

PRF

2003 Annual Report

PHYSICIANS REIMBURSEMENT FUND, INC.

A Risk Retention Group

President's Report

As most of PRF's Insureds know, the Physicians Reimbursement Fund (PRF) was founded in 1976 in the form of an offshore captive insurance company domiciled in Grand Cayman. From its inception in 1976 and through all the changes PRF has made during the 28 years that followed, the Company has remained true to its founding mission, principles and objectives. As new physicians join PRF and some of our original Insureds retire, one of the goals of the Board of Directors will be to maintain the collegial atmosphere of the Company. PRF is not your typical professional liability insurance company. PRF does not charge the highest premium rate that the market will bear; rather we strive to keep our rates as low as actuarially possible and our insurance product superior. PRF is physician owned and operated. The interests of PRF's Insureds and the interests of the Company are one and the same, because the Insureds are the Company.

PRF was formed when physicians joined together in direct response to the medical malpractice insurance crisis of 1975. At the time, the soaring costs of plaintiff jury awards had resulted in medical malpractice insurance companies either quadrupling their premiums or withdrawing from the "med mal" market altogether. The founders of PRF knew first hand that if the practice of medicine became cost prohibitive to the physician, then ulti-

mately, it would be the patient that would suffer with diminished access to healthcare. First and foremost, we want our Insureds to continue to be able to provide excellent patient care; affordable, secure professional liability coverage is a necessary component of physicians providing healthcare and patients having access to healthcare.

We as physicians and healthcare providers are fortunate to be practicing in the state of California. Thanks to the passage of MICRA legislation in 1975¹ and the cap on non-economic damages, the state as a whole has been able to keep the average professional liability premium well below the national average. However, keeping MICRA legislation in place is a matter of great concern to California physicians. MICRA has been threatened at both the state and national levels. Even if we succeed (as we have in the past) at maintaining the cap on non-economic damages in California, the passage of national legislation that puts the cap at a higher level will supercede state legislation. If national legislation is passed raising the cap on non-economic damages, that legislation would put pressure on the underlying premium structure of all medical malpractice insurance providers. The resultant increase in med mal premiums could mirror the insurance crisis of 1975. With this in mind, I have met with national legislators and used California's statistics compared with

the statistics of other states in crisis to demonstrate the benefits of MICRA legislation. These benefits apply not only to physicians, but more importantly to healthcare consumers (i.e., the constituency of legislators). I also serve on the Board of Directors of Californians Allied for Patient Protection (CAPP) and on the national Task Force for Professional Liability Reform. If necessary, in the future, we may ask PRF Insureds to send letters to appropriate legislators at strategic times, stating your position on pending legislation that would threaten the principles of MICRA. We should not ignore or underestimate the importance of this type of legislation to physicians and patients. I welcome your comments or questions regarding this matter.

I would like to take this opportunity to acknowledge and thank all the physician Insureds who give of their time and expertise by serving on the Company's committees and its Board of Directors. Direct physician involvement in the operations of the Company is one of the things that keeps PRF sensitive to the needs of its Insureds. The last page of this report has a complete listing of the members of PRF's committees and the Board of Directors. Many of these individuals have served on the Board or a committee for a number of years. The individual and the collective contributions of these physicians have been invaluable to the integrity and continuity of Physicians Reimbursement Fund. ■

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

¹ Medical Injury Compensation Reform Act of 1975.

Highlights of 2003

CHANGE IN BUSINESS PLAN

January 1, 2003, marked the beginning of the implementation of PRF's change in business plan. Historically, PRF has retained liability for damages up to the \$500,000 limit. The liability for damages in excess of \$500,000 and up to \$1,000,000 was retained by the excess insurance carrier, Physicians Excess Insurance Company (PEIC) until January 1, 2001. In January 2001, PRF purchased reinsurance for coverage of the excess level of liability. (However, PEIC continues to retain the liability for excess damages wherein the event giving rise to the claim occurred before January 1, 2001.)

