGI, was merged into PRA Professional Liability Group, Inc., another subsidiary of ProAssurance Corporation.

On December 1, 2008, PRA Casualty and PRA Specialty updated the Quota Share Reinsurance Agreement in order to add a provision which would allow for a reinsurance trust and to clarify the language contained in the agreement.

Effective December 15, 2008, Red Mountain changed its name to ProAssurance Specialty Insurance Company, Inc.

On March 1, 2010, PRA Casualty and PRA Specialty updated the Quota Share Reinsurance Agreement in order to increase the ceding commission and reflect the current Company names.

At December 31, 2010, the Company had 8,000,000 shares of \$1 par value common stock authorized of which 3,000,000 were issued and outstanding. The Company had no preferred stock authorized, issued or outstanding. The gross paid in and contributed surplus of the Company was \$12,455,528.

## **MANAGEMENT AND CONTROL**

### **Shareholder**

At December 31, 2010, the Company was a stock corporation with control vested in its stockholder. The Company was a wholly owned subsidiary of PRA Professional Liability Group, Inc., which was 100% owned by ProAssurance Corporation (PRA Corp.), a Delaware stock corporation.

### **Board of Directors**

Directors are elected for one year terms by the shareholder. Directors serving at December 31, 2010 were as follows:

| <b><u>Director/Residence</u></b>               | <b><u>Office</u></b>  |
|--|---|
| William Stancil Starnes<br>Birmingham, Alabama | Chairman  |
| Victor Thomas Adamo<br>Birmingham, Alabama     | Vice Chairman   |
| Howard Harley Friedman<br>Timonium, Maryland   | Director, President and<br>Chief Underwriting Officer       |
| Edward Lewis Rand, Jr.<br>Birmingham, Alabama  | Director, Senior Vice President and<br>Treasurer            |
| Darryl Keith Thomas<br>Hoover, Alabama         | Director, Senior Vice President and<br>Chief Claims Officer |

## Committees

### *Executive Committee*

Members of the Executive Committee at December 31, 2010 consisted of the following directors:

William Stancil Starnes  
Howard Harley Friedman

### *Investment Committee*

Members of the investment committee at December 31, 2010 consisted of the following directors and officers:

William Stancil Starnes  
Victor Thomas Adamo  
Howard Harley Friedman  
Darryl Keith Thomas  
Edward Lewis Rand, Jr.

## Officers

Officers are elected annually by the Board of Directors. Principal officers elected and serving at December 31, 2010 were:

| <u>Officer</u>              | <u>Title</u>   |
|-----------------------------|--|
| William Stancil Starnes     | Chairman   |
| Victor Thomas Adamo         | Vice Chairman  |
| Howard Harley Friedman      | President and Chief Underwriting Officer                               |
| Edward Lewis Rand, Jr.      | Senior Vice President and Treasurer                                    |
| Darryl Keith Thomas         | Senior Vice President, Chief Claims Officer and<br>Assistant Secretary |
| Hayes Vance Whiteside, M.D. | Senior Vice President  |
| Kathryn Anne Neville        | Vice President and Secretary   |
| Kelly Bounds Brewer         | Vice President and Assistant Treasurer                                 |
| Jeffrey Patton Lisenby      | Vice President, Assistant Secretary and<br>Assistant Treasurer         |
| Desmond Patrick O'Doherty   | Vice President, Managing Director                                      |
| Philip Rhett Plugge         | Controller   |

## **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 Bylaws were amended and restated in 2008 to reflect the change of the Company's name to ProAssurance Specialty Insurance Company, Inc. The documents were approved by the Board of Directors on November 10, 2008. The Articles were filed with the Judge of Probate, State of Alabama – Jefferson County on December 24, 2008. The Bylaws were certified by the Company's Secretary on November 10, 2008. Both documents were received by the Alabama Department of Insurance on February 5, 2009.

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 no dividends to its stockholder during the period covered by this examination.

### **Management and Service Agreements**

#### *Consolidated Tax Allocation Agreement*

The consolidated tax allocation agreement executed on December 1, 2010, by and between ProAssurance Corporation (PRA Corp.) and the following subsidiaries

(hereinafter referred to as “member” or “members”); succeeded the agreement, dated April 17, 2009, as amended July 1, 2009:

- PRA Professional Liability Group, Inc.
- ProAssurance Group Services Corporation
- American Physicians Service Group, Inc.
- ProAssurance Indemnity Company, Inc.
- IAO, Inc. (d/b/a ProAssurance Agency)
- ProAssurance Casualty Company
- ProAssurance Specialty Insurance Company, Inc.
- American Insurance Management Corp.
- PRA Services Corporation
- ProAssurance Wisconsin Insurance Company
- ProAssurance National Capital Insurance Company
- ProAssurance Mid-Continent Underwriters, Inc.
- Podiatry Insurance Company of America
- PACO Assurance Company, Inc.
- PRA Group Holdings, Inc.
- PICA Management Resources, Inc.
- PICA Group Services, Inc.
- American Physicians Management Consulting, Inc.
- APS Insurance Services, Inc.
- APS Investment Services, Inc.
- American Physicians Insurance Company
- APS Professional Liability Insurance Agency, Inc.
- American Physicians Insurance Agency, Inc.
- APS Capital Corporation
- APS Financial Corporation
- APMC Financial Services, Inc.

