



*2003 Annual Report*

*Working with our insureds*

*MedAmerica Mutual Risk Retention Group, Inc.*

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Dear MedAmerica Mutual Member:

Your Board of Directors and Management are pleased to announce that MedAmerica Mutual has successfully completed its 12<sup>th</sup> year of operation. MedAmerica Mutual was started with the fundamental goal of providing long-term access to affordable quality medical malpractice insurance, for existing and future generations of Emergency Medicine practitioners. We are committed to working with emergency medical groups to support their current operations and future growth by providing the security of knowing that they have access to a critically strategic component of their practice.

In 1992, with a \$500,000 commitment from California Emergency Physicians Medical Group, your insurance captive was launched under the Risk Retention Act of 1986. Twelve years later, as of 12/31/03, that initial capitalization has resulted in:

- \$10.6 M in Gross Written Premium
- \$6.1 M in Surplus
- \$16.7 M in Assets

Our financial performance is favorably outpacing the medical malpractice industry in two key insurance company performance ratios.

#1 - In 2003, MedAmerica Mutual's combined ratio (incurred losses, loss adjustment expenses and underwriting expenses) was 99% as compared to the national average of the other physician-owned medical malpractice carriers of 122%.

The "gold" standard for this key ratio is 100% or less; and we were one of few carriers within this standard. The other physician-owned medical malpractice carriers are not covering losses with the premium collected; this means they must make up the 22% difference with investment income or take funds out of surplus. In today's investment market, it is unlikely that investment income is going to offset a 22% difference; and therefore, many companies are using up the policyholders' surplus to fund current operations. Your insurance company has not needed to use any of the policyholders' surplus to fund operations in the last 12 years.

#2 - In 2003, MedAmerica Mutual produced net income within an industry that produced overall losses.

Why has MedAmerica Mutual outperformed the industry?

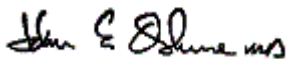
MedAmerica Mutual was established as a risk retention group owned by its policyholders, for its policyholders. Maintaining our core focus and competency solely on emergency medicine has served our policyholders very well. Specializing in one medical specialty has allowed your company to recognize loss development trends early on providing the opportunity to use our risk management expertise to offset this trend. Thus, this has enabled your company to charge the appropriate, yet adequate, rate that allows for the most affordable cost for our policyholders, while maintaining our financial strength to continue operating. Our competitors insure many medical specialties, which makes isolating subtle loss development patterns of only emergency medicine difficult and initiating specialty risk management techniques impossible resulting in substantial premium rate increases.

Your company's aggressive management and defense of claims has resulted in payments to plaintiffs for damages (indemnity) in only 6% of all reported claims since 1998. This is well below the national industry average for medical malpractice claims.

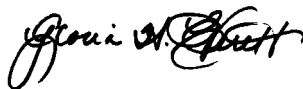
Through increasing operational efficiencies, your company has lowered its operating expense ratio by 7% since the end of 2001. This was the result of reducing headcount through re-engineering processes and gaining efficiencies in all operational areas. Additionally, the growth in premium is being written at lower incremental costs due to the economies of scale.

Historically, we have kept premium rates as low as possible to accomplish the goals as originally set forth. Now, as MedAmerica Mutual has enjoyed tremendous growth over the last few years, your company is taking action to implement a plan to further support the growth of the business. We are actively exploring a variety of methods to increase the available capital in support of increasing access and availability of medical malpractice insurance to you and future policyholders.

This is an exciting time for both Emergency Medicine and your company. We have the talent, people, resources and most of all desire to continue being your preferred medical malpractice insurance company. It has been a pleasure serving you and we look forward to working with you in the future.



John E. Osborne, MD  
Chairman & President



Gloria H. Everett  
Chief Executive Officer

**MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.**

## Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2003 and 2002

<b>Admitted Assets</b>	<b>2003</b>	<b>2002</b>
Cash investments:		
Cash and short-term investments	\$ 2,569,848	455,440
Debt securities	11,961,937	7,966,286
Common stock of subsidiaries	321,811	2,010,562
Total cash investments	14,853,596	10,432,288
Premiums receivable	189,923	167,908
Reinsurance balances recoverable	36,244	584,153
Deferred income tax asset	259,669	90,000
Equipment, net	15,446	15,047
Accrued investment income	196,488	137,060
Receivable from subsidiary	513,058	3,708
Other assets	734,766	884,059
Total admitted assets	\$ 16,799,190	12,314,223
<b>Liabilities and Surplus</b>		
Liabilities:		
Reserves:		
Losses	\$ 4,469,871	2,752,797
Loss adjustment expenses	4,325,302	3,365,815
Total reserves	8,795,173	6,118,612
Unearned premiums	305,969	214,358
Ceded reinsurance premiums payable	434,039	—
Accounts payable and accrued expenses	521,296	146,412
Commissions payable	510,673	—
Deferred income tax liability	36,875	2,000
Federal income taxes	1,396	195,000
Total liabilities	10,605,421	6,676,382
Surplus:		
Contributed surplus	250,000	250,000
Unassigned surplus	5,943,769	5,387,841
Total surplus	6,193,769	5,637,841
Total liabilities and surplus	\$ 16,799,190	12,314,223

See accompanying notes to statutory financial statements.

**MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.**

Statutory Statements of Income

Years ended December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Net underwriting income:		
Premiums earned	\$ 7,289,934	5,237,773
Losses and loss adjustment expenses	(5,813,493)	(4,056,059)
Other underwriting expenses	(1,450,691)	(1,011,852)
Net underwriting income	<u>25,750</u>	<u>169,862</u>
Net investment gains:		
Net investment income	477,977	408,413
Net realized capital gains	116,877	892
Net investment gains	<u>594,854</u>	<u>409,305</u>
Dividends to policyholders	(4,663)	(173,433)
Income before federal income taxes	615,941	405,734
Federal income taxes	(211,694)	(141,191)
Net income	<u>\$ 404,247</u>	<u>264,543</u>

See accompanying notes to statutory financial statements.

**MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.**

Statutory Statements of Changes in Surplus

Years ended December 31, 2003 and 2002

	<u>Contributed surplus</u>	<u>Unassigned surplus</u>	<u>Total surplus</u>
Balances at December 31, 2001	\$ 250,000	5,074,904	5,324,904
Net income	—	264,543	264,543
Increase in nonadmitted assets	—	(109,864)	(109,864)
Change in net unrealized gains	—	71,258	71,258
Change in net deferred income tax	—	87,000	87,000
Balances at December 31, 2002	<u>250,000</u>	<u>5,387,841</u>	<u>5,637,841</u>
Net income	—	404,247	404,247
Decrease in nonadmitted assets	—	71,503	71,503
Change in net unrealized gains	—	35,171	35,171
Change in net deferred income tax	—	45,007	45,007
Balances at December 31, 2003	<u>\$ 250,000</u>	<u>5,943,769</u>	<u>6,193,769</u>

See accompanying notes to statutory financial statements.

**MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.**

Statutory Statements of Cash Flows

Years ended December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Cash flows from operations:		
Premiums collected, net of reinsurance	\$ 8,054,298	3,616,279
Losses and loss adjustment expenses paid	(2,721,507)	(3,468,302)
Underwriting expenses paid	(567,134)	(1,243,314)
Net investment income received	377,702	411,237
Dividends paid to policyholders	(4,663)	(161,625)
Federal income taxes paid	(500,293)	(240,228)
Other income received	42,847	—
Net cash provided by (used in) operations	<u>4,681,250</u>	<u>(1,085,953)</u>
Cash flows from investment activities:		
Proceeds from sales, maturities, or repayments of debt securities	3,553,040	822,735
Purchases of debt securities	<u>(5,707,889)</u>	<u>(885,103)</u>
Net cash used in investment activities	<u>(2,154,849)</u>	<u>(62,368)</u>
Cash flows from financing and miscellaneous activities:		
Net transfers from affiliates	—	92,735
Other applications, net	<u>(411,993)</u>	<u>(563,973)</u>
Net cash used in financing and miscellaneous activities	<u>(411,993)</u>	<u>(471,238)</u>
Net increase (decrease) in cash and short-term investments	2,114,408	(1,619,559)
Cash and short-term investments:		
Beginning of year	<u>455,440</u>	<u>2,074,999</u>
End of year	\$ <u><u>2,569,848</u></u>	<u><u>455,440</u></u>

See accompanying notes to statutory financial statements.

## MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.

Notes to Statutory Financial Statements

December 31, 2003 and 2002

### NOTES TO STATUTORY FINANCIAL STATEMENTS

#### (1) Organization and Summary of Significant Accounting Policies

##### (a) *Organization and Description of Business*

MedAmerica Mutual Risk Retention Group, Inc. (Company) was incorporated under the laws of the state of Hawaii on December 26, 1991 and was formed as a captive insurance company as defined in Article 19 of Chapter 431 of the Hawaii Revised Statutes and the Liability Risk Retention Act of 1986, as amended. The Company is a mutual insurance company and is not authorized to issue shares of capital stock. The members of the Company are its policyholders.

The Company's wholly owned subsidiaries include MedAmerica Reinsurance Company, Inc. (MRC), MedAmerica Financial Services, Inc. (MAFS), and EMPAQ Purchasing Group (EMPAQ). MRC was capitalized on April 1, 2001 with \$2,000,000 of cash and securities and operated as a professional reinsurance company. All assumed business of MRC was commuted as of December 31, 2002. The commutation transaction was completed in December 2003. As of December 31, 2003, the majority of the assets of MRC were transferred to the Company and MRC is inactive. MAFS was purchased on January 1, 1999 and is a licensed insurance brokerage company. MAFS was inactive during 2001, but operated as an insurance management company in 2002. In 2003, MAFS was inactive. EMPAQ remains inactive.

The Company's principal activity is to provide medical malpractice insurance to emergency medicine practitioners in the state of California and also the state of Washington. The Company issues claims-made insurance policies primarily with limits of \$1 million/\$3 million for losses and no limit for allocated loss adjustment expenses such as legal defense costs. After reinsurance, the Company generally retains limits of up to \$250,000 for losses and allocated loss adjustment expense combined.

##### (b) *Basis of Presentation*

The accompanying statutory financial statements have been prepared in conformity with statutory accounting practices as prescribed or permitted by the Insurance Division of the Department of Commerce and Consumer Affairs of the State of Hawaii (Insurance Division), which vary in some respects from accounting principles generally accepted in the United States of America (GAAP).

