

# STATE OF MISSOURI



## DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND PROFESSIONAL REGISTRATION

P.O. Box 690, Jefferson City, Mo. 65102-0690

RE: Examination Report of Keystone Mutual Insurance Company

### ORDER

After full consideration and review of the report of the financial examination of Keystone Mutual Insurance Company for the period ended December 31, 2010, together with any written submissions or rebuttals and any relevant portions of the examiner's workpapers, I, John M. Huff, Director, Missouri Department of Insurance, Financial Institutions and Professional Registration pursuant to section 374.205.3(3)(a), RSMo., adopt such examination report. After my consideration and review of such report, workpapers, and written submissions or rebuttals, I hereby incorporate by reference and deem the following parts of such report to be my findings and conclusions to accompany this order pursuant to section 374.205.3(4), RSMo: summary of significant findings, subsequent events, company history, corporate records, management and control, fidelity bond and other insurance, pension, stock ownership and insurance plans, territory and plan of operations, growth of the company and loss experience, reinsurance, accounts and records, statutory deposits, financial statements, financial statement changes resulting from examination, and comments on financial statement items.

Based on such findings and conclusions, I hereby ORDER, that the report of the Financial Examination of Keystone Mutual Insurance Company as of December 31, 2010, be and is hereby ADOPTED as filed and for Keystone Mutual Insurance Company to take the following action or actions, which I consider necessary to cure any violation of law, regulation or prior order of the Director revealed by such report: (1) implement, and verify compliance with each item, if any, mentioned in the Comments on Financial Statement Items and/or Summary of Recommendations section of such report; (2) account for its financial condition and affairs in a manner consistent with the Director's findings and conclusions.

So ordered, signed and official seal affixed this 14th day of October, 2011.



John M. Huff, Director  
Department of Insurance, Financial Institutions  
and Professional Registration

REPORT OF  
FINANCIAL EXAMINATION

Keystone Mutual  
Insurance Company

**FILED**  
OCT 24 2011  
DIRECTOR OF INSURANCE,  
FINANCIAL INSTITUTIONS &  
PROFESSIONAL REGISTRATION

As of:  
DECEMBER 31, 2010



STATE OF MISSOURI  
DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS  
AND PROFESSIONAL REGISTRATION

JEFFERSON CITY, MISSOURI

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September 2, 2011  
St. Louis, MO

Honorable Joseph Torti III, Superintendent  
Division of Insurance Regulation  
State of Rhode Island  
Chairman, Financial Condition (E) Committee, NAIC

Honorable Stephen Robertson, Commissioner  
Department of Insurance  
State of Indiana  
Secretary, Midwestern Zone, NAIC

Honorable John M. Huff, Director  
Missouri Department of Insurance, Financial  
Institutions and Professional Registration  
301 West High Street, Room 530  
Jefferson City, Missouri 65101

Gentlemen:

In accordance with your financial examination warrant, a comprehensive financial examination has been made of the records, affairs and financial condition of

**Keystone Mutual Insurance Company**

hereinafter referred to as "Keystone" or the "Company." The Company's main office is located at 400 Chesterfield Center, #400; Chesterfield, Missouri 63017; telephone number (636) 537-7756. Examination fieldwork began on February 23, 2011 and concluded on the above date.

**SCOPE OF EXAMINATION**

Period Covered

This examination covers the period from the Company's inception, December 31, 2007, through December 31, 2010, and was conducted by examiners from the state of Missouri. This examination also considered material transactions or events occurring subsequent to December 31, 2010.

Procedures

We conducted our examination in accordance with the NAIC Financial Condition Examiners Handbook. The handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by

obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating systems controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with statutory accounting principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. Key activities were: Investments and Cash Management, Underwriting/Premium Process, Claims and Reserving, and Reinsurance.

The examiners relied upon information and workpapers provided by the Company's independent auditor, Brown Smith Wallace, LLC, for its audit covering the period from January 1, 2010 through December 31, 2010. Such reliance included fraud risk analysis, internal control narratives, and tests of internal controls.

### **SUMMARY OF SIGNIFICANT FINDINGS**

The Department of Insurance, Financial Institutions and Professional Registration (Department) retained the services of a consulting actuary to evaluate the Company's reserves. As a result of that evaluation, the consulting actuary determined that the reserves were understated by approximately \$108,000. Other items identified during the examination were typical issues experienced by start-up companies. The Company has already addressed some of these.