PRA Corp. allocates the consolidated tax liability among the members in accordance with the ratio for which that portion of the consolidated taxable income attributable to each member having taxable income bears to the consolidated taxable income. Each member will pay all amounts due to PRA Corp. within thirty days of the notice date. In lieu of actual payments, adjustments to intercompany payables and receivables will be made if such exist.

Any member having losses or tax credits in a given year, resulting in reduced taxes for the other members, will be reimbursed by the members receiving the tax reduction. Generally, reimbursement for the tax benefit of losses or tax credits will be made in the form of a reduction to intercompany payables. If the tax benefit exceeds the intercompany payable, an actual cash payment will be made.

Payments for additional tax amounts; reimbursement for overpayments; or adjustments for underpayments will be made within thirty days of the notice date. Changes in the amount of a member's tax liability and the reimbursement payment will be considered an intercompany liability or receivable and not a dividend or surplus contribution.

This agreement contained standard provisions regarding indemnification, severability and the ability to amend the agreement.

This agreement is effective until terminated by the mutual agreement of all the members. In the event any member ceases to be affiliated with the group, this agreement is automatically terminated as to that corporation.

#### *Expense Allocation Agreement*

Effective, May 1, 2009, this agreement was by and between ProAssurance Corporation (PRA Corp.) and the following subsidiaries (hereinafter referred to as "company" or "companies"):

- PRA Professional Liability Group, Inc.
- ProAssurance Indemnity Company, Inc.
- IAO, Inc. (d/b/a ProAssurance Agency)
- Medical Assurance of Indiana Agency, Inc.
- Mutual Assurance Agency of Ohio, Inc.
- ProAssurance Group Services Corporation
- ProAssurance Casualty Company
- ProAssurance Specialty Insurance Company, Inc.
- American Insurance Management Corporation
- ProNational Insurance Agency, Inc.
- Physicians Protective Plan, Inc.
- PRA Services Corporation
- NCRIC Corporation
- ProAssurance National Capital Insurance Company
- National Capital Insurance Brokerage, Ltd.
- NCRIC Insurance Agency, Inc.
- NCRIC Physicians Organization, Inc.
- ProAssurance Wisconsin Insurance Company
- Professional Service Network, Inc.
- PSA of Wisconsin, Inc.
- PMC of Wisconsin, Inc.
- Mid-Continent General Agency, Inc.
- Podiatry Insurance Company of America
- PACO Assurance Company, Inc.

- PICA Management Resources, Inc.
- PICA Group Services, Inc.

Direct expenses are allocated to the company incurring the expense while indirect expenses are allocated during each accounting period based on an estimate. This estimate will be allocated in a fair and reasonable method in conformity with customary insurance accounting practices and applied consistently. Expenses for each calendar quarter will be settled within thirty days after the end of the calendar quarter.

The agreement contained the standard provisions regarding severability and the ability to amend. The agreement will remain in-force for subsequent calendar years unless amended or modified by all parties involved.

On July 1, 2009, the agreement was amended to include PRA Group Holdings, Inc. as a party to this agreement. As a result, there was a change to the participants as follows:

- NCRIC Physicians Organization was dissolved
- NCRIC Corporation was merged into PRA Professional Liability Group, Inc.
- PRA Group Holdings, Inc. was formed by, and as a subsidiary of, PRA Corp.
- PMC of Wisconsin, Inc. and PSA of Wisconsin, Inc. were merged with Professional Services Network, Inc.
- MCGA, Corp. was merged into PRA Professional Liability Group, Inc.
- Professional Service Network, Inc. was merged into PRA Group Holdings, Inc.

#### *Management Services Agreement*

Effective, May 1, 2009, this agreement was by and between ProAssurance Corporation (PRA Corp.) and the following subsidiaries (hereinafter referred to as “company” of “companies”):

- PRA Professional Liability Group, Inc.
- ProAssurance Indemnity Company, Inc.
- IAO, Inc. (d/b/a ProAssurance Agency.)
- Medical Assurance of Indiana Agency, Inc.
- Mutual Assurance Agency of Ohio, Inc.
- ProAssurance Group Services Corporation
- ProAssurance Casualty Company
- ProAssurance Specialty Insurance Company, Inc.

