An Analysis

of the

Conduct, Performance and Financial Condition

of

NCRIC, Inc.,

2000-2004

by

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Executive Summary

This Report analyzes the performance of NCRIC, Inc. ("NCRIC") based on the Annual Statements and rate filings it has filed with the District of Columbia Department of Insurance, Securities and Banking ("Department"); its filings with the United States Securities and Exchange Commission ("SEC"); and other data NCRIC has made public in its annual reports to policyholders and on its website.

The Report first reviews NCRIC's Annual Statements filed with the D.C. Department for the last five years. According to the data contained in those Statements:

* Between 2000 and 2004 NCRIC increased its premiums by 51% in D.C. even though
  - its total paid claims in D.C. declined by 9%;
  - its average claim in D.C. declined by 28%; and
  - its estimated future claims for D.C.declined by 3%.

* In 2004 NCRIC's D.C. business was substantially more profitable than its Virginia or Maryland business.

* NCRIC has historically paid out 28% less on a given year's policies than it initially projected it would pay out. As a result, NCRIC's rates--which are based on its projections, not its actual payouts--have historically been excessive.

The Report also reviews NCRIC's rate increases filed with the D.C. Department, and the law governing those filings. The Report finds:

* Under D.C. law NCRIC, like all malpractice insurers, can raise its rates at will, without having those rates approved by the Department.

* The D.C. Department does have authority to disapprove a medical malpractice rate after it takes effect, but the Department has never exercised that authority.

* The Department has no authority to order refunds to doctors who have paid excessive malpractice rates.

* The D.C. Department does not disclose to the public the data which NCRIC relies on to support its proposed rate increases, although virtually all other state insurance departments do disclose such data.

The Report also reviews NCRIC's filings with the SEC, which contain information not found in its Annual Statements. For example, NCRIC notes in its SEC filings that it has authorized more than $2 million in stock for its officers and directors, and another $2 million in change-of-control payments for its three top executives if they are terminated in connection with the proposed acquisition of NCRIC by ProAssurance Corporation ("ProAssurance"). NCRIC's SEC filings also disclose that NCRIC has lost money in seeking to expand into businesses other than insurance, such as accounting, financial services and payroll services. In addition, NCRIC acknowledges in its 2004 Annual Report--called a "10-K"--several facts that malpractice insurers generally do not acknowledge. Specifically, NCRIC states in its 10-K

* that incurred losses are not actual claims payments, but rather estimates of future claims payments that may never actually be made;

* that the cyclical nature of the insurance industry is responsible for periodic malpractice rate increases;

* that changes in investment income significantly affect its operating results;

* that reinsurance limits its liability for large claims; and

* that the medical malpractice insurance business is highly competitive.

Finally, this Report discusses three major events in the history of NCRIC that have received little scrutiny, but that are likely to have major effects on NCRIC's policyholders. The first is the February 2004 $18.2 million verdict against NCRIC and in favor of Columbia Hospital for Women

that resulted, ironically, from litigation that NCRIC itself had initiated against the hospital. That $18.2 million is far more than NCRIC has ever paid to all victims of malpractice in D.C. in any year. The second major event is NCRIC's conversion, through a multi-step process, from a reciprocal company owned by its policyholders to a stock company owned by investors. Although policyholders typically receive cash or stock in connection with such conversions, NCRIC policyholders received neither. Finally, in February 2005 NCRIC and ProAssurance, the nation's fourth largest malpractice insurer, agreed to merge. That merger must be approved by the D.C. Department, which is holding a hearing on the proposed transaction on June 6, 2005. Notably, ProAssurance has increased its premiums substantially in recent years even though both its claims payments and its projected future claims payments have declined substantially. Should the Department approve ProAssurance's acquisition of NCRIC, therefore, it is reasonable to expect that rates for D.C. doctors could rise even while malpractice claims payments in the District continued to fall.

I. Introduction

A. Methodology

This Report analyzes the performance of NCRIC based on the data it has filed with the D.C. Department of Insurance and the U.S. Securities and Exchange Commission, as well as on the data contained in NCRIC's Annual Reports to its policyholders and shareholders, public statements NCRIC has made, and information that appears on NCRIC's website and affiliated websites.

The Report is divided into four parts. First, the Report analyzes the Annual Statements NCRIC has filed with the D.C. Department for the last five years, in order to determine whether its medical malpractice premiums are justified by either its actual claims payments or its estimated future claims payments. Second, it discusses the rate increases NCRIC has filed with the Department, the law applicable to those increases, and the manner in which the Department has dealt with those increases. Third, the Report analyzes NCRIC's 2004 Annual Report--its 10-K--and other filings it has made with the SEC, both to determine the areas in which NCRIC's SEC filings supplement its Annual Statement, and to examine any differences between NCRIC's statements in its SEC filings and the positions generally taken by the medical malpractice insurance industry. Finally, the Report examines three events that have received little scrutiny, but that will have major effects on NCRIC and its policyholders: its recent restructuring as a mutual holding company and subsequent demutualization; its pending merger with ProAssurance; and the $18 million verdict rendered against it in February 2004 in connection with its litigation against Columbia Hospital for Women.

B. History and structure of NCRIC

NCRIC was founded in 1980 as a reciprocal insurance company. A reciprocal insurer, like a mutual insurer, is owned by its policyholders; the difference between the two is that the policyholders of a reciprocal technically agree to insure each other, whereas in a mutual a pool which is funded by policyholders technically pays for policyholder losses. Because mutuals and reciprocals are owned by

their policyholders, those policyholders "do not have the divided loyalties of stockholders versus policyholders," according to The Doctors Company, the nation's largest malpractice reciprocal, since "any profits that a mutual or reciprocal company makes are either used to strengthen the company's financial position or are paid back to the policyholders in the form of dividends." www.thedoctors.com/whychoose/carrier/carrier.asp (visited May 13, 2005).

NCRIC's SEC filings do not state how, or by whom, the company was initially funded. Its 2004 10-K states that it was founded by D.C. physicians "with the assistance of" the D.C. Medical Society, but it does not disclose the extent, if any, to which either individual physicians or the Medical Society contributed money so the company could commence operations.