### **SUBSEQUENT EVENTS**

In response to the actuarial review of the Company's reserves, the Company developed and submitted a business plan to the Department. This plan outlines a strategy designed to help ensure the long-term solvency of the Company.

### **COMPANY HISTORY**

#### General

Keystone Mutual Insurance Company was incorporated under the laws of the state of Missouri on December 31, 2007 pursuant to Chapter 383, RSMo (Malpractice Insurance) as an assessable medical malpractice company with authority to write medical malpractice insurance in Missouri only. The company is not subject to Chapter 382, RSMo (Insurance Holding Companies).

#### Capital Stock

The Company is a mutual insurance company and has no capital stock.

### Surplus Debentures

The Company has issued surplus notes as follows:

Date Issued	Interest Rate	Carrying Value	Accrued Interest	Total
9/30/2009	7%	\$220,000	\$19,250	\$239,250
11/30/2009	7%	50,000	3,792	53,792
12/31/2009	7%	10,000	700	10,700
12/31/2010	7%	80,000	-	80,000
12/31/2010	7%	90,000	-	90,000
		<u>\$450,000</u>	<u>\$23,742</u>	<u>\$473,742</u>

### Dividends

The Company has paid no dividends since inception.

### Mergers and Acquisitions

There have been no mergers or acquisitions involving this company.

## **CORPORATE RECORDS**

Minutes of the meetings of the Board of Directors and annual meetings of the membership were reviewed for the years 2007 through 2010. Those minutes documented evidence of the overall guidance provided by the Board of Directors. The minutes did not, however, reflect the Board's appointment of the opining actuary for each year to ensure compliance with annual statement instructions.

## **MANAGEMENT AND CONTROL**

### Directors and Officers

As of December 31, 2010, the following eleven members comprised the Board of Directors:

<u>Name</u>	<u>Position</u>
James R. Bowlin, Chairman and Chief Executive Officer	General Counsel, American Association of Orthodontists
Scott B. Lakin, President	Principal, Lakin Consulting, LLC
Jerry N. Middleton, MD, Vice President	Physician, Obstetrical Associates of St. Louis, Inc.
Jerry D. Kennett, MD, Secretary	Cardiologist, Private Practice

Craig S. McPartlin, Treasurer	CFO/Treasurer, Con-Tech Carpentry, LLC
Katie Steele Danner	Director, Skaggs Foundation
Joel D. Hassien, MD	Radiologist, Northeast Missouri Imaging Associates, Inc.
Dennis A. Nahnsen	President, Missouri Valley Partners
Bruce C. Oetter	Attorney, Bryan Cave LLP
George K. Parkins, MD	Orthopedic Surgeon, Drisko, Fee & Parkins, PC
Albert A. Riederer	Attorney, Riederer Law Firm

#### Committees

Committee assignments as of December 31, 2010 were as follows:

<b><i>Rate &amp; Underwriting</i></b>	<b><i>Claims</i></b>	<b><i>Reinsurance</i></b>
Bruce C. Oetter, Chair	Jerry D. Kennett, Chair	Jerry N. Middleton, Chair
Craig S. McPartlin	Jerry N. Middleton	George K. Parkins
George K. Parkins	Bruce C. Oetter	Craig S. McPartlin
<b><i>Marketing</i></b>	<b><i>Government Affairs</i></b>	<b><i>Investment/Finance</i></b>
George K. Parkins, Chair	Jerry D. Kennett, Chair	Dennis A. Nahnsen, Chair
Scott B. Lakin	Scott B. Lakin	Katie Steele Danner
Joel D. Hassien	Jerry N. Middleton	Craig S. McPartlin
<b><i>Compensation</i></b>	<b><i>Audit</i></b>	<b><i>Appellate</i></b>
Katie Steele Danner, Chair	Albert A. Riederer, Chair	Joel D. Hassien, Chair
Joel D. Hassien	Joel D. Hassien	Scott B. Lakin
Dennis A. Nahnsen	Jerry D. Kennett	Albert A. Riederer

#### Conflict of Interest

Members of the senior management of this Company provided signed conflict of interest disclosures. No instances of conflict of interest situations were reported.

#### Organizational Structure

The Company is a single entity, owned by the membership with no equity holdings of its own.

### Intercompany Transactions

The Company has a single management agreement.

Parties: Keystone Mutual Insurance Company and Keystone Insurance Holding Company.