Due to the high cost of reinsurance premiums, in 2002 the PRF Board of Directors elected to not renew our reinsurance policy in 2003. Further, the Board elected to have PRF retain the full limits of liability, i.e., up to the \$1 Million limit per claim, \$3 Million aggregate per policy period. PRF is a risk retention group domiciled in Vermont. Therefore, PRF requested and obtained authorization for the change in business plan from the Insurance Commissioner of the Vermont Department of Banking, Insurance, Securities and Healthcare.

In order for PRF to implement its change in business plan, the Vermont Insurance Commissioner required PRF to acquire additional capital. The Company was able to secure the additional capital through a loan from the excess insurance company, Physicians Excess Insurance Company (PEIC) to PRF's parent company, Sphargis, Inc. This was an important step toward consolidating and simplifying PRF's operations and minimizing its overhead.

SPHARGIS, INC. PROMISSORY NOTES

In the late 1990s the Board of Directors began exploring various options to bring the Company onshore as a risk retention group. After extensive research, the Board settled on Vermont. The Vermont Department of Insurance required PRF to have an additional \$1 million in capital. The Board went directly to the Company's Insureds and put a call out to prospective investors. Seventy-one of PRF's Insureds opted to invest in the Company. PRF's parent company, Sphargis, Inc., issued promissory notes during the first and second quarters of 1998 as PRF Insureds invested a collective total of \$1.6 million. The notes paid simple annual 13% interest, with return of principal due by the fourth anniversary of the note (year 2002).

Sphargis Promissory Note (\$10K)

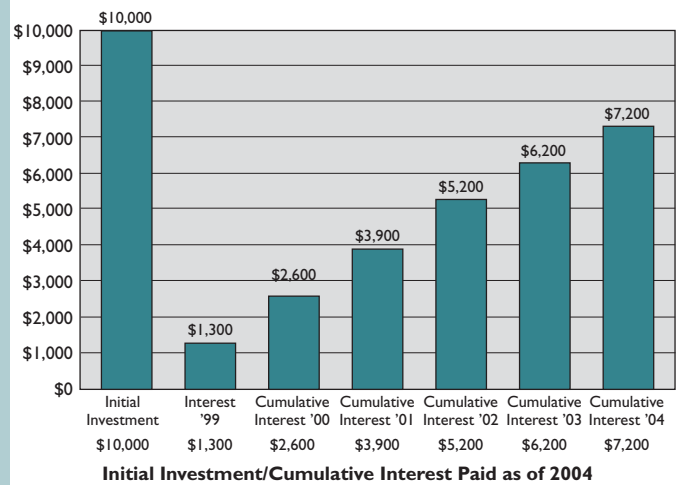


Figure 1. Sphargis Promissory Note: \$10,000 Investment (based on 6-year life of note).

Individual investments varied from \$10,000 to \$160,000. In 2002 investors were offered the opportunity to rollover their existing notes (up to \$20,000) and continue to collect 10% simple annual interest. Principal exceeding \$20,000 was returned to remaining investors in 2002; thus, none of the outstanding notes exceeded \$20,000. In 2003 the remaining outstanding rollover notes were paid down so that none of the outstanding notes exceed \$10,000. The aggregate debt of the promissory notes has been paid down to \$600,000. Figure 1 is a graphic representation of the return on investment realized by holders of the Sphargis Promissory Notes; all investors being PRF Insureds.

ANNUAL GENERAL MEETING

PRF held its Annual General Meeting (AGM) in April 2004. All PRF Insureds were invited to attend. The AGM is an opportunity for Insureds to meet the PRF Board of Directors, the staff and the Chair of the Patient Care and Management Committee, Reuben A. Clay, Jr., MD. The AGM focuses on the state of the business and the claims experience of the Company during the previous year. Historical information is also provided on the structure of the Company, the changes it has gone through and claims experience in terms of losses and costs of defense. The Board welcomes the chance to meet with Insureds and answer any questions they may have regarding the Company. We encourage each of you to attend the next AGM in April 2005. Notices of the exact date, time and location will be sent to all Insureds in March of 2005.

THE NUMBER OF INSURED / TYPES OF PRODUCTS

PRF closed 2002 with a total of 190 Insureds. The Company closed 2003 with 213 Insureds. As of July 1, 2004, the number of Insureds has grown to 222, with additional new applicants due to start in September 2004. For a graphic representation of the specialties comprising the Company's current Insureds, please see **Figure 2**, which shows the percentages of PRF Insureds by Specialty as of July 2004.