- American Insurance Management Corporation
- ProNational Insurance Agency, Inc.
- Physicians Protective Plan, Inc.
- PRA Service Corporation
- NCRIC Corporation
- ProAssurance National Capital Insurance Company
- National Capital Insurance Brokerage, Ltd.
- NCRIC Insurance Agency, Inc.
- NCRIC Physicians Organization, Inc.
- ProAssurance Wisconsin Insurance Company
- Professional Service Network, Inc.
- PSA of Wisconsin, Inc.
- PMC of Wisconsin, Inc.
- Mid-Continent General Agency, Inc.
- Podiatry Insurance Company of America
- PACO Assurance Company, Inc.
- PICA Management Resources, Inc.
- PICA Group Services, Inc.

PRA Indemnity was responsible for providing the following management services to all parties involved:

- Accounting Services, Financial Statements, and Tax Returns
- Underwriting
- Reinsurance
- Sales and Service
- Claims Administration
- Information Systems
- Administrative and Other Services
- Human Resources Administration
- Risk Management

PRA Indemnity may: perform any service using the personnel of any of the parties to the agreement; delegate the performance of any service to any of the parties; or engage consultants, advisors, investment managers and other third parties as deemed necessary and appropriate to perform any service.

Direct and indirect expenses incurred are allocated as prescribed in the *Expense Allocation Agreement* on page 9, where this was documented. PRA Indemnity will not charge any management fee, commission or overrides for functioning as the service manager.

Annually, the Board of Directors for each company will review and approve the

scope of services to be provided and PRA Indemnity will report to each company the allocation of expenses as prescribed in the expense allocation agreement. The allocation of expenses is subject to the review and approval of the Board of Directors for each company. This agreement contained standard provisions regarding the ability to amend and severability.

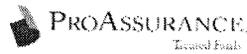
The agreement is automatically renewable for subsequent calendar years unless amended or modified by the parties to the agreement.

On July 1, 2009, the agreement was amended to include PRA Group Holdings, Inc., as a member to the agreement. As a result, there was a change to the participants as follows:

- NCRIC Physicians Organization, Inc. was dissolved
- NCRIC Corporation was merged into PRA Professional Liability Group, Inc.
- PRA Group Holdings, Inc. was formed by, and as a subsidiary of, PRA Corp.
- PMC of Wisconsin, Inc. and PSA of Wisconsin, Inc. were merged with Professional Services Network, Inc.
- MCGA, Corp. was merged into PRA Professional Liability Group, Inc.
- Professional Service Network, Inc. was merged into PRA Group Holdings, Inc.

### **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, 2010.



# ProAssurance Corporation

A Delaware Holding Corporation / FEIN: 63-1261433

## PRA Professional Liability Group, Inc.

A Delaware Holding Corporation (100%)  
FEIN: 01-0874962

### PACO Assurance Company, Inc.

An Illinois Stock Insurance Company (100%)  
FEIN: 36-3998471 / NAIC: 10222

### Podiatry Insurance Company of America

An Illinois Stock Insurance Company (100%)  
FEIN: 58-1403235 / NAIC: 14460

### PICA Management Resources, Inc.

A Tennessee Corporation (100%)  
FEIN: 62-1668162

### PICA Group Services, Inc.

A Tennessee Corporation (100%)  
FEIN: 62-1668160

### ProAssurance Casualty Company

f/k/a ProNational Insurance Company  
A Michigan Stock Insurance Corporation (100%)  
FEIN: 38-2317569 / NAIC: 38954

### ProAssurance General Insurance Company, Ltd.

f/k/a Professionals National Insurance Co., Ltd.  
Domiciled in Bermuda (100%)  
Company Registration No: EC-27597

### ProAssurance Indemnity Company, Inc.

f/k/a The Medical Assurance Company, Inc.  
An Alabama Stock Insurance Corporation (100%)  
FEIN: 63-0720042 / NAIC: 33391

### ProAssurance National Capital Insurance Company

f/k/a NCRIC, Inc.  
A District of Columbia Stock Insurance Company (100%)  
FEIN: 52-1194407 / NAIC: 41149

### ProAssurance Specialty Insurance Company, Inc.

f/k/a Red Mountain Casualty Insurance Company, Inc.  
An Alabama Stock Insurance Corporation (100%)  
FEIN: 36-3990058 / NAIC: 10179

### ProAssurance Wisconsin Insurance Company

f/k/a Physicians Insurance Co of Wisconsin, Inc.  
A Wisconsin Stock Insurance Corporation (100%)  
FEIN: 39-1567580 / NAIC: 23400

### American Insurance Management Corp.

An Indiana Corporation and Attorney in Fact for  
American Medical Insurance Exchange (100%)  
FEIN: 35-1749301