Effective: January 1, 2010

Services: Keystone Insurance Holding Company provides underwriting, claims and other corporate management services.

Rates: In exchange for the services provided, the Company pays an annual fee of \$45,000, payable in equal monthly installments.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company receives protection through a fidelity bond obtained during the examination which provides \$100,000 in coverage with a \$5,000 deductible. This coverage exceeds the minimum amount of fidelity insurance recommended by the NAIC.

The Company is also a named insured on policies that provide liability protection for Directors and Officers and for Errors and Omissions. The Company's coverages appear to be adequate.

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

The Company has two employees in sales positions. They receive compensation in the form of salary and commissions. A SIMPLE IRA is also provided by the Company with matching contributions up to 3% of salary. The Company does not provide benefits, but, provides additional compensation to the employees for the cost of health insurance, personal use of vehicles, and business use of mobile telephones.

### **TERRITORY AND PLAN OF OPERATION; TREATMENT OF POLICYHOLDERS**

#### Territory and Plan of Operation

The Company is licensed in Missouri under Chapter 383 RSMo (Malpractice Insurance) to write medical malpractice insurance only.

#### Treatment of Policyholders

The Missouri Department of Insurance, Financial Institutions and Professional Registration has a market conduct staff which performs reviews of these issues. The Company has never been subject to a market conduct examination.

## GROWTH OF COMPANY

The Company began writing business in 2008 and has seen substantial increases in premium each year since. Even though the Company has not yet generated positive net income, the surplus has been maintained through several infusions of funds through surplus notes.

## LOSS EXPERIENCE

The Company has experienced underwriting losses in each year of its existence. Although the Company has incurred loss adjustment expenses, no indemnity payments have been made to date.

## REINSURANCE

Premiums written by the Company during the examination period were as follows:

	<u>2008</u>	<u>2009</u>	<u>2010</u>
Direct Premiums Written	\$132,985	\$640,620	\$983,936
Ceded Premiums	33,246	152,955	222,776
Net Written Premiums	\$99,739	\$487,665	\$761,160

### Assumed Reinsurance

The Company does not assume any reinsurance.

### Ceded Reinsurance

The Company had one reinsurance contract as of December 31, 2010. The Medical Professional Liability Excess of Loss Contract was effective concurrent with the effective date of the first policy written by Keystone, but in no event effective later than March 1, 2008. Various amendments have renewed this agreement over time. The participating reinsurers in this agreement are Hannover Ruchversicherung AG (15%), Catlin Insurance Company Ltd. (35%), and Lloyd's Syndicates (50%). Keystone Mutual currently pays the reinsurers an annual minimum and deposit premium of \$235,000 payable in five equal installments. The Company's retention limit is \$200,000 on any one occurrence. To date, Keystone has not had a claim that has reached the \$200,000 retention limit attachment point.

## ACCOUNTS AND RECORDS

### General

The Company's financial statements are prepared on statutory accounting principles. Accounting entries are manually recorded on Excel spreadsheets by the Company's Chief Financial Officer.

### Independent Auditor

The Company's financial statements are audited annually by the accounting firm Brown Smith Wallace, LLC. The workpapers and reports of the most recent independent audit were reviewed for this examination. These workpapers and reports were used in the course of this examination as deemed appropriate.

### Independent Actuaries

Loss reserves, loss adjustment expense reserves and related actuarial accounts reported in the financial statements were opined on and certified by Ronald T. Kuehn, FCAS, MAAA, CPCU, ARM, FCA, of the actuarial firm Huggins Actuarial Services, Inc. His review concluded the Company's net reserves were within a reasonable range of acceptable actuarial estimates.

Pursuant to a contract with the Missouri Department of Insurance, Financial Institutions and Professional Registration, Jon W. Michelson, FCAS, MAAA of the actuarial firm Expert Actuarial Services, LLC reviewed the adequacy of the Company's loss and loss adjustment expense reserves. This Statement of Actuarial Opinion of the Company's reserves concluded that the Company's loss and loss adjustment expense reserves were deficient by approximately \$108,000 on a net (of reinsurance) basis.

### Information Systems

Because all transactions of the Company are recorded manually on Excel spreadsheets and the Company utilizes no automated systems for accounting, policy administration, loss reserving, or claims processing, a review of the Company's information systems was not performed for this financial examination.

## STATUTORY DEPOSITS

The company writes only in Missouri and, as a Chapter 383 company, is not required to maintain any deposits with the state.

## FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company as of December 31, 2010, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the financial

statements and/or comments regarding such are made in the "Comments on Financial Statements," which follow the financial statements.

There may have been additional differences found in the course of this examination, which are not shown in the "Comments on Financial Statements." These differences were determined to be immaterial in relation to the financial statements, and therefore were only communicated to the Company and noted in the workpapers for each individual annual statement item.

**BALANCE SHEET**  
As of December 31, 2010

<b>Assets</b>	<b>Assets</b>	<b>Nonadmitted Assets</b>	<b>Admitted Assets</b>
Cash, cash equivalents and short-term investments	\$674,248	\$0	\$674,248
Investment income due and accrued	687	0	687
Uncollected premiums	14,977	0	14,977
Deferred premiums	147,409	0	147,409
Electronic data processing equipment and software	11,148	11,148	0
Aggregate write-ins for other than invested assets	7,000	7,000	0
<b>Total Assets</b>	<u>\$855,469</u>	<u>\$18,148</u>	<u>\$837,321</u>
<b>Liabilities</b>			
Losses (Note 1)			\$312,000
Loss adjustment expenses (Note 1)			107,000
Other expenses (Note 2)			42,066
Taxes, licenses and fees			4,668
Current federal income taxes			462
Unearned premiums			324,347
Advance premium			43,931
Ceded reinsurance premiums payable			8,266
Aggregate write-ins for liabilities (Note 2)			5,477
<b>Total Liabilities</b>			<u>\$848,217</u>
<b>Surplus</b>			
Surplus notes			\$473,742
Gross paid in and contributed surplus			52,213
Unassigned funds (surplus)			(536,851)
Surplus as Regards Policyholders (Note 3)			<u>(10,896)</u>
<b>Total Liabilities and Surplus</b>			<u>\$837,321</u>

**INCOME STATEMENT**  
**For Year Ending December 31, 2010**

Premiums earned		\$717,886
Losses incurred	150,000	
Loss adjustment expenses incurred	216,727	
Other underwriting expenses incurred	460,545	
Total underwriting deductions	<u>827,272</u>	
Net underwriting gain (loss)		<u>(109,386)</u>
Net investment gain (loss)		2,896
Finance and service charges not included in premiums		<u>20,721</u>
Net income before federal income taxes		(85,769)
Federal and foreign income taxes incurred		<u>444</u>
Net income		<u>(\$86,213)</u>

**CAPITAL AND SURPLUS**  
**Changes for 2010**

Surplus as regards policyholders, December 31, 2009		\$12,052
Net income	(86,213)	
Change in nonadmitted assets	(12,898)	
Change in surplus notes	189,600	
Surplus adjustments paid in	14,425	
Aggregate write-ins for gains and losses in surplus	(19,600)	
Change per examination (Note 1)	(108,262)	
Change in surplus as regards policyholders for the year		<u>(22,948)</u>
Surplus as regards policyholders, December 31, 2010 (Note 3)		<u>(\$10,896)</u>

## ANALYSIS OF EXAMINATION CHANGES

As of December 31, 2010

Surplus as Reported by Company			\$97,366
	Increase in Surplus	Decrease in Surplus	
Loss Reserve (Note 1)		162,000	
Loss Adjustment Expense Reserve (Note 1)	53,738		
Total Changes	53,738	162,000	
Net Change in Surplus			(108,262)
Surplus Per Examination			(\$10,896)

### COMMENTS ON FINANCIAL STATEMENTS

**Note 1** Loss Reserve \$312,000  
Loss Adjustment Expense Reserve \$107,000

The Department's consulting actuary determined that the Company's carried reserves could not be supported actuarially as being reasonable. As a result, adjustments were made to the loss and loss adjustment expense reserves in the financial statements above. The loss reserve was increased by \$162,000 from \$150,000 to \$312,000. The loss adjustment expense reserve was decreased by \$53,738 from \$160,738 to \$107,000. This resulted in an overall decrease in surplus of \$108,262.

**Note 2** Other Expenses \$42,066  
Aggregate Write-ins for Liabilities \$5,477

The Company included \$5,477 of premium refunds in the other expenses line item. A reclassification was made to show this as an aggregate write-in for liabilities. This was merely a reclassification and had no impact on surplus.