In 1998 NCRIC reorganized as a stock insurer held by two stock holding companies held by a mutual holding company, as more fully described in section VB. In 1999, 40% of the stock of the downstream stock holding company was sold to the public, and in 2003 the remaining 60% was sold. NCRIC is thus now a stock insurance company owned by investors, rather than a reciprocal insurer owned by its policyholders. Interestingly, although a reciprocal insurer by definition is owned by its policyholders, NCRIC now avoids describing the original NCRIC reciprocal in this way. Rather, both in its 2004 10-K and on its website, NCRIC characterizes itself as having been founded as a "physician-governed reciprocal insurance company."

NCRIC also states on its website that it is "endorsed by" the D.C. Medical Society. Similarly, it states in its 10-K that it "maintains the exclusive endorsement of" the D.C. Medical Society and has an "endorsement agreement" with the Medical Society guaranteeing it a seat on the board. Neither the 10-K nor the website, however, discloses anything about the nature of the endorsement agreement, about either party's rights or duties under the endorsement agreement, or about the circumstances, if any, under which the endorsement agreement authorizes payments from NCRIC to the Medical Society.

Finally, in February 2005 NCRIC and ProAssurance Corporation, the nation's fourth largest malpractice insurer, announced that NCRIC had agreed to be acquired by ProAssurance. The acquisition must be approved by the D.C. Department, which will hold a hearing on the proposed transaction on June 6 of this year.

II. NCRIC's Annual Statements

A. Annual Statement Data

Insurance companies must file comprehensive financial statements with state insurance departments by March 1 each year. Those statements, known as Annual Statements, include extensive financial data for the most recent calendar year, and summary data for each of the most recent five calendar years. In particular, an insurer's Annual Statement includes data on:

- the premium it collects;
- its claims payments and projected claims payments;
- its reserves—the amount it sets aside to pay projected future claims; and
- its surplus—the extra cushion held by the insurer in addition to the amount it sets aside to pay future claims.

This section analyzes all those elements of NCRIC's performance based on data in its Annual Statements.

1. Written premiums vs. paid losses

One way to measure an insurer's performance is to compare "written premium" with "paid losses"--i.e., to compare the premium an insurer takes in in a given year with the claims it pays out in that same year. Such a comparison does not provide a complete picture of an insurer's performance, since claims paid out in a given year are typically covered by policies written in prior years. On the other hand, the trend over several years in an insurer's written

premiums and paid losses, and in the amount of its average claim, are relevant indicators of the insurer's performance, of the excessiveness or inadequacy of the insurer's rates, and of the litigation environment. This Report shows these trends both for NCRIC's D.C. business and for all of NCRIC's business.

2. Earned premiums vs. projected losses

A second way to measure the performance of an insurance company is to compare the premiums it earns in a given year with the claims it projects it will pay in future years on policies in effect in that year.

Earned premium refers to the portion of the premium attributable to a particular period of coverage. For example, if a policy covering the period July 1, 2004 through June 30, 2005 costs $100, the insurance company writes $100 in premium but earns only $50 in premium for 2004, since only half of the coverage provided by that policy occurs in 2004. Because insurance companies continually write policies, earned premium and written premium typically do not differ greatly.

The claims an insurer projects it will ultimately pay that are covered by premiums earned in a given year are referred to by insurers as their "incurred losses" for that year. To the lay person the term "incurred losses" is misleading, since an insurer's "incurred losses" are not payments it has made but rather are estimates of the payments it projects it will make in the future. These estimated payments may never be made, and NCRIC's Annual Statements reveal that it has historically posted "incurred loss" estimates that ultimately proved to be substantially overstated, as will be discussed in section IIB3. Nevertheless, insurers and regulators typically use the incurred loss ratio--the ratio of an insurer's incurred loss estimates to its earned premium--as a measure of its profitability. Accordingly, this Report examines that ratio both for all NCRIC business and for its D.C. business.

3. Reserve analysis

A third type of analysis based on the data in the Annual Statements is an analysis of the accuracy of an insurer's reserves, which are the amounts an insurer sets aside to pay its projected "incurred losses." Whether or not an insurer has reserved the correct amount for claims covered by policies in a given year--i.e., whether or not the insurer's "incurred loss" estimates are accurate--can not possibly be known until substantially all of those claims are actually paid, which for medical malpractice claims is approximately 10 years after the year the policy is written. The data in its current Annual Statement therefore does not permit us to determine how accurate NCRIC's current reserve estimates are. The Annual Statement does, however, enable us to determine how accurate NCRIC's reserve estimates have been in the past. The Report makes that determination by analyzing two separate sets of data in the Annual Statement.

4. Surplus analysis

Surplus is the extra cushion an insurance company accumulates over and above the amount it has set aside to pay its estimated future claims. A company increases its surplus to the extent that, after setting aside a sufficient amount to pay all projected future claims, it both earns a profit and declines to distribute that profit to its shareholders (in a stock company) or policyholders (in a mutual company). The National Association of Insurance Commissioners ("NAIC") has developed a formula, based on the risk assumed by the insurer and the quality of the assets it holds, that calculates the level of surplus the NAIC views as adequate for each company.

This Report analyzes the change in NCRIC's surplus between 2000 and 2004. It also compares NCRIC's actual surplus for each year to the surplus the NAIC deemed adequate for NCRIC for that year.

B. Findings

1. Written premiums vs. paid losses

Table 1 sets forth NCRIC's net written premium and net paid loss on all its business in each year 2000 through 2004. It indicates that over that five year period, NCRIC increased its premiums by 317%, although its paid losses rose by only 122%. Thus, NCRIC increased its premiums by almost three times the increase in its paid losses during that period.

Table 1

Net Premiums Written v. Net Paid Losses, All Jurisdictions, 2000-2004 (in $ millions)

Year	NPW	NPL	Ratio
2000	17.4	9.6	55.2%
2001	25.3	10.1	39.9%
2002	36.7	9.7	26.4%
2003	59.3	18.1	30.5%
2004	72.5	21.3	29.4%
Change 2000-2004:	+316.6%	+122.0%	

Source: NCRIC Annual Statement for 2004, Five Year Historical Data pages.