### American Medical Insurance Exchange

Domiciled in Indiana  
FEIN: 35-1756545 / NAIC: 31402

### ProAssurance Mid-Continent Underwriters, Inc.

A Texas Corporation (100%)  
FEIN: 76-0205255

### IAO, Inc. d/b/a ProAssurance Agency

An Alabama Insurance Agency (100%)  
FEIN: 63-0725911

### PRA Group Holdings, Inc.

A Delaware Holding Corporation (100%)  
FEIN: 27-0386608

### PRA Services Corporation

A Michigan Corporation (100%)  
FEIN: 38-2684456

### ProAssurance Group Services Corporation

An Alabama Corporation (100%)  
FEIN: 63-1285505

### American Physicians Service Group, Inc.

A Texas Corporation (100%)  
FEIN: 75-1458323

### APS Insurance Services, Inc.

A Delaware Corporation (100%)  
FEIN: 74-2692427

### American Physicians Insurance Company

A Texas Stock Insurance Company (100%)  
FEIN: 75-1517531 / NAIC: 32557

### APS Professional Liability Insurance Agency, Inc.

A Texas Corporation (100%)  
FEIN: 13-2838900

### American Physicians Insurance Agency, Inc.

A Texas Corporation (100%)  
FEIN: 75-1212528

### American Physicians Management Consulting, Inc.

A Texas Corporation (100%)  
FEIN: 42-1563806

### APMC Financial Services, Inc.

A Texas Corporation (100%)  
FEIN: 57-1169213

### APS Investment Services, Inc.

A Delaware Corporation (100%)  
FEIN: 74-2881896

### APS Capital Corporation

A Delaware Corporation (100%)  
FEIN: 20-2541581

### APS Financial Corporation

A Colorado Corporation (100%)  
FEIN: 74-2324164

## **FIDELITY BOND AND OTHER INSURANCE**

The Company was a named insured on a financial institution bond issued by Chubb Group of Insurance Companies, which met the suggested minimum requirements of the NAIC *Financial Condition Examiners Handbook*. The bond covered acts of dishonesty by employees and/or in a trade or loan; forgery and alteration; extended forgery; counterfeit money; and computer systems.

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

- Commercial Property
- Comprehensive General Liability
- Commercial Umbrella
- Excess Umbrella
- Flood Coverage - all locations
- Worker Compensation
- Business Auto
- International Liability Policy
- Trustee & Fiduciary Bond
- Directors & Officers
- Error & Omissions
- Corporate Travel Accident
- Employment Practice Liability
- Pension Plan Bond
- Cyber Security Coverage

## **PENSION, STOCK OWNERSHIP AND INSURANCE PLANS**

The Company has no employees of its own. The Company is part of a consolidated group of companies for which employees of ProAssurance Group Services Corporation (PRA Group Services), an affiliate, provide services. PRA Group Services sponsors a defined contribution plan for these employees and allocates amounts to the Company based on gross written premiums.

Under the PRA Group Services' defined contribution plan, eligible employees receive a base contribution of five percent of eligible wages. In addition, the Plan provides for matching contributions to the plan of up to five percent of eligible employees' salary. The Company's expense allocated under the Agreements for the

defined contribution plan for the year ended December 31, 2010, was approximately \$60,062.

The Company is also a participant in the ProAssurance Corporation (PRA Corp.) stock ownership plan for full-time and part-time employees who have completed minimum service requirements. The plan allows eligible officers, directors, and employees of PRA Corp. and its subsidiaries to purchase shares of PRA Corp.'s common stock through cash deposits deducted from compensation or by depositing previously owned shares. The Plan will provide matching shares using a matching formula in proportion to the employee's contribution after service requirements are met. The matching shares are vested and transferred to the employee. Effective January 1, 2011, employees are no longer permitted to deposit shares into the plan.

The Company's expense for the stock ownership plan was approximately \$23,313 for the year ended December 31, 2010. These expenses were higher than the 2009 expenses of \$14,970, due to the termination of the plan and the acceleration of vesting the benefits. PRA Corp. replaced the existing plan with a new plan with substantially similar features, which was effective January 1, 2011. The 2011 expenses will be allocated using the same methodology as the 2010 plan, and are expected to be minimal in 2011. The expenses will increase over a three-year period before stabilizing to reflect the vesting feature of the new plan.

PRA Group Services also allocates expenses to the Company for various health insurance and other benefits offered to its employees. PRA Group Services provides group health and dental benefits for eligible full-time and part-time regular employees and their eligible dependents. In addition, PRA Group Services provides life and long-term disability insurance to its eligible full-time regular employees.

