September 2002

Newsletter of the Physicians Reimbursement Fund, Inc.

PRF NEWS

Volume 5, Number 2

Covering Practice and Risk Management Issues for Physicians

LETTER TO INSUREDS

Dear PRF Insureds:

The Physicians Reimbursement Fund was founded in 1976 in the form of an offshore *captive insurance company* domiciled in Grand Cayman. Today, Physicians Reimbursement Fund, Inc. still insures 17 of the 71 original founding members. Approximately 60% of PRF's current insureds have been with the company less than seven years. With this in mind, the purpose of this annual report is two-fold – to inform the company's insureds regarding the operations of the business in our most recent calendar year, 2001, and to provide our newer insureds with a history and character of the company.

In summary, January 2001 began a year of transition for Physicians Reimbursement Fund, Inc., a Risk Retention Group (PRF). Effective January 1, 2001, PRF purchased reinsurance for the excess level of coverage the company provides its insureds. Prior to January 2001 Physicians Excess Insurance Company (PEIC), an offshore company domiciled in Anguilla, provided the excess level of coverage. As a PRF insured, you may recall that in years prior to 2001 you received three Declaration pages, i.e., one from PRF (the primary insurance carrier); one from PEIC (the excess insurance carrier); and a third Declaration page showing the combined coverage provided by both companies of $1 Million per occurrence / $3 Million aggregate per policy period. Currently, the PRF issues its insureds one Declaration page for the $1 Million / $3 Million coverage. This is one more step to simplify operations both for the company and for its insureds.

As you read through the history and objectives of the company, its structure and management, the highlights of 2001 and the projections for 2002 and 2003, I hope you will gain a better understanding of how the company works and why it is uniquely qualified to handle your professional liability insurance needs.

Sincerely,

George F. Lee, MD, President
Physicians Reimbursement Fund, Inc.,
a Risk Retention Group

Highlights of 2001

EXAM/AUDIT BY THE VERMONT DEPARTMENT OF INSURANCE

At the end of June 2001 the PRF office underwent a comprehensive, week-long examination by the Vermont Department of Insurance. Three examiners from the State of Vermont Department of Insurance worked closely with the PRF staff to audit all the company's financial, underwriting and business processes. This was the first time PRF was examined by the Vermont Department of Insurance, and it is a pleasure to report that the examiners gave the company an excellent report with no irregularities. As a risk retention group domiciled in the state of Vermont, the company will have to undergo this exam every three years. The next exam is slated for June 2004.

ANNUAL GENERAL MEETING

As is customary, PRF held its Annual General Meeting in April 2002. All insureds are invited to attend the Annual General Meeting and attendance is encouraged, especially for all new insureds. It is an opportunity to learn more about the company, meet the management team, and gain an understanding of what sets PRF apart from other medical malpractice insurance companies.

THE NUMBER OF INSUREDS / TYPES OF PRODUCTS

For the year ended December 31, 2001 there was a total of 185 PRF insureds. This number consisted of 90 specialists; 4 office-based specialists; 50 primary care physicians; 4 Ph.D.s; 20 allied health professionals and 17 oral surgeons. In addition to medical malpractice insurance for physicians and allied health professionals, the company offers medical malpractice insurance for laboratories. Currently the company insures five medical laboratories. The company also offers Medical Board Coverage for a nominal annual premium. Insureds who purchase Medical Board

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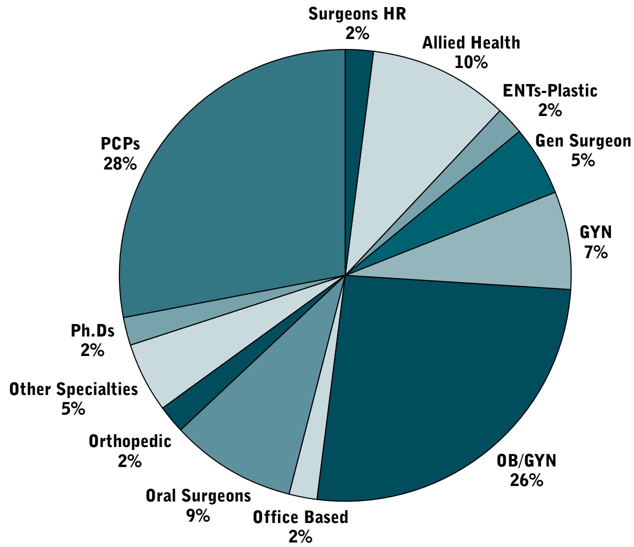
Coverage are provided with counsel who will review the case in question with the insured and accompany the insured to their Medical Board hearing (in the event the insured is called to appear before the Medical Board).