Table 2 sets forth NCRIC's written premium and paid loss experience for each of the last five years for its D.C. business only. It indicates that during that period NCRIC increased its premiums substantially, even though both its total paid claims and its average payment per claim declined.

Table 2

DC Written Premiums, Paid Losses, Number of Claims and Average Claim 2000-2004

	Written Premium (in $millions)	Paid Losses (in $millions)	Paid Loss Ratio	# of Claims	Avg. Claim
2000	16.9	14.0	82.8%	27	$520,122
2001	17.5	12.7	72.6%	27	$469.537
2002	21.8	9.8	45.0%	28	$350,527
2003	23.1	11.6	50.2%	31	$375,669
2004	25.5	12.7	49.8%	34	$372,184

Source: NCRIC Annual Statement for 2004, Supplement A to Schedule T.

Notably, NCRIC increased its premium by 51% -- from $16.9 million to $25.5 million -- between 2000 and 2004, even though its total paid losses decreased by 9% and the size of its average claim paid decreased by 28%. As a result, the ratio between its paid losses and written premium decreased sharply—from 82.8% in 2000 to 49.8% in 2004. That 49.8% paid loss ratio means that in 2004 NCRIC took in $2 of premium for each dollar it paid out in claims.

Chart 1 graphically displays the sharp upward trend in NCRIC's written premium for D.C. along with the moderate downward trend in its total paid losses for D.C.:

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Chart 2 graphically displays the sharp downward trend in the size of NCRIC's average paid claim in D.C.:

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2. Earned premiums vs. incurred losses

Table 3 sets forth NCRIC's earned premium and incurred loss experience for each of the most recent five years for D.C. business. They indicate that during that period NCRIC's earned premiums, like its written premiums, increased by approximately 50%, even though its "incurred losses"--its estimated future claims payments—actually decreased slightly. As a result, NCRIC's incurred loss ratio, like its paid loss ratio, declined sharply – from 77.0% in 2000 to 49.6% in 2004. That 49.6% incurred loss ratio means that in 2004 NCRIC earned $2 of premium for each dollar it projected it would pay out in claims.

Table 3

D.C. Earned Premiums v. D.C. Incurred Losses, 2000-2004 (in $millions)

Year	Earned Premiums	Incurred Losses	Ratio
2000	16.1	12.4	77.0%
2001	16.7	8.2	49.1%
2002	19.3	9.7	50.1%
2003	22.8	13.0	57.0%
2004	24.2	12.0	49.6%

Source: NCRIC Annual Statements, 200- through 2004, Supplement A to Schedule T.

Chart 3 graphically displays the trends in NCRIC's earned premiums and incurred losses in D.C.

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Table 4 compares NCRIC's D.C. 2004 incurred loss ratio--i.e., the ratio between its estimated future claims payments in 2004 and its earned premium in 2004--to that same ratio for the other jurisdictions in which it writes. It indicates that, contrary to popular perception, NCRIC is projecting that it will pay out less per premium dollar in D.C. than in any of the other four jurisdictions in which it writes.

Table 4

DC v. other NCRIC jurisdictions, 2004: Earned Premium v. Incurred Losses (in $millions)

Jurisdiction	Earned premium	Incurred losses	Ratio
DC	24.2	12.0	49.6%
DE	10.8	6.9	63.9%
MD	10.7	8.4	78.5%
VA	26.3	19.8	75.3%
WV	8.6	4.3	50.0%

Source: NCRIC Annual Statement for 2004, Supplement A to Schedule T.

Chart 4 displays NCRIC's 2004 projected loss ratios for D.C., Virginia and Maryland. NCRIC is projecting that less than 50 cents of every premium dollar D.C. doctors pay will go to pay claims against D.C. doctors, but that more than 75 cents of every premium dollar Virginia and Maryland doctors pay will go to pay claims against them. Looked at another way,

for every premium dollar D.C. doctors pay to NCRIC more than 50 cents goes for profit and overhead, while for every premium dollar Virginia and Maryland doctors pay to NCRIC less than 25 cents goes for profit and overhead. Thus, NCRIC makes more money insuring D.C. doctors than it does insuring Virginia and Maryland doctors. If NCRIC's projected payouts per premium dollar for D.C. doctors were as high as they currently are for Virginia and Maryland doctors, NCRIC's D.C. malpractice rates would fall substantially.

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3. Reserve analysis

The extent to which NCRIC's reserve estimates for prior years' policies have proved to be accurate is shown in Schedule P, Part 2F of its Annual Statement. That schedule sets out NCRIC's initial estimate of its ultimate payments for claims covered by policies in effect in each of the nine years preceding the year for which the Annual Statement is filed, along with the revised estimate NCRIC made in each succeeding year as to its ultimate payments for those claims.

As explained in section IIA2, an insurer's "incurred losses" are not actual losses but rather estimates – guesses – of projected future payments which may or may not be made. Each year, as the insurer receives more information about the "incurred losses" it has guessed it will ultimately pay for claims covered by policies in effect in a previous year, it adjusts that guess based on that information.

Because virtually all medical malpractice claims are paid within 10 years, as explained in section IIA3, an insurer's estimate of its true liability for claims it guesses it has incurred in a given year is substantially accurate after 10 years. Whether NCRIC's current reserves are too low or too high can therefore not be definitively known until 10 years from now. On the other hand, because at least 10 years has now elapsed between each year prior to 1996 and the present, we can now determine

the extent to which the reserves NCRIC established for each of those years have proved to be too low or too high.

Accordingly, Table 5 compares NCRIC's initial estimate of its ultimate payments for claims covered by policies written in each year 1991-1995 – the five years for which the Annual Statements for 2000 through 2004 report ultimate losses -- with its true ultimate payments for claims covered by those policies. Table 5 demonstrates that for each year during that five-year period, NCRIC's initial incurred loss estimate turned out to be substantially overstated: from 11.2% overstated for claims covered by policies in effect in 1995 to 43.2% overstated for claims covered by policies in effect in 1991. In total, for the five-year period 1991-1995, NCRIC's initial incurred loss estimates proved to be excessive by 28.1%.