## SCHEDULE OF SPECIAL DEPOSITS

The Company maintained the following deposits with the respective statutory authorities at December 31, 2010, as required or permitted by law.

| States and<br>Territories | Book Value          | Fair Value          |
|---------------------------|---------------------|---------------------|
| Alabama                   | \$ 2,616,435        | \$ 2,642,416        |
| Arkansas                  | 100,000             | 100,000             |
| Louisiana                 | 100,000             | 100,000             |
| Michigan                  | 99,120              | 101,961             |
| New Mexico                | 110,104             | 108,771             |
| Oklahoma                  | 110,104             | 108,772             |
| <b>TOTAL</b>              | <b>\$ 3,135,763</b> | <b>\$ 3,161,920</b> |

## FINANCIAL CONDITION/GROWTH OF THE COMPANY

|       | Admitted Assets | Liabilities  | Capital & Surplus | Premiums<br>Earned |
|-------|-----------------|--------------|-------------------|--------------------|
| 2010* | \$31,649,042    | \$5,736,001  | \$25,913,041      | \$0                |
| 2009  | \$32,371,101    | \$6,135,605  | \$26,235,496      | \$0                |
| 2008  | \$50,817,383    | \$25,246,624 | \$25,570,759      | \$0                |
| 2007  | \$53,442,256    | \$29,308,143 | \$24,134,113      | \$0                |
| 2006* | \$54,485,391    | \$33,018,395 | \$21,466,996      | \$0                |

\*Per Examination

## SCHEDULE T – EXHIBIT OF PREMIUMS WRITTEN

| <u>States</u>        | <u>Premiums</u>               | <u>States</u>  | <u>Premiums</u>             |
|----------------------|-------------------------------|----------------|-----------------------------|
| Alaska               | \$ 36,772                     | Nebraska       | \$ 157,087                  |
| Arizona              | 572,274                       | Nevada         | 192,712                     |
| Arkansas             | 465,972                       | New Jersey     | 720,936                     |
| Colorado             | 131,132                       | New Mexico     | 178,383                     |
| Delaware             | 134,645                       | North Carolina | 449,206                     |
| District of Columbia | 294,437                       | North Dakota   | 8,630                       |
| Florida              | 3,070,300                     | Ohio           | 1,279,955                   |
| Georgia              | 1,521,714                     | Oklahoma       | 290,804                     |
| Hawaii               | 79,640                        | Oregon         | 109,707                     |
| Idaho                | 81,978                        | Pennsylvania   | 462,214                     |
| Illinois             | 1,237,719                     | South Carolina | 240,521                     |
| Indiana              | 327,657                       | South Dakota   | 27,450                      |
| Iowa                 | 265,751                       | Tennessee      | 587,496                     |
| Kansas               | 102,686                       | Texas          | 2,520,137                   |
| Kentucky             | 435,970                       | Utah           | 195,702                     |
| Louisiana            | 741,928                       | Vermont        | 60,668                      |
| Maryland             | 535,531                       | Virginia       | 447,466                     |
| Michigan             | 939,977                       | Washington     | 263,259                     |
| Minnesota            | 199,763                       | West Virginia  | 90,065                      |
| Mississippi          | 746,245                       | Wisconsin      | 465,133                     |
| Missouri             | 203,424                       | Wyoming        | 36,494                      |
| Montana              | 60,194                        |                |                             |
|                      | <b>Total Premiums Written</b> |                | <b><u>\$ 20,969,734</u></b> |

## LOSS EXPERIENCE

Since the Company cedes 100% of its losses to ProAssurance Casualty Company, Transatlantic Reinsurance Company, Hannover Ruckversicherungs AG and Magna Carta, there is no loss experience to report.

## **MARKET CONDUCT ACTIVITIES**

### **Plan of Operations**

On December 31, 2010, the Company was licensed in the State of Alabama as a property and casualty insurer, offering surplus lines for professional liability insurance in states other than Alabama. Besides the traditional professional liability coverage, the Company offered innovative coverage for the emerging liability areas of electronic data and e-discovery. This included electronic medical record systems and the attendant risks.

The Company marketed its products through surplus line brokers and wholesalers outside of the State of Alabama.

The Company has entered into a 100% quota share agreement with ProAssurance Casualty Company, an affiliate.

### **Territory**

As of December 31, 2010, the Company wrote excess and surplus for professional liability in the following forty-three states:

|                      |             |                |               |
|----------------------|-------------|----------------|---------------|
| Alaska               | Indiana     | Nebraska       | South Dakota  |
| Arizona              | Iowa        | Nevada         | Tennessee     |
| Arkansas             | Kansas      | New Jersey     | Texas         |
| Colorado             | Kentucky    | New Mexico     | Utah          |
| Delaware             | Louisiana   | North Carolina | Vermont       |
| District of Columbia | Maryland    | North Dakota   | Virginia      |
| Florida              | Michigan    | Ohio           | Washington    |
| Georgia              | Minnesota   | Oklahoma       | West Virginia |
| Hawaii               | Mississippi | Oregon         | Wisconsin     |
| Idaho                | Missouri    | Pennsylvania   | Wyoming       |
| Illinois             | Montana     | South Carolina |               |

### **Policy Forms and Underwriting**

The Company, a surplus lines insurer licensed in Alabama, did not write business within the state, so there were no form filings in Alabama for the period under review.

### **Advertising and Marketing**

As an excess and surplus lines writer licensed in Alabama, the Company did not advertise for business within the state.