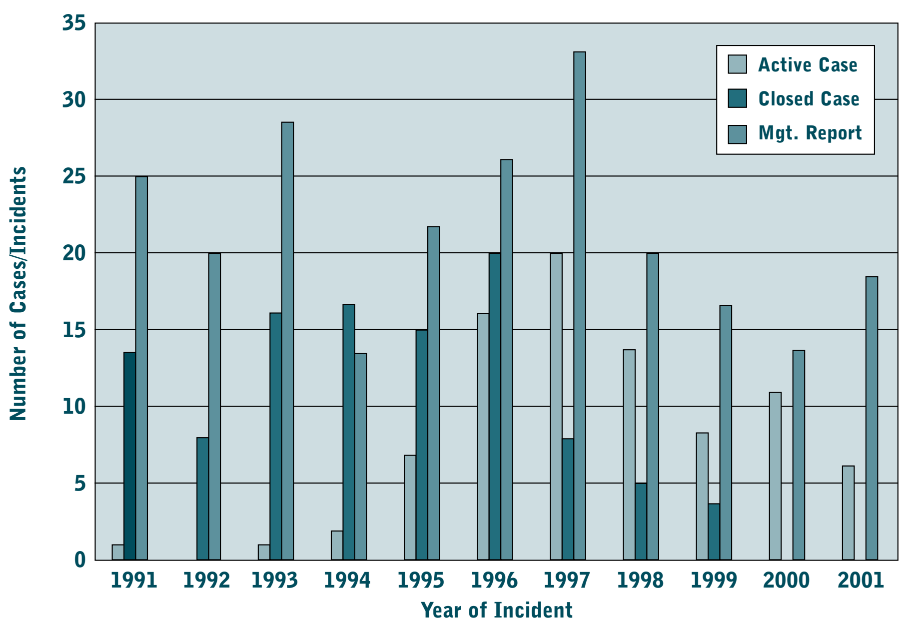
PRF Insureds by Specialty as of April 2002



PRF'S LEVEL OF LOSS EXPERIENCE

In the year 2001 PRF's loss experience was excellent. The total payout for the year was $187,000. This figure compares favorably with $345,000 paid out in 2000 and $976,000 paid out in 1999. Historically PRF's overall loss experience has been excellent, especially considering that PRF's membership has a large percentage of high risk specialties.

PRF Cases/Incidents per Year (based on Year of Incident) 1991-2001



INVESTMENTS

The company's investment portfolio accounts are held with Advest under the supervision of PRF's Treasurer and Chief Financial Officer, Damian Augustyn, MD. In spite of the state of the economy and the market and the tragic events of September 11, 2001, PRF's overall investment portfolio increased by 7.3% at the close of 2001, compared to the previous calendar year. ■

MEDICAL LIABILITY COVERAGE – KEY TERMS

Captive Insurance Company: A captive insurance company is a company established and owned by a parent firm for the purpose of insuring the parent firm's loss exposure. One of the reasons for forming a captive insurance company is that a group of individuals with similar risk exposure (in the instance of PRF, physicians and allied health care professionals) cannot purchase insurance from commercial insurance companies. Such was the case during the medical malpractice insurance crisis of 1975, when many commercial insurers were either tripling their rates or withdrawing from the medical malpractice market entirely. PRF operated as a captive insurance company from 1976 through 1998. PRF made the transition from captive insurance company to risk retention group in 1998.

Risk Retention Group (RRG): A capitalized member-owned insurance company licensed under the federal Liability Risk Retention Act of 1986 that is limited to writing liability insurance for groups with similar liability exposures. The company may be licensed in one state and market its product in other states. An RRG must be registered in any state in which it does business. PRF–RRG is a risk retention group licensed and domiciled in the state of Vermont and registered with the state of California.