The National Association of Insurance Commissioners (NAIC) has adopted the codification of Statutory Accounting Principles Project (Codification) as the NAIC supported basis of accounting. The Codification project was approved with the provision for commissioner discretion in the determination of appropriate statutory accounting for insurers. Such discretion will allow prescribed or permitted accounting practices that may differ from state to state. The state of Hawaii and, accordingly, the Company have adopted Codification effective January 1, 2001. The more significant differences between GAAP and statutory principles are as follows:

- (1) Market values of certain investments in bonds are based on values specified by the NAIC rather than on actual or estimated market values. Changes between cost and admitted asset investment amounts are credited and charged directly to unassigned surplus rather than to a separate surplus account.

## **MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.**

### Notes to Statutory Financial Statements

December 31, 2003 and 2002

- (2) Certain assets designated as “nonadmitted assets”, principally certain short-term investments and deferred tax assets, are excluded from the accompanying statutory statements of admitted assets, liabilities, and surplus and are charged directly to unassigned surplus.
- (3) Unearned premiums and the liability for losses and loss adjustment expenses are recorded net of ceded unearned reinsurance premiums and reinsurance recoverable on unpaid losses and loss adjustment expenses, respectively.
- (4) The accounts and operations of the Company and its subsidiaries are not consolidated as would be required under GAAP. The Company values its investment in an insurance subsidiary based on the underlying statutory equity, and the investment in noninsurance subsidiaries based on the underlying GAAP equity. The Company’s share of undistributed earnings and losses of the subsidiaries are included in unrealized gains and losses in the statutory statements of changes in surplus.
- (5) Deferred income tax assets and liabilities are recognized with modifications for the realization criteria for deferred tax assets and the recording of the impact of changes in its deferred tax balances. Deferred tax assets are subject to an admissibility test and are admitted based on a defined formula. Changes in deferred tax assets and liabilities, including changes in tax rates are recognized as a separate component of gains and losses in unassigned surplus.
- (6) Acquisition costs, such as commissions, premium taxes, and other items, are charged to current operations as incurred, whereas related premium income is taken into earnings on a pro rata basis over the periods covered by the policies.
- (7) Cash and short-term investments in the statutory statements of cash flows represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with initial maturities of three months or less.

The presentation methodology of the statutory statements of cash flows is not in conformity with GAAP. The statements also do not include a reconciliation of net income to net cash from operations.

- (8) The presentation methodology of the statutory statements of admitted assets, liabilities, and surplus is also not in conformity with GAAP in regard to the reporting of comprehensive income.
- (9) Accounting changes are recognized as a separate component of surplus rather than as a component of net income.

## MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.

### Notes to Statutory Financial Statements

December 31, 2003 and 2002

#### (c) *Investments*

Debt securities, common stock of subsidiaries, and short-term investments are stated at values prescribed by the NAIC, as follows:

- (1) Bonds are generally stated at amortized cost using the level-yield basis. Bonds which do not qualify to be carried at amortized cost are stated at the NAIC value.
- (2) Common stock of insurance subsidiaries are reported based on the underlying statutory equity, and common stock of noninsurance subsidiaries are reported based on the underlying GAAP equity. The Company's share of undistributed earnings (losses) of the subsidiaries are reported in unassigned surplus.
- (3) Short-term investments are stated at amortized cost, which approximates fair value.
- (4) Mortgage-backed securities are carried at amortized cost or market value based on valuation procedures determined by the NAIC. The Company considers anticipated portfolio prepayments in the carrying value of mortgage-backed securities in accordance with policies adopted by the NAIC. Accordingly, the amortized cost for mortgage-backed securities are periodically adjusted retrospectively for such prepayment experience and other revisions on the underlying mortgage collateral.
- (5) Investment securities, for which a decline in the fair value is determined to be other than temporary, are stated at fair value with the write down accounted for as a realized loss. To determine whether an impairment is other-than-temporary, the Company considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the magnitude of impairment, the severity and duration of the impairment, changes in value subsequent to year-end, and forecast performance of the investment. Realized capital gains and losses on sales of investment securities are determined using specific certificate identification.

#### (d) *Premiums*

Insurance premiums are earned pro rata over the period the insurance policy is in force. Premiums applicable to future periods are deferred in the accompanying statutory statements of admitted assets, liabilities, and surplus.

#### (e) *Losses and Loss Adjustment Expenses*

The liability for losses and loss adjustment expenses represent estimates of reported losses and loss adjustment expenses and are based on target losses and loss adjustment expense ratios that management and its appointed actuary believe are reasonable and reflective of anticipated ultimate experience. The ultimate settlement of outstanding claims and estimated losses may vary significantly from the estimated amounts included in the accompanying statutory financial statements.

## **MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.**

### Notes to Statutory Financial Statements

December 31, 2003 and 2002

**(f) Reinsurance**

In the normal course of business, the Company seeks to reduce the loss that may arise from extremely large losses and catastrophic events by reinsuring certain levels of risk with other insurance enterprises. Premiums earned and losses and loss adjusting expenses incurred relating to reinsurance are accounted for in a manner consistent with the underlying policies. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy.

**(g) Income Taxes**

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in surplus in the period that includes the enactment date.

The admissibility of the Company's deferred tax assets is determined by identifying the amount of loss carrybacks exceeding the amount of gross deferred tax assets that can be recovered by the end of the subsequent calendar year. This amount is deemed to be admissible according to NAIC statutory accounting principles. The amount calculated will be subjected to further reduction if it exceeds 10% of capital and surplus or it exceeds the amount of gross deferred tax liabilities.

Federal income taxes are provided based upon a calculation of income taxes currently payable or benefits currently recoverable. The federal income tax returns of the Company are filed on the basis of annual statements filed with the Insurance Division.