### **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 no complaints registered with the ALDOI.

### **Producers' Licensing**

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 producers in the state of Alabama and utilized the services of brokers and wholesalers in all other states.

### **Privacy Standards**

The examiners reviewed the Company's Privacy Procedures and determined the following:

1. The Company provides new employees with a copy of the Employee Handbook which contains the Code of Ethics. Also, included in the Code of Ethics is the Company's general policy on Confidential Information as well as its requirements under HIPAA. All employees are expected to comply with all federal and state laws and regulations applicable to the Company's businesses and policies. The employees are required to sign the Employee Handbook Acknowledgment Form.
2. The Company has safeguards in its data system to prevent unauthorized access to nonpublic and personal information.
3. The Company sends an initial privacy notice with every new policy and at renewal.

4. The Company does not disclose any nonpublic information, which includes personal health and financial information, on its policyholders unless required by law. For this reason, the Company does not need to provide opt-out statements to its policyholders.

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

## **REINSURANCE**

### **Reinsurance Assumed**

As of December 31, 2010, the Company did not assume any reinsurance business.

### **Reinsurance Ceded**

As of December 31, 2010, a 100% Quota Share treaty was in effect between the Company as Reinsured and PRA Casualty as Reinsurer. The treaty had an effective date of March 1, 2010 and no expiration date. The treaty covered all policies written or renewed by the Company with the exception of finite risk policies subject to deposit accounting and policies for which the Company arranged reinsurance on a specific basis. The Reinsurer assumed 100% of the gross liability on the risks covered. The gross liability assumed by the Reinsurer for a loss in Excess of Policy Limits or Extra Contractual Obligation shall be limited to \$1,000,000. The Company ceded \$20,542,000 in premiums and had recoverables totaling \$34,019,000.

In addition to the quota share treaty, the Company had treaties with three other reinsurers which at December 31, 2010, accounted for 2% of the ceded premiums and 2.4% of the recoverables. The treaties were as follows:

- Transatlantic Reinsurance Company - an excess of loss treaty for \$4 million excess of \$1 million for which the Company ceded \$412,000 in premiums and had recoverables totaling \$291,000.
- Hannover Ruckversicherungs AG - a facultative treaty for which the Company ceded \$16,000 in premiums and had \$11,000 in recoverables.
- Magna Carta - treaty was in run-off. The Company had \$542,000 in recoverables.

The review of the Company's reinsurance treaties disclosed no unusual provisions.

## ACCOUNTS AND RECORDS

The Company's principal accounting records were maintained primarily on electronic data processing (EDP) equipment. The Company uses the Oasis system to maintain files on claims and underwriting, including premiums. This system interfaces with the Company's SunSystem general ledger as needed. The Company uses other systems for investments, reinsurance and processing legal firms' invoices.

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 Towers Watson, Atlanta, Georgia, was retained by the Company throughout the examination period and prepared the 2010 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.

## 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 examination for the year 2010. Amounts shown in the comparative statements for the years 2007, 2008, 2009 and 2010 were compiled from Company copies of filed Annual Statements. The statements are presented in the following order:

|  |    |
|--|----|
| Statement of Assets, Liabilities, Surplus and Other Funds (Assets) .....     | 22 |
| Statement of Assets, Liabilities, Surplus and Other Funds (Liabilities)..... | 23 |
| Statement of Income.....   | 24 |

**ProAssurance Specialty Insurance Company, Inc.**  
**Statement of Assets, Liabilities, Surplus and Other Funds**  
**For the Year Ended December 31, 2010**

|  | <u>Assets</u>               | <u>Nonadmitted<br/>Assets</u> | <u>Net Admitted<br/>Assets</u> |
|--|-----------------------------|-------------------------------|--------------------------------|
| Bonds  | \$ 24,434,654               | \$ -                          | \$ 24,434,654                  |
| Cash, cash equivalents and short-term investments                        | 4,714,846                   | -                             | 4,714,846                      |
| Subtotal, cash and invested assets                                       | \$ 29,149,500               | \$ -                          | \$ 29,149,500                  |
| Investment income due and accrued  | 194,807                     | -                             | 194,807                        |
| Premium considerations:  |                             |                               |                                |
| Uncollected premiums and agents' balances in<br>the course of collection | 521,119                     | 75,104                        | 446,015                        |
| Reinsurance:   |                             |                               |                                |
| Amounts recoverable from reinsurers                                      | 626,036                     | -                             | 626,036                        |
| Net deferred tax asset   | 101,179                     | 26,421                        | 74,758                         |
| Receivable from parent, subsidiaries<br>and affiliates                   | 1,157,926                   | -                             | 1,157,926                      |
| Prepaid other taxes and fees   | 2,946                       | 2,946                         | -                              |
| <b>TOTAL</b>   | <b><u>\$ 31,753,513</u></b> | <b><u>\$ 104,471</u></b>      | <b><u>\$ 31,649,042</u></b>    |

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN  
INTEGRAL PART THEREOF.