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History and Objectives of the Company

PRF, Ltd., a medical malpractice captive insurance company, was organized in 1975 to provide professional liability insurance coverage to physicians practicing principally at California Pacific Medical Center (CPMC) (formerly Children's Hospital and Presbyterian Hospital). PRF, Ltd., was formed in response to the crisis in availability of medical malpractice insurance in California.

At that time, as a result of a sharp increase in both the expense and the number of medical malpractice injury awards, malpractice carriers in California either stopped writing policies or drastically increased their premiums. The high cost of professional liability insurance became so prohibitive that some physicians either stopped practicing or left California to practice in states with affordable premiums.

The founding objectives of PRF, Ltd., were to:

a) Eliminate the overhead expenses inherent in commercial insurance coverage;

b) Implement a philosophy in risk and claims management which involved early identification and resolution of patient problems before they turn into lawsuits;

c) Retain for the owner-physicians the benefit of these efficiencies in the form of stable, below market insurance premiums, and;

d) Offer *occurrence based coverage* (not *claims made*) (see Key Terms on page 4) thereby allowing its insureds an increased sense of security and freedom in terms of their individual choice of practice.

Even though the company has grown from an offshore captive insurance company to a fully regulated onshore *risk retention group*, its objectives remain the same. In simple terms, PRF's objectives are to proactively take better care of patients, thereby reducing the number of lawsuits and maintaining competitively priced premiums.

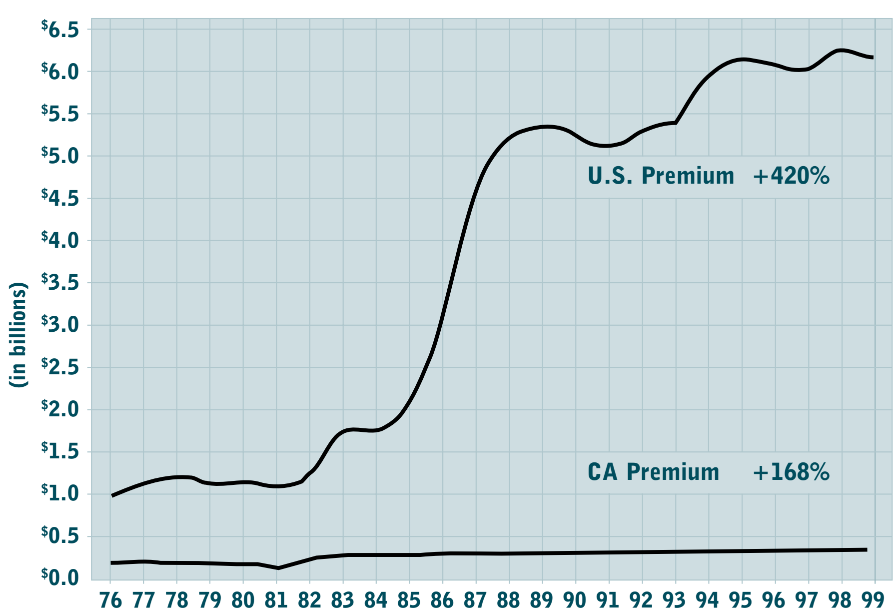
LOSS PREVENTION/ RISK MANAGEMENT TACTICS

Today, as in the past, the PRF strives to reduce the incidence and cost of medical malpractice lawsuits through the following methods:

- Code Green is PRF's program for resolving patient issues without regard to whether anyone is to blame or is responsible in the legal sense.
- Binding Arbitration. It is PRF's policy that its insureds make every good faith effort to have each patient sign an arbitration agreement. While the discovery process for disputes resolved by trial or arbitration is similar, the amount of time the insured defendant spends away from his or her practice is significantly shortened, and arbitration provides a less public forum than trial by jury.
- Management Reports. PRF requests that insureds inform the PRF office whenever an undesirable outcome occurs. A simple one-page management report is provided to the insured, wherein the pertinent facts are outlined by the insured.
- The Patient Care and Management Committee oversees the handling of all claims, code green incidents, and management reports.
- The Patient Education and Risk Management Committee oversees the production of PRF's newsletter which focuses on topical risk-management issues relevant to our insureds.