The Company files a separate return for state premium taxes. The Company is exempt from state income taxes.

**(h) Use of Estimates**

The preparation of the statutory financial statements requires management to make estimates and assumptions that affect the reported amounts of admitted assets and liabilities and disclosure of contingent assets and liabilities at the date of the statutory financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**(i) Reclassification**

Deferred income tax assets were reported net of deferred income tax liabilities in the 2002 financial statements. In the 2003 financial statements, deferred income tax assets and liabilities are reported at gross. These reclassifications have no effect on previously reported results of operations.

**MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.**

Notes to Statutory Financial Statements

December 31, 2003 and 2002

**(2) Investments**

The admitted value and the fair value of investments in debt securities are summarized as follows:

	<u>Count</u>	<u>Admitted value</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Fair value</u>
At December 31, 2003:					
U.S. government bonds	3	\$ 251,902	12,176	—	264,078
Municipal bonds	46	7,383,633	36,872	—	7,420,505
Corporate bonds	29	3,147,985	49,708	9,788	3,187,905
Mortgage-backed securities – U.S. government agencies	8	1,178,417	2,629	—	1,181,046
Total debt securities	<u>86</u>	<u>\$ 11,961,937</u>	<u>101,385</u>	<u>9,788</u>	<u>12,053,534</u>
At December 31, 2002:					
U.S. government bonds	1	\$ 443,864	73,636	—	517,500
Municipal bonds	37	5,884,798	14,952	—	5,899,750
Corporate bonds	9	936,896	40,367	—	977,263
Mortgage-backed securities – U.S. government agencies	4	700,728	—	—	700,728
Total debt securities	<u>51</u>	<u>\$ 7,966,286</u>	<u>128,955</u>	<u>—</u>	<u>8,095,241</u>

A summary of the amortized cost and fair value of the Company's investments in debt securities at December 31, 2003, by contractual maturity, is as follows:

	<u>Amortized cost</u>	<u>Fair value</u>
Years to maturity:		
One or less	\$ —	—
After one through five	2,607,239	2,646,192
After five through ten	2,316,545	2,330,261
After ten	5,859,736	5,896,035
Mortgage-backed securities – U.S. government agencies	1,178,417	1,181,046
Total	<u>\$ 11,961,937</u>	<u>12,053,534</u>

The expected maturity of mortgage-backed securities is presented in total since the principal cash flows of these securities are not received at a single maturity date.

At December 31, 2003, seven investment securities which have gross unrealized losses in 2003, have been in an unrealized loss position for less than one year. The unrealized losses on investment securities were caused by interest rate increases. Management believes that these investments would not be settled at a price less than the amortized cost of the investments. As the decline in fair value is attributable to changes in interest rates and not credit quality, as applicable, and as the Company has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Proceeds from the sale of investments in debt securities during 2003 and 2002 were \$1,804,742 and \$822,735, respectively; gross gains of approximately \$117,000 and \$900, respectively; and gross losses of approximately nil was realized on those sales.

**(3) Investment in Subsidiaries**

The Company records its investment in insurance subsidiary (MRC) based on the underlying statutory equity, and the investment in noninsurance subsidiaries (MAFS and EMPAQ) based on the underlying GAAP equity. As of December 31, 2003, the Company's investment in its wholly owned subsidiaries is as follows:

	<u>MRC</u>	<u>MAFS</u>	<u>EMPAQ</u>	<u>Total</u>
Assets	\$ 798,191	37,439	6,996	842,626
Liabilities	505,066	15,749	—	520,815
Equity	293,125	21,690	6,996	321,811
Net gain (loss)	(188,406)	4,233	(545)	(184,718)

**(4) Federal Income Taxes**

The Company and its subsidiaries file a consolidated federal income tax return. Income tax is allocated to the subsidiaries on a separate-return basis.

Total income tax expense for the years ended December 31, 2003 and 2002 was allocated as follows:

	<u>2003</u>	<u>2002</u>
Income from operations	\$ 211,694	141,191
Change in deferred income taxes	(78,007)	(87,000)
Total income tax expense	<u>\$ 133,687</u>	<u>54,191</u>

**MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.**

Notes to Statutory Financial Statements

December 31, 2003 and 2002

The tax effects of temporary differences that give rise to significant portions of deferred tax assets at December 31, 2003 and 2002 are as follows:

	<u>2003</u>	<u>2002</u>
Deferred tax assets:		
Nondeductible portion of losses and loss adjustment expenses	\$ 391,191	366,000
Unearned premiums	20,806	15,000
Deferred compensation	41,735	11,000
Other	18,150	—
	<u>471,882</u>	<u>392,000</u>
Total gross deferred tax assets		
Nonadmitted deferred tax assets	<u>(212,213)</u>	<u>(302,000)</u>
Admitted deferred tax assets	259,669	90,000
Deferred tax liabilities – other	<u>(36,875)</u>	<u>(2,000)</u>
Deferred income tax assets, net	<u>\$ 222,794</u>	<u>88,000</u>

Income tax expense of \$133,687 and \$54,191 in 2003 and 2002, respectively, differs from the “expected” tax expense for those years (computed by applying the current federal corporate income tax rate of 34% to income before federal income taxes) as follows:

	<u>2003</u>	<u>2002</u>
Computed “expected” tax expense	\$ 209,000	138,000
Tax-exempt interest income	(81,000)	(78,000)
Other	5,687	(5,809)
	<u>\$ 133,687</u>	<u>54,191</u>

**MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.**

Notes to Statutory Financial Statements

December 31, 2003 and 2002

**(5) Losses and Loss Adjustment Expense Reserves**

Activity in the losses and loss adjustment expense reserves for the years ended December 31, 2003 and 2002 are as follows:

	<u>2003</u>	<u>2002</u>
Reserve balance, beginning of year	\$ 6,118,612	5,011,881
Incurred related to:		
Current year	6,246,000	3,674,000
Prior year	(432,507)	382,059
Total incurred	<u>5,813,493</u>	<u>4,056,059</u>
Less paid losses and loss adjustment expenses relating to:		
Current year	694,000	651,000
Prior year	2,442,932	2,298,328
Total paid	<u>3,136,932</u>	<u>2,949,328</u>
Reserve balance, end of year	<u>\$ 8,795,173</u>	<u>6,118,612</u>

As indicated above, included in losses and loss adjustment expenses incurred for 2003 and 2002 is an adjustment of \$(432,507) and \$382,059, respectively, in the estimates of the ultimate settlement value of claims in the prior claim reporting years. This adjustment is the net effect of changes made to case and incurred-but-not-reported reserves as additional information became available and claims were closed.

**(6) Reinsurance**

The Company's reinsurance program provides for the protection against individual losses and against multiple claims from the same incident. The Company issues claims-made insurance policies with loss limits of \$1 million per claim and \$3 million aggregate. After reinsurance, the Company retained the first \$100,000 of indemnity risk and ceded 100% of all loss adjustment expenses for policies written prior to 2001. Beginning in 2001, the Company retains the first \$250,000 of combined indemnity and loss adjustment expenses for policies written in 2001 and 2002. In 2003, the Company retained the first \$250,000 of indemnity and pro rata portion of loss adjustment expenses. Reinsurance contracts do not relieve the Company from its obligation to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. Reinsurance contracts do not relieve the Company from its obligation to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company.

At December 31, 2003 and 2002, the Company had ceded outstanding losses and loss adjustment expense reserves totaling \$5,064,000 and \$4,067,000, respectively. Also, at December 31, 2003 and 2002, the Company had ceded paid losses and loss adjusting expenses recoverable from reinsurers approximating \$36,000 and \$584,000, respectively.

## **MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.**

Notes to Statutory Financial Statements

December 31, 2003 and 2002

The Company had direct and ceded premiums written of approximately \$10,668,000 and \$3,286,000 in 2003 and approximately \$7,838,000 and \$2,627,000 in 2002, respectively, and direct and ceded premiums earned of approximately \$10,548,000 and \$3,258,000 in 2003 and approximately \$7,879,000 and \$2,641,000 in 2002, respectively. Ceded incurred losses and loss adjustment expenses for the years ended December 31, 2003 and 2002 totaled approximately \$2,344,000 and \$1,272,000, respectively.

### **(7) Surplus**

The Company is required, by the Insurance Division, to maintain minimum capital and surplus requirements of \$500,000. The maximum amount of dividends which can be paid by state of Hawaii insurance companies without prior approval of the Insurance Commissioner is subject to certain restrictions. The maximum dividend payout which may be made without prior approval is the lesser of statutory net income, not including realized capital gains, or 10% of statutory unassigned surplus as reported in the annual statement for the preceding period. Dividends can be paid only to the extent of a positive unassigned surplus. Also, no dividends which would reduce surplus to an amount less than the minimum required by the state of Hawaii can be declared or paid. The maximum amount of dividends allowed to be paid by the Company without prior approval of the Insurance Commissioner for the year ending December 31, 2004 amounts to \$287,000. The Company paid policyholder dividends of \$4,663 and \$173,473 for the years ended December 31, 2003 and 2002, respectively.

### **(8) Risk-Based Capital**

The Company is subject to risk-based capital (RBC) requirements imposed by the Insurance Division. The RBC calculation serves as a benchmark for the regulation of property and casualty insurance companies by state insurance regulators. RBC provides for surplus formulas similar to target surplus formulas used by commercial rating agencies. The RBC guidelines define specific capital levels based on a company's authorized control level RBC (ACLCL) that is determined by the ratio of the company's total adjusted capital (TAC) to its ACLCL.

As of December 31, 2003 and 2002, the Company's TAC substantially exceeded the ACLCL required at the "Company Action Level."

### **(9) Related Party Transactions**

An agreement exists between the Company and MedAmerica, Inc. whereby MedAmerica, Inc. provides administrative services to the Company. MedAmerica, Inc. is majority owned by California Emergency Physicians Medical Group (CEP). The majority of the Company's policyholders are CEP physicians. Total administrative fees paid to MedAmerica, Inc. were \$50,500 for 2003 and 2002.

Beginning January 1, 2001, the Company leases office space from MedAmerica, Inc. under a noncancelable operating lease agreement that expires in December 2004. Rental expense for 2003 was approximately \$85,000. Future minimum lease payments under this sublease are \$67,000 for the year ended December 31, 2004.

The Company incurs expenses on behalf of its subsidiaries. At December 31, 2003 and 2002, the receivable balance from subsidiaries for these expenses amounted to \$513,058 and \$3,708, respectively.

**MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.**

Notes to Statutory Financial Statements

December 31, 2003 and 2002

**(10) Fair Value of Financial Instruments**

The fair value of financial instruments is the amount at which the instrument could be exchanged in a current transaction between willing parties. The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

*Cash and Short-Term Investments, Receivables, and Other Assets* – the admitted values approximate the fair values because of the short maturity of these instruments.