**ProAssurance Specialty Insurance Company, Inc.**  
**Statement of Assets, Liabilities, Surplus and Other Funds (Continued)**  
**For the Year Ended December 31, 2010**

| <u>LIABILITIES</u>  | <u>2010</u>          |
|---|----------------------|
| Loss adjustment expenses  | \$ 1,230,000         |
| Commissions payable, contingent commissions and other similar charges                         | 4,281                |
| Other expenses  | 37,239               |
| Taxes, licenses and fees  | 46,139               |
| Current federal and foreign income taxes  | 160,302              |
| Unearned premiums (after deducting unearned premiums for<br>ceded reinsurance of \$8,515,945) | -                    |
| Advance premiums  | 43,554               |
| Ceded reinsurance premiums payable  | 2,999,059            |
| Amounts withheld or retained by company for account of others                                 | 379,059              |
| Provision for reinsurance   | 399,000              |
| Payable to parent, subsidiaries and affiliates  | 248,618              |
| Unearned fee income   | 188,750              |
| <b>TOTAL LIABILITIES</b>  | <b>\$ 5,736,001</b>  |
| <br>  |                      |
| <u>CAPITAL AND SURPLUS</u>  |                      |
| Common capital stock  | \$ 3,000,000         |
| Gross paid in and contributed surplus   | 12,466,528           |
| Unassigned funds (surplus) (Note 1)   | 10,446,513           |
| Surplus as regards policyholders  | \$ 25,913,041        |
| <b>TOTAL LIABILITIES, CAPITAL AND SURPLUS</b>   | <b>\$ 31,649,042</b> |

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN  
INTEGRAL PART THEREOF.

**ProAssurance Specialty Insurance Company, Inc.**  
**Statement of Income**  
**For the Years Ended December 31, 2010, 2009, 2008 and 2007**

|   | <u>2010</u>                        | <u>2009</u>                        | <u>2008</u>                        | <u>2007</u>                        |
|---|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| <b><u>Underwriting income</u></b>   |                                    |                                    |                                    |                                    |
| Premiums earned   | \$ -                               | \$ -                               | \$ -                               | \$ -                               |
| <b><u>Deductions:</u></b>   |                                    |                                    |                                    |                                    |
| Losses incurred   | -                                  | -                                  | -                                  | -                                  |
| Loss expenses incurred  | 1,081,218                          | 408,829                            | 236,881                            | 200,400                            |
| Other underwriting expenses incurred  | 73,291                             | 586,017                            | 47,618                             | 362,023                            |
| Total underwriting deductions   | <u>\$ 1,154,509</u>                | <u>\$ 994,846</u>                  | <u>\$ 284,499</u>                  | <u>\$ 562,423</u>                  |
| <b>Net underwriting gain (loss)</b>   | <b><u>\$ (1,154,509)</u></b>       | <b><u>\$ (994,846)</u></b>         | <b><u>\$ (284,499)</u></b>         | <b><u>\$ (562,423)</u></b>         |
| <b><u>Investment income</u></b>   |                                    |                                    |                                    |                                    |
| Net investment income earned  | \$ 774,441                         | \$ 1,085,947                       | \$ 2,027,807                       | \$ 2,379,842                       |
| Net realized capital gains (losses)   | 42,113                             | (134,084)                          | (75)                               | (30)                               |
| <b>Net investment gain (loss)</b>   | <b><u>\$ 816,554</u></b>           | <b><u>\$ 951,863</u></b>           | <b><u>\$ 2,027,732</u></b>         | <b><u>\$ 2,379,812</u></b>         |
| <b><u>Other income</u></b>  |                                    |                                    |                                    |                                    |
| Net gain (loss) from agents' or premium<br>balances charged off               | \$ (104,347)                       | \$ (41)                            | \$ (4)                             | \$ -                               |
| Finance and service charges not included in premiums                          | 2,500                              | -                                  | -                                  | -                                  |
| Fee income  | 216,250                            | 306,150                            | 1,280,671                          | 1,849,433                          |
| Client risk survey income   | -                                  | -                                  | 7,000                              | 5,000                              |
| Miscellaneous income  | 2,000                              | 1,000                              | 14,162                             | -                                  |
| <b>Total other income</b>   | <b><u>\$ 116,403</u></b>           | <b><u>\$ 307,109</u></b>           | <b><u>\$ 1,301,829</u></b>         | <b><u>\$ 1,854,433</u></b>         |
| Net income before dividends and all other<br>federal and foreign income taxes | \$ (221,552)                       | \$ 264,126                         | \$ 3,045,062                       | \$ 3,671,822                       |
| Federal and foreign income taxes incurred                                     | <u>(106,387)</u>                   | <u>105,695</u>                     | <u>967,631</u>                     | <u>1,359,391</u>                   |
| <b>NET INCOME</b>   | <b><u><u>\$ (115,165)</u></u></b>  | <b><u><u>\$ 158,431</u></u></b>    | <b><u><u>\$ 2,077,431</u></u></b>  | <b><u><u>\$ 2,312,431</u></u></b>  |
| <b><u>Capital and Surplus Account</u></b>                                     |                                    |                                    |                                    |                                    |
| Surplus as regards policyholders, prior year                                  | \$ 26,235,496                      | \$ 25,570,759                      | \$ 24,134,113                      | \$ 21,466,995                      |
| Net income  | (115,165)                          | 158,431                            | 2,077,431                          | 2,312,431                          |
| Change in net deferred income tax   | (42,694)                           | 2,000                              | 110,671                            | (34,165)                           |
| Change in nonadmitted assets  | (38,596)                           | 285,306                            | (318,456)                          | 13,852                             |
| Change in provision for reinsurance   | (126,000)                          | 219,000                            | (433,000)                          | 375,000                            |
| Change in surplus as regards policyholders                                    | <u>\$ (322,455)</u>                | <u>\$ 664,737</u>                  | <u>\$ 1,436,646</u>                | <u>\$ 2,667,118</u>                |
| <b>Surplus as regards policyholders,<br/>December 31, current year</b>        | <b><u><u>\$ 25,913,041</u></u></b> | <b><u><u>\$ 26,235,496</u></u></b> | <b><u><u>\$ 25,570,759</u></u></b> | <b><u><u>\$ 24,134,113</u></u></b> |