The implementation of the Medical Injury Compensation Reform Act of 1976 (MICRA), which placed a $250,000 cap on non-economic damages, has been instrumental in containing the cost of medical malpractice insurance in California. MICRA is crucial to the availability of professional liability insurance assuring that physicians have the means to practice medicine and treat their patients. PRF supports the continuation of MICRA through its annual contribution to Californians Allied for Patient Protection (CAPP). In addition, George F. Lee, MD, president of PRF and one of its founding members, serves on the Board of Directors of CAPP and is currently serving on a national task force, which is supporting federal legislation similar to MICRA. ■

Medical Liability Premiums, CA vs. US (in billions) 1976-1999



Source: National Association of Insurance Commissioners Profitability Study, cited in the American Hospital Association's *Health Care Liability Crisis 2002* presentation.

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Company Structure

In spite of recent organizational changes within the company, from offshore captive insurer, to onshore risk retention group, to purchasing reinsurance, the corporate structure of the company has remained constant. PRF is under the direction and management of its Board of Directors, which consists of five physicians who are insureds or former insureds of the company.

The day-to-day operations of the company are the responsibility of its Executive Director, June Riley, and its Director of Membership, Soad Kader. The Board of Directors and the PRF staff are assisted by various standing committees, i.e., the Patient Care and Management Committee, the Education and Risk Management Committee and the Peer Review Committee. To doubly ensure that the Board of Directors is kept apprised of any and all important developments in between Board meetings, the Executive Director meets with the President on a weekly basis.

NECESSITY OF OUTSIDE MANAGEMENT PROFESSIONALS

The Physicians Reimbursement Fund, Inc. is domiciled in the state of Vermont. The company works in concert with the staff of Vermont Insurance Management (VIM) to ensure that PRF is in compliance with all regulatory issues and that its audited financial statements are timely filed with the Vermont Department of Insurance. In addition to filing quarterly financial statements with the Vermont Department of Insurance, PRF is required to have an annual actuarial analysis. Typically, the actuarial analysis is preformed concurrently with the annual audit process.

PRF works with the accounting firm of Saslow, Lufkin & Buggy, for the purposes of the annual audit of the financial statements, preparation of tax filings and any audit or tax issues that may arise during the course of the year. The company employs a corporate attorney, Alan Sparer, of Howard, Rice, et al., who attends all meetings of the Board of Directors and the Patient Care and Management Committee and oversees defense of all active claims. If and when a suit is filed relating to a claim made against one of its insureds, PRF works with several highly-esteemed local law firms and will assign outside counsel from one of these firms to represent the interests of its insured. The Company's investments are managed by Advest along with the advice and consent of Dr. Damian Augustyn, PRF's Treasurer and Chief Financial Officer. Finally, through its broker at Tillinghast–Towers Perrin, the PRF has contracted with ProMutual for reinsurance for the excess level of liability (claims greater than $500,000).

PROJECTIONS FOR 2002 AND 2003

The Board of Directors of the Physicians Reimbursement Fund will continue to diligently monitor the business operations of the company. The Board will continue to seek more economical methods of doing business, while at the same time offering the most cost-effective premium to its insureds. The company has a proven record of success spanning 26 years. The Board of Directors is pleased and proud to provide a valuable service to its insureds which enables them to put all their efforts and talents into the practice of medicine and the care and treatment of their patients. ■

Medical Liability Coverage - Key Terms *(continued from page 2)*

Claims Made Coverage: A method of determining whether or not coverage is available for a specific claim. If a claim is filed during the time period when a liability policy is in effect, an insurance company is responsible for its payment, up to the limits of the policy. Conversely, if a claim is filed during a period of time when the policy is *not in effect* (even if the event causing the claim occurred when the policy *was* in effect) an insurance company is not responsible for its payment. Therefore, claims made coverage necessitates the need for the insured to purchase costly "tail" or "prior acts" coverage to extend coverage beyond the policy period.

Occurrence Based Coverage: Liability insurance coverage for injuries suffered by others as a result of events that occurred during the time the policy was in force regardless of when a claim is filed. Occurrence based coverage eliminates the need for the insured to purchase a "tail" if and when the insured elects to change malpractice insurance carriers, for whatever reason.