Table 5

Initial Incurred Loss Estimates vs. Incurred Losses Reported After 10 Years ($000's omitted)

Year	Initial Estimate of Incurred Loss For Year	Reported Loss 10 Years Later For Year	Difference in $$	Difference in %
1991	24,103	13,692	10,411	43.2%
1992	18,305	14,744	3,561	19.5%
1993	16,379	11,805	4,574	27.9%
1994	17,176	12,103	5,073	29.5%
1995	13,389	11,889	1,500	11.2%
Totals	89,352	64,233	25,119	28.1%

Source: NCRIC Annual Statements for 2000 through 2004, Schedule P, Part 2F.

Chart 5 displays the data set out in Table 5 graphically: **Error! Not a valid link.**

Another way to determine the accuracy of NCRIC's reserves is by reading the Notes to Financial Statements section of its Annual Statement. For each of the last four years, insurers have been required to disclose in those Notes the extent to which they have adjusted their reserves. Insurers whose reserves have proved to be too low disclose the extent to which they have added to those reserves during the previous year; those whose reserves have proved to be too high disclose the extent to which they have reduced them.

Notably, as Table 6 indicates, for each of the last four years NCRIC has acknowledged that its reserves for prior years were too high, and accordingly has reduced them. In 2001 it reduced its reserves for prior years by $20.0 million; in 2002 it reduced them by $15.3 million; in 2003, by $20.5 million; and in 2004, by $17.4 million. Importantly, in both 2003 and 2004 NCRIC explained that it decreased its reserves as a result of its "ongoing analysis of recent loss development trends." NCRIC

is thereby disclosing that it is today paying out less than it believed it would pay out when it initially set its reserves because the litigation environment today is more conservative than NCRIC thought it would be when it initially set its reserves.

Table 6

NCRIC's Change in Reserves, 2000-2004, according to its Note to Financial Statements

2001

Note 26 – Change in Incurred Loses and Loss Adjustment Expenses

"Reserves for incurred losses and loss adjustment expense attributable to insured events of prior years has decreased by $20,048,000 from $53,297,000 at December 31, 2000 to $33,249,000 at December 31, 2001 as a result of reestimation of unpaid losses and loss adjustment expense." (Emphasis supplied.)

2002

Note 24 – Change in Incurred Losses and Loss Adjustment Expenses

"Reserves for incurred losses and loss adjustment expenses attributable to insured events of prior years has decreased by $15,288,000 from $53,584,000 at December 31, 2001 to $38,296,000 at December 31, 2002 as a result of reestimation of unpaid losses and loss adjustment expenses." (Emphasis supplied.)

2003

Note 25 – Change in Incurred Losses and Loss Adjustment Expenses

"Reserves for incurred losses and loss adjustment expenses attributable to insured events of prior years has decreased by $20,496,872 from $61,609,872 at December 31, 2002 to $41,113,000 at December 31, 2003 as a result of payments and reestimation of unpaid losses and loss adjustment expenses principally medical malpractice lines of insurance. This decrease is generally the result of ongoing analysis of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual claims." (Emphasis supplied.)

2004

Note 25 – Changes in Incurred Losses and Loss Adjustment Expenses

"Reserves for incurred losses and loss adjustment expenses attributable to insured events of prior years has decreased by $17,368,000 from $81,318,000 at December 31, 2003 to $63,950,000 at December 31, 2004 as a result of payments and re-estimation of unpaid losses and loss adjustment expenses principally medical malpractice lines of insurance. This decrease is generally the result of ongoing analysis of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual claims." (Emphasis supplied.)

Source: NCRIC Annual Statements for 2000 through 2004, Notes to Financial Statements.

4. Surplus Analysis

Table 7 sets forth NCRIC's surplus—the extra cushion it has accumulated over and above the amount it has set aside to pay future claims—as of December 31 of each of the last five years. It indicates that NCRIC's surplus has grown from $29.8 million to $63.0 million during that period, while its excess surplus—the surplus it holds in addition to the surplus the NAIC views as adequate—has grown from $22.4 million to $35.4 million.

Table 7

NCRIC: Actual vs. Adequate Surplus, 2000-2004
(in $ millions)

Year	Actual surplus	Adequate surplus	Excess surplus
2000	29.8	7.4	22.4
2001	32.8	9.4	23.4
2002	44.3	13.4	30.9
2003	70.4	21.2	49.2
2004	63.0	27.6	35.4

Source: NCRIC Annual Statement for 2004, Five Year Historical Data pages.

The greater an insurer's surplus, the greater the protection for policyholders in case the amount the insurer has set aside to pay future claims turns out to be insufficient. As demonstrated in section IIB3, however, NCRIC has historically set aside to pay claims substantially more than it ultimately ended up paying out. Having a huge surplus is therefore less important for NCRIC than it would be for a company that had traditionally understated its ultimate liabilities, rather than overstating them as NCRIC has.

5. Conclusion

Insurance commissioners typically do not review Annual Statement data when determining whether to approve an insurer's proposed rate increase, and the D.C. commissioner has no authority to require a medical malpractice insurer to obtain his approval before it increases its rates in any event. Nevertheless, Annual Statement data are relevant to the question whether NCRIC's rates are excessive. Based on that data, NCRIC's current rates for D.C. business do appear to be excessive.

III. NCRIC's Rate Filings

In D.C., as in most states, insurers submit rate filings to the Department of Insurance when they change their rates. Such filings contain data, projections and actuarial assumptions which purport to justify the rate change the insurer is implementing. The D.C. insurance statute, like those in virtually all other states, provides that malpractice rates may not be "excessive, inadequate or unfairly discriminatory." D.C. Code sec. 31-2703(a). In many states, the commissioner must find that a proposed rate increase does not result in rates that violate this standard before that increase can take effect. In D.C., however, malpractice insurers need not obtain the commissioner's approval before raising their rates, but rather may raise their rates at will. Sec. 31-2704.