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN  
INTEGRAL PART THEREOF.

## NOTES TO FINANCIALS

### Note 1 – Unassigned funds (surplus)

\$10,446,513

The above captioned amount is the same as reported in the 2010 Annual Statement.

There were no material adjustments made, and the immaterial items were not material in the aggregate.

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                | \$10,446, 513       |
| Examination increase/ (decrease) to assets: _____     | 0                   |
| Total increase/ (decrease) to assets                  | _____ 0             |
| Examination (increase)/decrease to liabilities: _____ | 0                   |
| Total (increase)/decrease to liabilities:             | _____ 0             |
| Unassigned funds (surplus) per Examination            | <u>\$10,446,513</u> |

## CONTINGENT LIABILITIES AND PENDING LITIGATION

The review of contingent liabilities and pending litigation included an inspection of representations made by management to the Company's independent certified public accountants regarding the Company and its affiliates, a review of the report on litigation and claims made by the Company's counsel to the Company's independent certified public accountants, a review of the 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 except for the review of February 16, 2012 memorandum to the CPAs from Jeff Lisenby, General Counsel, that disclosed a complaint against the Company that may have a material effect. The plaintiff recently amended the complaint to name Red Mountain Casualty Insurance Company, Inc. (d/b/a PRA Specialty) as a defendant. The amended complaint was filed June 29, 2011 and the expected verdict range is 0 to \$500,000.

## **SUBSEQUENT EVENTS**

At the August 25, 2011, PRA Specialty's Board of Directors (Board) meeting, the Board granted authority to the officers of the Company to: (a) determine if and when, making or receiving either a capital contribution or a short term intercompany loan would be the most efficient and cost effective way to resolve current cash flow needs of an affiliate and (b) enter into such transactions. The Board resolved that the amount of the capital contribution or short-term intercompany loans may not exceed \$750,000 in the aggregate, without specific Board approval of the transaction.

## **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**

There were no important points, comments or recommendations reported.

## 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, the following examiners, representing the respective Departments of Insurance, participated in certain phases of this examination:

Alabama Department of Insurance (Lead State):

|                   |                      |
|-------------------|----------------------|
| Lori Brock, CFE   | Robert Thompson      |
| Toni Bean, CFE    | Charles Turner, CISA |
| Mora Perkins, MCM |                      |

Michigan Office of Financial and Insurance Regulation:

|                       |                    |
|-----------------------|--------------------|
| Abigail L. Perry, CFE | Mark Laccetti, CPA |
| Jennifer Cox          |                    |

District of Columbia Department of Insurance, Securities and Banking:

|                            |                      |
|----------------------------|----------------------|
| David C. Schleit, CFE, CPA | Chauvin Alleman, CFE |
|----------------------------|----------------------|

Wisconsin Office of the Commissioner of Insurance:

|                  |                          |
|------------------|--------------------------|
| DuWayne Kottwitz | Ana Careaga              |
| Angelita Romaker | Victoria Chi, CISA, CISM |

Merlinos & Associates, Inc. was contracted to perform the actuarial portions of this examination. The actuaries were as follows:

|                                    |                             |
|------------------------------------|-----------------------------|
| Suejeudi (Sue) Buehler, FCAS, MAAA | Rebecca Freitag, ACAS, MAAA |
| Jeremy Hoch, ACAS, MAAA            |                             |

Respectfully submitted,



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