PRF Insureds by Specialty as of July 2004

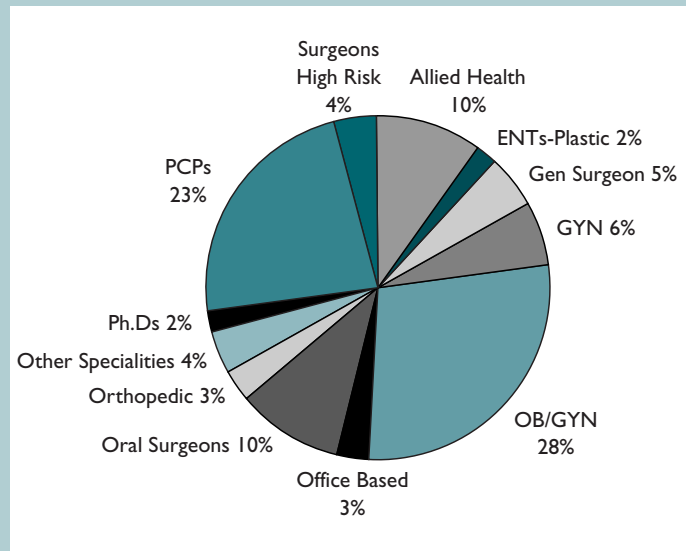


Figure 2.

In addition to medical malpractice insurance for physicians and allied healthcare professionals, the Company offers medical malpractice insurance for laboratories. The Company also offers Medical Board Coverage for a nominal annual premium. Insureds who purchase Medical Board Coverage are provided with counsel, who will review the case in question with the Insured and accompany the Insured to their Medical Board hearing.

INVESTMENTS

The Company's investment portfolio accounts are held with Lebenthal, a Division of Advest Inc., under the supervision of PRF's Treasurer and Chief Financial Officer, Damian Augustyn, MD. PRF's investment portfolio has shown increases in 2001, 2002 and 2003.

THE STRUCTURE OF THE COMPANY

In spite of all the organizational changes within the Company, from offshore captive insurer, to onshore risk retention group to the purchase of 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. 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. We strongly encourage members to serve on the various committees. We will be reassessing the membership of the committees this year so as to involve additional members in the committees' vital activities.

PRF'S LEVEL OF LOSS (JUDGMENTS/AWARDS) EXPERIENCE

The total loss payout for the year 2003 was an exceptionally low \$62,000 compared to the total loss payout in 2002 of \$528,000. With some major cases having already closed or coming to closure in 2004, the loss experience in 2004 is certain to exceed the previous year's losses. However, the Company has adequately reserved for these losses. Historically PRF's overall loss experience has been excellent, especially considering the fact that PRF's membership has a large percentage of high risk specialties.

The figures noted above only represent the costs associated with settlements, judgments or awards. It is not unusual for the total costs of defending claims to exceed the dollars paid out in losses. In fact, six times in the past 10 years the aggregate cost of defending claims has exceeded the aggregate cost associated with settlements or judgments. (See **Figure 3.**)

PRF Cost of Claims 1994 through 2003

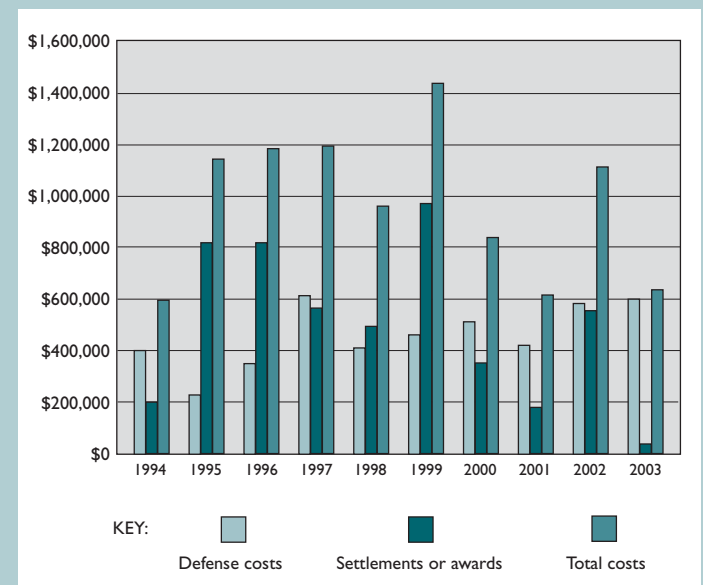


Figure 3.