*Investments in Debt Securities* – the fair values, which amounted to \$12,053,534 and \$8,095,241 at December 31, 2003 and 2002, respectively, are estimated based on quoted market prices for these investments. Admitted values amounted to \$11,961,937 and \$7,966,286 at December 31, 2003 and 2002, respectively.

## MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.

## Supplemental Schedule – Investment Summary Schedule

December 31, 2003

	Gross investment holdings		Admitted assets as reported in the annual statement	
	Amount	Percentage	Amount	Percentage
Bonds:				
U.S. treasury securities	\$ 251,902	2%	\$ 251,902	2%
U.S. government agency and corporate obligations (excluding mortgage-backed securities):				
Issued by U.S. government agencies	1,178,418	8%	1,178,418	8%
Issued by U.S. government sponsored agencies		0%		0%
Foreign government (including Canada, excluding mortgage-backed securities)		0%		0%
Securities issued by states, territories, and possessions and political subdivisions in the U.S.:				
States, territories, and possessions general obligations	281,720	2%	281,720	2%
Political subdivisions of states, territories, and possessions and political subdivisions general obligations	1,509,980	10%	1,509,980	10%
Revenue and assessment obligations	5,372,479	36%	5,372,479	36%
Industrial development and similar obligations		0%		0%
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities:				
Guaranteed by GNMA		0%		0%
Issued by FNMA and FHLMC		0%		0%
Privately issued		0%		0%
CMOs and REMICs:				
Issued by FNMA and FHLMC		0%		0%
Privately issued and collateralized by MBS issued or guaranteed by GNMA, FNMA, or FHLMC		0%		0%
All other privately issued		0%		0%
Other debt and other fixed income securities (excluding short-term):				
Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	3,367,438	23%	3,367,438	23%
Unaffiliated foreign securities		0%		0%
Affiliated securities		0%		0%
Equity interests:				
Investments in mutual funds		0%		0%
Preferred stocks:				
Affiliated		0%		0%
Unaffiliated		0%		0%
Publicly traded equity securities (excluding preferred stocks):				
Affiliated	321,809	2%	321,809	2%
Unaffiliated		0%		0%
Other equity securities:				
Affiliated		0%		0%
Unaffiliated		0%		0%
Other equity interests including tangible personal property under lease:				
Affiliated		0%		0%
Unaffiliated		0%		0%
Mortgage loans:				
Construction and land development		0%		0%
Agricultural		0%		0%
Single-family residential properties		0%		0%
Multifamily residential properties		0%		0%
Commercial loans		0%		0%
Real estate investments:				
Property occupied by company		0%		0%
Property held for production of income (includes \$0 of property acquired in satisfaction of debt)		0%		0%
Property held for sale (\$0 including property acquired in satisfaction of debt)		0%		0%
Policy loans		0%		0%
Receivables for securities		0%		0%
Cash and short-term investments	2,569,848	17%	2,569,848	17%
Other invested assets		0%		0%
Total invested assets	\$ 14,853,594	100%	\$ 14,853,594	100%

See accompanying independent auditors' report.

## MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.

## Supplemental Schedule – Investment Risks Interrogatories

For the year ended December 31, 2003

The Investment Risk Interrogatories are to be filed by April 1. They are also to be included with the Audited Statutory Financial Statements.

Answer the following interrogatories by stating the applicable U.S. dollar amounts and percentages of the reporting entity's total admitted assets held in that category of investments as shown on the Summary Investment Schedule. All reporting entities must answer interrogatories 1 through 4, 11, 13 through 17, 19 and, if applicable, 20 through 24. Answer each of the interrogatories 5 through 10 only if the reporting entity's aggregate holding in the gross investment category addressed in interrogatory 4 equals or exceeds 2.5% of the reporting entity's total admitted assets. Answer interrogatory 12 only if the reporting entity's aggregate holding in the gross investment category addressed in interrogatory 11 equals or exceeds 2.5% of the reporting entity's total admitted assets. Answer interrogatory 18 only if the reporting entity's aggregate holding in the gross investment category addressed in interrogatory 17 equals or exceeds 2.5% of the reporting entity's total admitted assets. For Life, Health, and Fraternal blanks, responses are to exclude Separate Accounts. For Property Casualty blank, responses are to exclude Protected Cell Accounts.

1. State the reporting entity's total admitted assets as reported on Page 2 of the annual statement. \$ 16,799,192
2. State by investment category the 10 largest exposures to a single issuer/borrower/investment, excluding U.S. government, U.S. government agency securities, and those U.S. government money market funds listed in the Appendix to the SVO Purposes and Procedures Manual as exempt, property occupied by the Company and policy loans.

Investment category	Amount	Percentage of total admitted assets
2.01 Federated Prime Cash Obligation Fund (60934N)	\$ 1,237,003	7.36%
2.02 MedAmerica Reinsurance Company Inc. (58403@)	293,125	1.74%
2.03 Sayer PA Healthcare Facility A (805777)	253,880	1.51%
2.04 Nationsbank Corp. (638585)	250,977	1.49%
2.05 Harris County, Tx, (414004)	248,145	1.48%
2.06 Las Vegas Nev, (517696)	247,991	1.48%
2.07 California Health Fac (13033A)	243,897	1.45%
2.08 Boone County KY School Dist. (098825)	227,487	1.35%
2.09 Wisconsin State Health & Educa (97710V)	225,805	1.34%
2.10 Maine State Hsg (56052E)	224,473	1.34%

3. State the amounts and percentages of the reporting entity's total admitted assets held in bonds and preferred stocks by NAIC rating.