The D.C. commissioner does have the authority to disapprove a rate after it takes effect. Sec. 31-2704(b), (c). However, the commissioner has never disapproved any NCRIC rate increases. Moreover, in D.C. the commissioner has no authority to order refunds of excessive malpractice rates; all he can do is prohibit them prospectively. Sec. 31-2704(c).

In addition, NCRIC has historically taken the position that the data, assumptions, and projections which it claims justify its rate increases may not be released to the public, and the Department has honored that position. Keeping such data confidential has had three harmful effects.

First, keeping such data confidential serves as a barrier to entry. To know how much to charge for insurance in a particular market, potential competitors must know what the underlying experience is in that market, in as much detail as possible, and on a specialty-by-specialty basis. Because potential competitors can not obtain such data for the D.C. market, they are unlikely to enter it.

Second, the withholding from the public of the data which NCRIC relies on to support its rate increases prevents doctors or other members of the public from challenging its rate increases. It also enables NCRIC to argue that the underlying data support its rate increases, even if in fact they do not.

Third, keeping such data non-public enables NCRIC to argue that it has been forced to raise its rates because litigation is increasing, even if the data demonstrate that litigation is not increasing.

No principled, pro-competitive rationale is apparent for withholding from the public data that an insurer claims justifies its rate increases. In virtually all states, therefore, such data is available to the public; the D.C. Department is a notorious exception.

IV. NCRIC's SEC Filings

Since NCRIC is a public company, it must file Annual Reports (so-called "10-K's") and current reports (so-called "8-K's"), as well as quarterly and proxy filings, with the SEC. NCRIC's SEC filings contain substantial information that is not contained in the Annual Statement filed with state insurance departments. This section first describes some of the significant information in NCRIC's SEC filings that supplements the data in NCRIC's 2004 Annual Statement. It then describes some of the statements NCRIC makes in its 2004 10-K as to the reasons malpractice rates have risen which are inconsistent with the public positions the malpractice insurance industry has taken on that issue. Finally, it explains NCRIC's discussion of reserves in its 10-K.

A. NCRIC's 10-K statements that supplement its Annual Statement

1. Executive Compensation and Benefits

Some Departments of Insurance require insurers to file an Annual Compensation Supplement listing the company's 10 highest-paid executives and their total compensation. D.C. does not require such disclosure. NCRIC's SEC filings, however, do disclose substantial information concerning executive compensation and benefits. For example, its 2004 10-K notes that in September 2000 NCRIC authorized 74,000 shares to be awarded to officers and directors, and that in 2003 it authorized an additional 159,120 shares to be awarded. 10-K at 78. The value of those shares at NCRIC's May 13, 2005 stock price of $9.50 is approximately $2.2 million. The 10-K also states that compensation expenses in connection with NCRIC's stock award plans were $424,900 in 2004, $299,400 in 2003, and $153,800 in 2002. Id. The 10-K does not explain the rationale for the awarding of these shares.

In addition, a proxy statement filed by NCRIC on April 26, 2005 sets forth the compensation received during the last four years by the four highest paid NCRIC executives. The proxy statement notes that each executive was awarded restricted stock in 2003, as set forth in Table 10. Like the 10-K, however, it does not explain the basis for such an award.

Table 8

Executive Compensation

Name & Principal Position	Year	Annual Compensation: Salary	Long-Term Compensation Awards: Restricted Stock Award	Long-Term Compensation Awards: Options/ SARs	All Other Compensation	Total Compensation
R. Ray Pate, Jr.	2004	367,500	--	--	88,220	455,720
President and Chief	2003	350,000	374,595	72,515	45,589	842,699
Executive Officer	2002	290,000	--	--	26,208	316,208

Stephen S. Fargis	2004	200,000	--	--	58,479	258,479
Senior Vice President &	2003	200,000	187,298	37,293	37,869	462,460
Chief Operating Officer	2002	170,000	--	--	24,339	194,339

Rebecca B. Crunk	2004	231,000	--	--	56,403	287,403
Senior Vice President &	2003	220,000	187,298	37,293	39,186	483,777
Chief Financial Officer	2002	170,000	--	--	26,500	196,500

William E. Burgess	2004	183,750	--	--	56,181	239,931
Senior Vice President and	2003	175,000	187,298	37,293	36,657	436,248
Secretary	2002	128,398	--	--	18,739	147,137

Source: NCRIC Form DEF 14A filed April 26, 2005, at 15 (hereinafter "proxy statement").

The proxy statement also sets forth the number of NCRIC shares beneficially owned by each director and officer. Table 9 shows both the number of shares owned by each director and officer and the value of those shares, calculated at $9.50 per share. The proxy statement does not explain how each officer and director came to own these shares, nor the amount, if any, he paid for the shares.

Table 9

Shares Owned

Name	Positions Held in the Company	Shares of Common Stock Beneficially Owned (3)	Percent of Class	Value of Shares ($)
		NOMINEES		
Vincent C. Burke, III	Director	21,293	*	202,283
Prudence P. Kline	Director	20,580	*	195,510
J. Paul McNamara	Director	55,895	*	531,002
Frank K. Ross	Director	--	*	0
		DIRECTORS CONTINUING IN OFFICE		
Leonard M. Glassman	Director	65,138	*	618,811
Stuart A. McFarland	Director	10,208	*	96,976
R. Ray Pate, Jr.	President, Chief Executive Officer and Vice Chairman of the Board	222,363	3.1%	2,112,448
David M. Seitzman	Director	28,907	*	274,616
Luther W. Gray, Jr.	Director	28,100	*	266,950
Leonard M. Parver	Director	43,971	*	417,724
Nelson P. Trujillo	Chairman of the Board	122,815	1.7%	1,166,742
		EXECUTIVE OFFICERS WHO ARE NOT DIRECTORS		
Rebecca B. Crunk	Senior Vice President and Chief Financial Officer	115,418	1.6%	1,096,471
William E. Burgess Secretary	Senior Vice President and	90,410	1.2%	858,895

* less than 1%.

Source: Proxy statement at 5.