**Note 3** Surplus as Regards Policyholders (\$10,896)

As a result of the decrease in surplus described in Note 1 above, the Company is now in a negative surplus condition. Section 383.035.5 RSMo states, "If, after its second full calendar year of operation, any association licensed under the provisions of sections 383.010 to 383.040 shall file an annual statement which shows a surplus as regards policyholders of less than zero dollars, or if the director has other conclusive and credible evidence more recent than the last annual statement indicating the surplus as regards policyholders of an association is less than zero dollars, the director may order such

association to submit, within ninety days following such order, a voluntary plan under which the association will restore its surplus as regards policyholders to at least zero dollars. The director may monitor the performance of the association's plan and may order modifications thereto, including assessments or rate or premium increases, if the association fails to meet any targets proposed in such plan for three consecutive quarters." The Company has already submitted such a plan, without regard to Section 383.035.5.

## **SUMMARY OF RECOMMENDATIONS**

### **Corporate Records, Page 3**

The Company should ensure that the Board of Director meeting minutes reflect the annual appointment of the Company's opining actuary.

### **Comments on Financial Statements, Note 1, Page 11**

The Company should ensure that its actuarial analysis adequately documents the assumptions used and methodologies employed in establishing the reserve estimates.

### **Comments on Financial Statements, Note 3, Page 11**

The Company should monitor its performance regarding the plan to generate positive income and improve its surplus position as set out in such plan.





September 30, 2011

*Via Email and Certified United States Mail – Return Receipt Requested*

Frederick G. Heese, CFE, CPA  
Chief Financial Examiner & Division Director  
Missouri Department of Insurance, Financial Institutions  
& Professional Registration  
301 W. High St., Room 530  
P.O. Box 690  
Jefferson City, MO 65102-0690

RE: Examination Report, dated September 02, 2011 (the "Report")

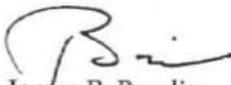
Dear Mr. Heese:

Thank you for your September 21, 2011 correspondence, which has been forwarded to me for response.

Please find enclosed our Company's response to the Report included with your letter. We ask that this response be included with the Report as a public document.

Please let me know if you have any questions or comments.

Sincerely,



James R. Bowlin  
CFO

Encl. – 1

c; Craig S. McPartlin, CFO (w/Encl.)  
Craig S. Weaver, Analyst (w/Encl. via email)  
Mike Shadowens, CFE (w/Encl. via email)  
Robert Jordan, Examiner in Charge (w/Encl. via email)

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**Missouri Department of Insurance, Financial Institutions & Professional Registration (the “Department”)  
Missouri Market Conduct Examination  
Keystone Mutual Insurance Company (NAIC #13073)  
Company Response – Examination Report dated 09/02/11 (the “Report”)**

**COMMENTS ON FINANCIAL STATEMENTS**

**NOTE 1 – LOSS & LOSS ADJUSTMENT EXPENSE RESERVES**

The Company has adopted the adjustments set forth to the Company’s loss and loss adjustment expense reserves, as set forth in Note 1.

**NOTE 2 – OTHER EXPENSES – AGGREGATE WRITE-INS FOR LIABILITIES**

The Company has reclassified the \$5,477 of premium refunds as indicated by Note 2.

**NOTE 3 – SURPLUS AS REGARDS POLICYHOLDERS**

As noted in Note 3, the Company has already submitted to the Department its *Internal Business Plan Regarding Surplus* without regard to the statute referenced in Note 3.

**SUMMARY OF RECOMMENDATIONS**

**CORPORATE RECORDS**

The Report stated:

*The Company should ensure that Board of Director meeting minutes reflect the annual appointment of the Company’s opining actuary.*

Company Response:

The Company agrees with this recommendation. The Company’s actuary was selected in 2006 on a perpetual basis. The Company has made provision for ensuring that its relationship with its opining actuary is reaffirmed each year by the Company’s Board of Directors.

## FINANCIAL STATEMENTS, NOTE 1

The Report stated:

*The Company should ensure that its actuarial analysis adequately documents the assumptions used and methodologies employed in establishing the reserve estimates.*

Company Response:

The Company agrees with this recommendation. The Company has advised its opining actuary to comply with the same, and the Company will provide a more comprehensive analysis for 2011 and thereafter.

## FINANCIAL STATEMENTS, NOTE 3

The Report stated:

*The Company should monitor its performance regarding the plan to generate positive income and improve its surplus position as set out in such plan.*

Company Response:

The Company agrees with this recommendation. In addition to items already in place, the Company has implemented a variety of measures designed to promote the generation of positive income and improve the Company's surplus position.