Bonds	Amount	Percent
3.01 NAIC-1	\$ 12,865,422	76.58%
3.02 NAIC-2	482,942	2.87%
3.03 NAIC-3	NONE	
3.04 NAIC-4	NONE	
3.05 NAIC-5	NONE	
3.06 NAIC-6	NONE	
Preferred stocks		
3.07 P/RP-1	NONE	
3.08 P/RP-2	NONE	
3.09 P/RP-3	NONE	
3.10 P/RP-4	NONE	
3.11 P/RP-5	NONE	
3.12 P/RP-6	NONE	

4. State the amounts and percentages of the reporting entity's total admitted assets held in foreign investments (regardless of whether there is any foreign currency exposure) and unhedged foreign currency exposure (defined as the statement value of investments denominated in foreign currencies which are not hedged by financial instruments qualifying for hedge accounting as specified in SSAP No. 31 – *Derivative Instruments* and SSAP No. 86 – *Derivative Instruments*), including:

Description	Amount	Percent
4.01 Foreign-currency-denominated investments of	NONE	
4.02 Supporting insurance liabilities denominated in that same foreign currency of	NONE	
4.03 Excluding Canadian investments and currency exposure of	NONE	
4.04 Assets held in foreign investments less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatories 5-10.		Yes [ X ] No [ ]

## MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.

Supplemental Schedule – Investment Risks Interrogatories

For the year ended December 31, 2003

5. Aggregate foreign investment exposure categorized by NAIC sovereign rating:

Description	Amount	Percent
5.01 Countries rated NAIC-1	NONE	
5.02 Countries rated NAIC-2	NONE	
5.03 Countries rated NAIC-3 or below	NONE	

6. Two largest foreign investment exposures to a single country, categorized by the country's NAIC sovereign rating:

Description	Amount	Percent
Countries rated NAIC-1:		
6.01	NONE	
6.02	NONE	
Countries rated NAIC-2:		
6.03	NONE	
6.04	NONE	
Countries rated NAIC-3 or below:		
6.05	NONE	
6.06	NONE	

7. Aggregate unhedged foreign currency exposure.

NONE

8. Aggregate unhedged foreign currency exposure categorized by NAIC sovereign rating:

Description	Amount	Percent
8.01 Countries rated NAIC-1	NONE	
8.02 Countries rated NAIC-2	NONE	
8.03 Countries rated NAIC-3 or below	NONE	

9. Two largest unhedged foreign currency exposures to a single country, categorized by the country's NAIC sovereign rating:

Description	Amount	Percent
Countries rated NAIC-1:		
9.01	NONE	
9.02	NONE	
Countries rated NAIC-2:		
9.03	NONE	
9.04	NONE	
Countries rated NAIC-3 or below:		
9.05	NONE	
9.06	NONE	

10. List the 10 largest non-sovereign (i.e., non-governmental) foreign issues:

NONE

Description – Include NAIC rating	Amount	Percent
10.01 – 10.10	NONE	

11. State the amounts and percentages of the reporting entity's total admitted assets held in Canadian investments and unhedged Canadian currency exposure, including:

Description	Amount	Percent
11.01 Canadian-currency-denominated investments of	NONE	
11.02 Supporting Canadian-denominated insurance liabilities of	NONE	
11.03 Assets held in Canadian investments less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 12.		Yes [ X ] No [ ]

12. Aggregate Canadian investment exposure.

Description	Amount	Percent
12.01 Canadian investments	NONE	
12.02 Unhedged Canadian currency exposure	NONE	

## MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.

## Supplemental Schedule – Investment Risks Interrogatories

For the year ended December 31, 2003

13. State the aggregate amounts and percentages of the reporting entity's total admitted assets held in investments with contractual sales restrictions (defined as investments having restrictions that prevent investments from being sold within 90 days).

Assets held in investments with contractual sales restrictions less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 13.

Yes [ X ] No [ ]

Description	Amount	Percent
13.01 Aggregate statement value of investments with contractual sales restrictions	NONE	
Largest 3 investments with contractual sales restrictions: 13.02 – 13.04	NONE	

14. State the amounts and percentages of admitted assets held in the largest 10 equity interests (including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other equity securities, and excluding money market and bond mutual funds listed in the Appendix to the SVO Purposes and Procedures Manual as exempt or Class 1).

Assets held in equity interests less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 14.

Yes [ X ] No [ ]

Investment Category	Amount	Percent
Assets held in equity interests: 14.01 – 14.10	NONE	

15. State the amounts and percentages of the reporting entity's total admitted assets held in nonaffiliated, privately placed equities (included in other equity securities) and excluding securities eligible for sale under Securities Exchange Commission (SEC) Rule 144a or SEC Rule 144 without volume restrictions.

Assets held in nonaffiliated, privately placed equities less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 15.

Yes [ X ] No [ ]

Description	Amount	Percent
15.01 Aggregate statement value of investments held in nonaffiliated, privately placed equities	NONE	
Largest 3 investments held in nonaffiliated, privately placed equities: 15.02 – 15.04	NONE	

16. State the amounts and percentages of the reporting entity's total admitted assets held in general partnership interests (included in other equity securities).

Assets held in general partnership interests less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 16.