Chart 6 compares the value of the shares owned by the eight NCRIC executives with the largest stakes in the company:

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The proxy statement also discloses the compensation received by NCRIC directors. Specifically, it notes that each non-employee director receives an annual retainer of $45,000, and that the Chairman of the Board receives $150,000 annually. Proxy statement at 8.

Finally, the proxy statement discloses the change of control payments the three most highly paid NCRIC executives would receive in connection with the pending NCRIC – ProAssurance merger.

CEO Roy Pate would receive three times his annual base compensation, while CFO Rebecca Crunk and Secretary William Burgess would receive twice their annual base compensation. Proxy statement at 16. Mr. Pate's 2005 base compensation is $385,875, Dr. Crunk's is $242,550, and Mr. Burgess's is $192,938. Thus, if terminated in connection with a change of control (or if terminated without cause even if not in connection with a change of control), Mr. Pate would receive $1,157,625; Dr. Crunk would receive $485,100; and Mr. Burgess would receive $385,876. A fourth executive, COO Stephen Fargis, terminated effective December 31, 2004, and therefore is not eligible to receive any change of control payment in connection with the acquisition.

2. Non-insurance services provided by NCRIC.

NCRIC offers what it calls "practice management" services in addition to insurance. Those services consist of accounting, tax and financial services, in connection with which it competes with accounting firms; retirement plan administration, in connection with which it competes with large brokerage firms; and payroll services, in connection with which it competes with national companies. 10-K at 5. The 10-K discloses that NCRIC has not been successful in providing those services. Specifically, NCRIC's income from providing practice management services declined 24% in the last two years—from $5.8 million in 2002 to $4.4 million in 2004. 10-K at 42.

Moreover, NCRIC's consolidated balance sheet reveals that its practice management business has consistently lost money. In 2004, for example, while its income from its practice management and related businesses was $4.4 million, its expenses in connection with that business were $5 million. 10-K at 59.

3. NCRIC's marketing methods: D.C. vs. other jurisdictions

NCRIC notes that in D.C. it sells directly to doctors without using agents, whereas in other jurisdictions it uses agents and pays them approximately 9% of the premium they

produce. 10-K at 10. The additional 9% that NCRIC spends on acquiring business in other states, in combination with the substantially lower loss ratio produced by D.C. business than by business in other states, indicates that the rates NCRIC is charging its D.C. doctors may include a load for agent's commissions even though NCRIC does not pay an agent's commission on the policies it sells to D.C. doctors.

4. Experience rating

NCRIC states that in general, the total credits or surcharges it applies to a policyholder's premiums do not exceed 25% of its base rate. 10-K at 11. This would seem to indicate that the maximum surcharge NCRIC applies to doctors found to have committed malpractice—no matter how egregious the malpractice or catastrophic the injury thereby caused—is 25%. This is significantly less than the surcharge applied by most malpractice carriers. Increasing that surcharge could lower rates for doctors with clean records.

B. NCRIC's 10-K statements vs. the public positions of the medical malpractice insurance industry

1. Characterization of "incurred losses"

On its website, NCRIC states that in 1985 it founded the Tort Reform Institute to promote the cause of tort reform, and that it works to promote tort reform with the American Tort Reform Association, the Health Care Liability Alliance, and the Chamber of Commerce, to whose websites the Tort Reform Institute website provides links. Medical malpractice insurers consistently lead the public to believe that incurred loss estimates are actual payments.[1] In its 10-K, in contrast, NCRIC frankly acknowledges that incurred losses are not

[1] For example, in a November 2004 news release available on its website, NCRIC quotes the statement that "malpractice insurers paid out $1.34 in claims and costs for every $1.00 they received in revenue (including investment income)," even though in fact malpractice insurers in fact only estimated they would ultimately pay out $1.34 in the future for every dollar they received.

actual payments but rather are only estimates of payments it projects it will make in the future, which in fact may or may not ever be made. NCRIC explains that "the process of estimating loss reserves is a difficult and complex exercise involving many variables and subjective judgments," that "actual results are likely to differ from original estimates," and that "our ultimate liability will be known only after all claims are closed, which is likely to be several years into the future." 10-K at 20.

NCRIC further notes that "loss development could potentially have a significant impact on our results of operations. Developments changing the ultimate aggregate liability as little as 1% could have a material impact on our reported operating results." 10-K at 32.

Finally, NCRIC specifically admits:

> [I]t is possible that the Company's actual incurred losses and loss adjustment expenses will not conform to the assumptions inherent in the determination of the liabilities. Accordingly, the ultimate settlement of losses and the related loss adjustment expenses may vary from the amounts included in the financial statements.

10-K at 71.

2. The cyclical nature of the medical malpractice insurance industry

Malpractice insurers publicly attribute the rate increases of the past several years to allegedly increasing litigation, while failing to acknowledge the cyclical nature of the insurance industry. NCRIC's 2004 10-k, in contrast, acknowledges both the existence of the insurance cycle and its effect on insurance company pricing. It explains:

> Historically, the financial performance of the property and casualty insurance industry has tended to fluctuate in cyclical patterns characterized by periods of greater competition in pricing and underwriting terms and conditions, a soft insurance market, followed by a period of capital shortage, lesser competition and increasing premium rates, a hard insurance market.
>
> For several years in the 1990s, the medical professional liability industry faced a soft insurance market that generally resulted in lower premium

> rates. The medical professional liability industry is currently in a hard insurance market cycle.

10-K at 22.

NCRIC's 2001 Annual Report to its shareholders contains this same admission. It stated:

> The history of medical professional liability insurance is one of cycles. "Soft" cycles, or phases when insurance premiums are low and coverage is readily available, have been followed by "hard" cycles, or periods when insurance carriers have minimal capacity and physicians find it difficult to get insurance coverage at any price.
>
> In 2001, the hard market resurfaced in numerous areas across the country, having previously not been seen since the late 1980's.