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Physicians Reimbursement Fund, Inc.

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June Riley

Executive Director

Soad Kader

Director of Membership

DIRECTORS

George F. Lee, MD

Stephen J. Scheifele, MD

Damian H. Augustyn, MD

W. Gordon Peacock, MD

Michael E. Abel, MD

Andrew Sargeant, ACA, CFA

(USA Risk Group of Vermont, Inc.)

Patient Care and Management Committee

Reuben A. Clay, Jr., MD, Chair
Donald Brown, MD
Nima Grissom, MD
N. William Hagbom, MD
Holly Holter, MD
Jordan Horowitz, MD
Fung Lam, MD
Margaret Miller, MD
Peter Volpe, MD
May Yen Yau, MD

Education and Risk Management Committee

Stephen J. Scheifele, MD, Chair
Robert Nachtigall, MD
Nancy Carteron, MD
Clare Siu, MD

Peer Review Committee

W. Gordon Peacock, MD, Chair
Lesley Anderson, MD
Alan Johnson, MD
Madelyn Kahn, MD
Audrey Koh, MD
Joseph Kushner, MD
Ziyad Hannon, MD
Marie Lewandowski, MD
David Manace, MD
Rachel Shu, MD
Clare Siu, MD
Michael Small, MD
William Wolfenden, MD

OUTSIDE PROFESSIONALS NECESSARY TO THE MANAGEMENT OF THE COMPANY

Physicians Reimbursement Fund, Inc. is domiciled in the state of Vermont. The Company continues to work in concert with the staff of U.S.A. Risk Group of Vermont to ensure that it is in compliance with all regulatory issues and that its audited financial statements are filed in a timely manner 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 performed concurrently with the annual audit process. In 2002 PRF established a working relationship with the actuarial firm Milliman U.S.A. Milliman performed the actuarial analysis for years 2002 and 2003.

PRF works with the accounting firm of Saslow, Lufkin & Buggy for 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 retains a corporate attorney, Alan Sparer, of The Law Offices of Alan W. Sparer, 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 Bay Area law firms and will assign outside counsel from one of these firms to represent the interests of its Insured. The Company's investment

portfolio is managed by Lebenthal, a Division of Advest Inc., along with the advice and consent of Dr. Damian Augustyn, PRF's Treasurer and Chief Financial Officer.

PROJECTIONS FOR 2004 AND 2005

The first two quarters of 2004 have shown a marked increase in the cost of defense of claims. Some of the Company's older (by date of incident), major cases have recently come to arbitration or mediation, and there is additional arbitration scheduled before the close of 2004.

Therefore, the increased cost of defense is somewhat of a timing issue. In addition, a new statute went into effect in January 2003, which did not impact PRF until the recent arbitrations of 2004. The new statute mandates that in the instance of consumer arbitration the defendant will bear the cost of the arbitration. Previously, this cost had been split between the plaintiff and the defendant. The costs associated with expert witnesses has also increased in 2004, due in part to the complexities of the relevant cases.

As noted under the Number of Insureds section, PRF has experienced continual growth over the past three years. With a proven track record spanning 28 successful years, PRF has shown that it offers the best product (occurrence based coverage) at a premium rate that is reasonable and manageable to PRF Insureds. The Board of Directors is pleased to provide this necessary and valuable service to PRF Insureds, enabling physicians to concentrate on the health care needs of their patients. ■

Mission Statement

The purpose of Physicians Reimbursement Fund is to provide competitively priced, occurrence-based medical malpractice insurance to our policyholders while proactively working with our insureds to advocate excellent patient care and to reduce the occurrence of malpractice claims.

—Approved by the PRF-RRG Board of Directors, August 20, 2002