Yes [ X ] No [ ]

Description	Amount	Percent
16.01 Aggregate statement value of investments held in general partnership interests	NONE	
Largest 3 investments with contractual sales restrictions: 16.02 – 16.04	NONE	

17. With respect to mortgage loans reported in Schedule B, state the amounts and percentages of the reporting entity's total admitted assets held.

Mortgage loans reported in Schedule B less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatories 17 and 18.

Yes [ X ] No [ ]

Each of the 10 largest aggregate mortgage interests. The aggregate mortgage interest represents the combined value of all mortgages secured by the same property or same group of properties:

Type (Residential, Commercial, Agricultural)	Amount	Percent
17.01 – 17.10	NONE	

## MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.

Supplemental Schedule – Investment Risks Interrogatories

For the year ended December 31, 2003

18. Aggregate mortgage loans having the following loan-to-value ratios as determined from the most current appraisal as of the annual statement date:

Loan-to-Value	Residential		Commercial		Agricultural	
	Amount	Percent	Amount	Percent	Amount	Percent
18.01 Above 95%	NONE		NONE		NONE	
18.02 91% to 95%	NONE		NONE		NONE	
18.03 81% to 90%	NONE		NONE		NONE	
18.04 71% to 80%	NONE		NONE		NONE	
18.05 Below 70%	NONE		NONE		NONE	
Description					Amount	Percent
18.06 Construction loans					NONE	
18.07 Mortgage loans over 90 days past due					NONE	
18.08 Mortgage loans in the process of foreclosure					NONE	
18.09 Mortgage loans foreclosed					NONE	
18.10 Restructured mortgage loans					NONE	

19. State the amounts and percentages of the reporting entity's total admitted assets held in each of the five largest investments in one parcel or group of contiguous parcels of real estate reported in Schedule A, excluding property occupied by the company.

Assets held in each of the five largest investments in one parcel or group of contiguous parcels of real estate reported in Schedule A less than 2.5% of the reporting entity's total admitted assets, therefore detail not required for interrogatory 19. Yes [ X ] No [ ]

Description	Amount	Percent
19.01 – 19.05	NONE	

20. State the amounts and percentages of the reporting entity's total admitted assets subject to the following types of agreements:

Description	At Year-End		Amount at End of Each Quarter		
	Amount	Percent	1st Qtr.	2nd Qtr.	3rd Qtr.
20.01 Securities lending (do not include assets held as collateral for such transactions)	NONE		NONE	NONE	NONE
20.02 Repurchase agreements	NONE		NONE	NONE	NONE
20.03 Reverse repurchase agreements	NONE		NONE	NONE	NONE
20.04 Dollar repurchase agreements	NONE		NONE	NONE	NONE
20.05 Dollar reverse repurchase agreements	NONE		NONE	NONE	NONE

21. State the amounts and percentages indicated below for warrants not attached to other financial instruments, options, caps, and floors:

Description	Owned		Written	
	Amount	Percent	Amount	Percent
21.01 Hedging	NONE		NONE	
21.02 Income generation	NONE		NONE	
21.03 Other	NONE		NONE	

22. State the amounts and percentages indicated below of potential exposure (defined as the amount determined in accordance with the NAIC Annual Statement Instructions) for collars, swaps, and forwards:

Description	At Year-End		Amount at End of Each Quarter		
	Amount	Percent	1st Qtr.	2nd Qtr.	3rd Qtr.
22.01 Hedging	NONE		NONE	NONE	NONE
22.02 Income generation	NONE		NONE	NONE	NONE
22.03 Replications	NONE		NONE	NONE	NONE
22.04 Other	NONE		NONE	NONE	NONE

## MEDAMERICA MUTUAL RISK RETENTION GROUP, INC.

## Supplemental Schedule – Investment Risks Interrogatories

For the year ended December 31, 2003

23. State the amounts and percentages indicated below of potential exposure (defined as the amount determined in accordance with the NAIC Annual Statement Instructions) for futures contracts:

Description	At Year-End		Amount at End of Each Quarter		
	Amount	Percent	1st Qtr.	2nd Qtr.	3rd Qtr.
23.01 Hedging	NONE		NONE	NONE	NONE
23.02 Income generation	NONE		NONE	NONE	NONE
23.03 Replications	NONE		NONE	NONE	NONE
23.04 Other	NONE		NONE	NONE	NONE

24. State the amounts and percentages of 10 largest investments included in the Write-ins for Invested Assets category included on the Summary Investment Schedule:

Investments	Amount	Percent
24.01 – 24.10	NONE	

See accompanying independent auditors' report.

## **INDEPENDENT AUDITORS' REPORT**

**The Board of Directors**

**MedAmerica Mutual Risk Retention Group, Inc.**

We have audited the accompanying statutory statements of admitted assets, liabilities, and surplus of MedAmerica Mutual Risk Retention Group, Inc. as of December 31, 2003 and 2002, and the related statutory statements of income, changes in surplus, and cash flows for the years then ended. These statutory financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these statutory financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in note 1 to the financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the Insurance Division of the Department of Commerce and Consumer Affairs of the State of Hawaii, which practices differ from accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between the statutory basis of accounting and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of MedAmerica Mutual Risk Retention Group, Inc. as of December 31, 2003 and 2002 or the results of its operations or its cash flows for the years then ended.

Also, in our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of MedAmerica Mutual Risk Retention Group, Inc. as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in note 1.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in schedules 1 and 2 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated on the basis of accounting described in note 1, in all material respects, in relation to the basic financial statements taken as a whole.

**KPMG LLP**

March 19, 2004

## **2003 Board of Directors**

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