3. The importance of investment income

Malpractice insurers and their advocates publicly maintain that changes in investment income have little if any effect on insurance company pricing. See, e.g., Did Investments Affect Medical Malpractice Premiums? Raghu Ramachandran, Brown Brothers Harriman, January, 2003 at 3 ("We can state with a fair degree of certainty that investment yield and the performance of the economy and interest rates do not influence medical malpractice premiums.") NCRIC's 2004 10-K, in contrast, NCRIC acknowledges the importance of investment income. Specifically, it states that "investment income is an important component in support of our operating results," 10-K at 16, and further explains:

> We generally rely on the positive performance of our investment portfolio to offset insurance losses and to contribute to our profitability. As our investment portfolio is primarily comprised of interest-earning assets, prevailing economic conditions, particularly changes in market interest rates, may significantly affect our operating results.

10-K at 21.

4. The effect of reinsurance

Malpractice insurers typically do not acknowledge the role played by reinsurance--insurance that insurance companies buy to cover losses above a certain amount--in limiting an insurer's liability. NCRIC's 2004 10-K, in contrast, does make that role clear: it states that "by reducing our potential liability on individual risks, reinsurance protects us against large losses." 10-K at 13. Specifically, the 10-K discloses that until 2003 NCRIC bought reinsurance to cover all claims exceeding $500,000, and that in 2003 and 2004 it raised that threshold to $1 million. 10-K at 13-14.

5. Characterization of the degree of competition in the medical malpractice market

Malpractice insurers often claim that insurers want to avoid the medical malpractice business. NCRIC's 10-K, however, says the opposite. It acknowledges:

> Medical professional liability insurance is a competitive industry. A number of carriers that operate in our market territory have higher financial ratings or have significantly larger financial resources than we do.

10-K at 6. It further notes that three other carriers--Professionals Advocate, an affiliate of Medical Mutual of Maryland; The Doctors Company; and American International Group--have at least 5% of the D.C. market. All three carriers are highly profitable, have substantially greater surplus than NCRIC, and are rated more highly than NCRIC by A.M. Best.

C. NCRIC's discussions of its reserves

NCRIC's discussion of its reserves in its 10-K appears at times to be consistent with its discussion of its reserves in its Annual Statement, and at other times to be inconsistent with that discussion. On the one hand, a table in its 10-K, like Schedule P in its Annual Statement, demonstrates that NCRIC has consistently overestimated the amount it would ultimately pay out for claims. Whereas Schedule P compares NCRIC's initial estimate as to its ultimate liability for claims covered by policies in effect in a given year with its later estimates as to its ultimate liability on that year's policies, the table in the 10-K appears to compare the initial

reserve NCRIC posted in a given year for all claims—whether against policies in effect in that year or policies in effect in previous years—with its subsequent estimates for those claims. 10-K at 13.

The 10-K table and Schedule P from the Annual Statement both indicate that NCRIC overstates its reserves. Schedule P in the Annual Statement indicates that NCRIC's ultimate liabilities on policies written during the five-year period 1991-1995 proved to be 28.1% less than NCRIC's initial estimates of those liabilities; the 10K table indicates that for the 10 year period 1994-2003, NCRIC's initial estimated liabilities were 16.3% higher than its current estimated liabilities. 10-K at 13.

On the other hand, NCRIC's characterization of its reserves in another section of its 10-K conflicts with its characterization of its reserves in its Annual Statement. Specifically, while in its 2004 Annual Statement NCRIC states that "Reserves for incurred losses and loss adjustment expenses attributable to insured events of prior years has decreased by $17,368,000," Annual Statement at Note 25, in its 2004 10-K NCRIC states that "in 2004 we experienced unfavorable development of $17.1 million on estimated losses for prior years' claims." 10-K at 44. Similarly, although in its 2003 Annual Statement NCRIC states that "Reserves for incurred losses and loss adjustment expenses attributable to insured events of prior years has decreased by $20,496,872," 2003 Annual Statement at Note 25, in its 2004 10-K NCRIC states that "in 2003 we experienced unfavorable development of $5.9 million on estimated losses for prior years' claims." 10-K at 45.

NCRIC does not explain these inconsistencies. It does acknowledge, however, that its 80% loss ratio—i.e., its projected losses divided by its earned premiums—for 2004 had declined from 94.3% in 2003, and that frequency of reported losses also declined in 2004. 10-K at 44. It also acknowledges that what it characterized as adverse loss development for 2003

in its 10-K was primarily driven not by D.C. experience but by its Virginia claims reported in 2001 and 2002. 10-K at 45.

V. Three Major Events in the History of NCRIC

A. The Columbia Hospital for Women Litigation

Although NCRIC attributes rising malpractice rates to increasing litigation between injured individuals and doctors, it is business litigation between NCRIC and Columbia Hospital for Women, rather than a malpractice case brought by an injured individual, that could have the most significant negative impact on NCRIC.

Specifically, in September 2004 a D.C. jury found that NCRIC had charged unlawfully high malpractice rates and had tortiously interfered with the operations of Columbia Hospital for Women by encouraging its doctors to practice elsewhere. The jury awarded the hospital $18.2 million in damages. Ironically, NCRIC itself had initiated the litigation that resulted in the verdict against it: NCRIC had initially sued the hospital in 2000, claiming that the hospital owed it $3 million in malpractice premiums and interest. NCRIC's lawsuit against the hospital spawned a countersuit by the hospital against NCRIC, and after a 2 ½ week trial the jury found for the hospital and against NCRIC. NCRIC responded to the verdict by accusing the hospital's management of targeting NCRIC as a scapegoat for the hospital's own failure, and by accusing the jury of being "driven by misguided sympathy for a failed hospital that had been on a downward spiral for many years." See, e.g., Jury Awards Columbia Hospital $18.2 Million, Washington Post, February 18, 2004, at E2.

The $18.2 million verdict against NCRIC engendered by NCRIC's lawsuit against the hospital is more than the total of all malpractice claims NCRIC has paid in D.C. in any year.

B. NCRIC's reorganization as a Mutual Holding Company and Subsequent Demutualization

Over the last several years, many large mutual insurance companies have converted to stock company status. Such a conversion is known as a demutualization. In connection with such a conversion, the policyholders who own the mutual company typically receive stock or other compensation in exchange for giving up their ownership of the company to private investors. Large insurers who have de-mutualized in recent years, and who in connection therewith distributed stock to their policyowners, include Prudential, Principal, Anthem, Metlife, and John Hancock.

Like those companies, NCRIC has demutualized. Unlike those companies, however, NCRIC did not distribute stock to its policyholders in connection with its demutualization.

NCRIC demutualized through a series of steps. First, it worked to enact legislation authorizing mutual and reciprocal insurers to reorganize as mutual holding companies. See, e.g., Reciprocal Insurance Company Conversion Act of 1998, Bill No. 12-445, effective May 12, 2998, codified as D.C. Code sec. 31-751 *et seq*. Under such legislation, a reciprocal insurer may re-organize as a stock company that is directly held by a newly-formed stock holding company which is owned by another stock holding company which is owned by a mutual holding company. Sec. 31-752. The policyholders are no longer members of the insurance company, since it has been converted to a stock company, but instead become members of the mutual holding company. Sec. 31-753.

While mutual holding company legislation has been enacted in several states, the D.C. legislation is unusual in at least two respects. First, it provides that the mutual holding company has no duty to compensate policyholders when it restructures. Sec. 31-735(e)(2). Second, it provides that anyone objecting to the proposed reorganization must object within 30 days—i.e., it establishes a 30-day statute of limitations. Sec. 31-758.

Pursuant to this statute, NCRIC reorganized as a stock company held by a stock holding company held by another stock holding company held by a mutual holding company in 1998. Then, in July 1999, the downstream stock holding company which directly owned 100% of NCRIC, and which

itself was owned 100% by the upstream stock holding company which was owned by the mutual holding company, sold 40% of its stock to the public in an IPO. Finally, in January 2003, NCRIC fully de-mutualized: the remaining 60% of the stock of the downstream stock holding company held by the upstream stock holding company was sold to private investors. 10-K at 2; NCRIC Form 8-K filed Jan. 30, 2003. NCRIC policyholders, including the doctors who founded the company, received no compensation in connection with NCRIC's conversion to a stock company. If they wished to maintain an ownership interest in the company, they were required to buy stock in the company. In effect, if they wanted to keep what they had they were required to pay for it.

Mutual holding company conversions have been controversial since their inception, because they enable insurers to do indirectly, in a step transaction, that which they have traditionally not been able to do directly: convert to stock status without compensating their policyholder/owners. NCRIC is one of the few insurers to have completed such a process without compensating its policyholders.

C. The ProAssurance Merger

On February 28th of this year, NCRIC announced that it has agreed to be acquired by ProAssurance Corporation, the fourth largest malpractice insurer in the nation. The merger must be approved by the D.C. Department of Insurance.

Pursuant to the merger agreement, stockholders of NCRIC are to receive shares of ProAssurance. Such a transaction would appear to be an excellent deal for those shareholders, for at least three reasons. First, ProAssurance is much bigger than NCRIC: ProAssurance wrote more than $500 million in net premium in 2004, while NCRIC wrote only $72.5 million. ProAssurance may thus have attained economies of scale that NCRIC has not. Second, ProAssurance, with an A- rating from Best's, is more highly rated than NCRIC, which Best's rates B+. Third, ProAssurance's stock has far outperformed NCRIC's over the last three years: NCRIC's stock has remained essentially flat, while ProAssurance's stock has more than doubled.

For the doctors who founded NCRIC, on the other hand, NCRIC's acquisition by ProAssurance would appear to add insult to injury. Those doctors, along with all other doctors insured by NCRIC, were not compensated when NCRIC converted to a mutual holding company; were not compensated when NCRIC fully de-mutualized; and, should the ProAssurance acquisition be approved, they will not be compensated when NCRIC is acquired by ProAssurance.

In addition, the acquisition of NCRIC by ProAssurance would appear to have the potential to increase NCRIC's malpractice rates. This is because the two medical malpractice companies ProAssurance owns today—Medical Assurance and ProNational—have increased their premiums substantially in recent years even though their claims payments have declined substantially, as Charts 7 and 8 demonstrate. **Error! Not a valid link.**

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Charts 7 and 8 indicate that during the period 2000-2004 Medical Assurance increased its premiums by 88.7% even though its claims payments fell by 33.6%, and that ProNational increased its premiums by 79.1% even though its claims payments fell by 63.0%. Moreover, in 2004 both companies continued to increase their premiums even though both their claims payments and their projected future claims payments fell: Medical Assurance increased its premiums by 16% while reducing its projected future claims payments by 12%, and Pro National increased its premiums by 7% while reducing its projected future claims payments fell by 31%.

As a result of their rising premiums and declining losses, Medical Assurance and ProNational in 2004 projected that they would pay out in claims only 34.4 and 33.1 cents, respectively, for each dollar they earned in premium. This is far less than the 75.3 and 78.5 cents on the premium dollar

NCRIC currently projects it will pay out in Virginia and Maryland, and less than even the 49.6 cents NCRIC currently projects it will pay out in D.C.

In short, the two ProAssurance companies have been increasing their premiums while both their actual claims payments and their projected claims payments have been falling, as a result of which they now project they will pay out in claims only about one-third of each premium dollar they collect. It is reasonable to expect that ProAssurance would operate NCRIC in the same manner as it operates Medical Assurance and ProNational. Under such a method of operation, rates for D.C. doctors would rise even while malpractice claims payments in the District continued to fall.

Jay Angoff

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He formerly served as insurance commissioner of Missouri and chaired Missouri's Commission on Health Insurance Reform. He has also served as deputy insurance commissioner of New Jersey, as the director of the private health insurance group at the U.S. Health Care Financing Administration, as counsel to the National Insurance Consumer Organization, and as vice-president for strategic planning at Quotesmith.com, an internet insurance broker and quotation service.

Recently, Mr. Angoff served as an adviser to the Maryland Insurance Administration in connection with the proposed conversion of CareFirst, Inc. to for-profit status.

Mr. Angoff began his career as an antitrust lawyer with the Federal Trade Commission. He has taught and written about insurance and antitrust law in both popular and legal publications.

He is a graduate of Oberlin College and Vanderbilt Law School.