

**Pennsylvania Professional  
Liability Joint  
Underwriting Association**

**Statutory Financial Statements and  
Supplementary Information  
December 31, 2017 and 2016**



# **Pennsylvania Professional Liability Joint Underwriting Association**

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## *Table of Contents*

*December 31, 2017 and 2016*

	<b>Page(s)</b>
<i>Independent Auditors' Report .....</i>	<i>1-2</i>
<i>Statutory Statements of Admitted Assets, Liabilities and Surplus .....</i>	<i>3</i>
<i>Statutory Statements of Income and Changes in Surplus .....</i>	<i>4</i>
<i>Statutory Statements of Cash Flows .....</i>	<i>5</i>
<i>Notes to Statutory Financial Statements .....</i>	<i>6-14</i>
<i>Investment Risk Interrogatories .....</i>	<i>15</i>
<i>Summary Investment Schedule .....</i>	<i>16</i>
<i>Reinsurance Interrogatories.....</i>	<i>17</i>

## *Independent Auditors' Report*

To the Board of Directors of  
Pennsylvania Professional Liability Joint Underwriting Association

We have audited the accompanying financial statements of the Pennsylvania Professional Liability Joint Underwriting Association (the "Association"), which comprise the statutory statements of admitted assets, liabilities, and surplus as of December 31, 2017 and 2016, and the related statutory statements of income and changes in surplus and cash flows for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting practices prescribed or permitted by the Insurance Department of the Commonwealth of Pennsylvania. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of the Pennsylvania Professional Liability Joint Underwriting Association as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended, in accordance with accounting practices prescribed or permitted by the Insurance Department of the Commonwealth of Pennsylvania as described in Note 2.

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**Basis of Accounting**

We draw attention to Note 2 of the financial statements, which describes the basis of accounting. As described in Note 2 to the financial statements, the financial statements are prepared by the Association in accordance with accounting practices prescribed or permitted by the Insurance Department of the Commonwealth of Pennsylvania, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of the Insurance Department of the Commonwealth of Pennsylvania. Our opinion is not modified with respect to this matter.

**Emphasis of Matter**

As described in Note 8 to the financial statements, the Association is involved in legal proceedings with the Commonwealth of Pennsylvania regarding the required transfer of \$200,000,000 of the Association's surplus to the Pennsylvania's General Fund or face dissolution of the Association. Dispositive motions have been filed before the court to resolve the Association's request for a permanent injunction and related declarations of rights, with both the Association and the defendants seeking summary judgment in their favor. Our opinion is not modified with respect to this matter.

**Report on Supplementary Information**

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The investment risk interrogatories, summary investment schedule, and reinsurance interrogatories are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

**Restriction on Use**

Our report is intended solely for the information and use of the board of directors and management of the Association and the Insurance Department of the Commonwealth of Pennsylvania and is not intended to be and should not be used by anyone other than these specified parties.

*Mazars USA LLP*

April 26, 2018

# Pennsylvania Professional Liability Joint Underwriting Association

## *Statutory Statements of Admitted Assets, Liabilities and Surplus* *December 31, 2017 and 2016*

	<u>2017</u>	<u>2016</u>
<b>Admitted Assets</b>		
Bonds	\$ 284,003,253	\$ 274,735,819
Preferred stocks	409,825	670,041
Common stock	1,966	750
Cash and cash equivalents	11,420,271	13,572,794
Receivable for securities	201	-
Other invested assets	<u>1,003,596</u>	<u>1,003,662</u>
 Total cash and invested assets	 296,839,112	 289,983,066
 Premiums receivable	 160,617	 170,786
Accrued investment income	1,868,848	1,821,463
Other assets	<u>13,809</u>	<u>-</u>
 Total admitted assets	 <u><u>\$ 298,882,386</u></u>	 <u><u>\$ 291,975,315</u></u>
 <b>Liabilities and Surplus</b>		
Unpaid losses	\$ 13,772,033	\$ 15,465,162
Unpaid loss adjustment expenses	5,458,226	6,016,433
Unearned premiums	1,379,550	1,511,523
Advanced premiums	491,125	558,800
Accrued taxes, licenses and fees and other expenses	520,766	227,825
Amounts withheld for the account of others	<u>71,340</u>	<u>71,080</u>
 Total liabilities	 <u>21,693,040</u>	 <u>23,850,823</u>
 Surplus		
Unappropriated	274,189,346	265,124,492
Appropriated	<u>3,000,000</u>	<u>3,000,000</u>
 Total surplus	 <u>277,189,346</u>	 <u>268,124,492</u>
 Total liabilities and surplus	 <u><u>\$ 298,882,386</u></u>	 <u><u>\$ 291,975,315</u></u>

The accompanying notes are an integral part of these statutory financial statements.

## Pennsylvania Professional Liability Joint Underwriting Association

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### *Statutory Statements of Income and Changes in Surplus*

*Years Ended December 31, 2017 and 2016*

	<u>2017</u>	<u>2016</u>
Premiums earned	\$ 3,091,509	\$ 3,288,036
Expenses:		
Losses incurred	1,606,871	2,323,962
Loss adjustment expenses incurred	781,402	1,282,030
Underwriting expenses	<u>1,653,563</u>	<u>1,077,600</u>
Total expenses	<u>4,041,836</u>	<u>4,683,592</u>
Underwriting loss	(950,327)	(1,395,556)
Net investment income	8,330,548	8,267,792
Net realized gain on investments	1,460,235	677,721
Service fees	<u>9,142</u>	<u>11,562</u>
Net income	8,849,598	7,561,519
Surplus, beginning of year	268,124,492	260,149,368
Unrealized gain on investments	222,351	418,974
Increase in nonadmitted assets	<u>(7,095)</u>	<u>(5,369)</u>
Surplus, end of year	<u>\$ 277,189,346</u>	<u>\$ 268,124,492</u>

The accompanying notes are an integral part of these statutory financial statements.

## Pennsylvania Professional Liability Joint Underwriting Association

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### *Statutory Statements of Cash Flows* *Years Ended December 31, 2017 and 2016*

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Premiums collected	\$ 2,902,030	\$ 3,144,445
Benefit and loss related payments	(1,693,129)	(1,045,441)
Commissions, expenses paid and aggregate write-in for deductions	(2,405,432)	(2,271,809)
Service fees collected	9,140	11,562
Investment income proceeds, net of investment expenses	<u>9,128,202</u>	<u>9,050,052</u>
Net cash from operating activities	<u>7,940,811</u>	<u>8,888,809</u>
Cash flows from investing activities:		
Proceeds from bonds sold, matured or repaid	48,551,037	61,430,865
Proceeds from stocks sold	549,573	658,768
Cost of bonds acquired	(57,008,143)	(64,885,235)
Cost of stocks acquired	(265,210)	(495,082)
Miscellaneous applications	<u>(201)</u>	<u>-</u>
Net cash from investing activities	<u>(8,172,944)</u>	<u>(3,290,684)</u>
Cash flows from financing and miscellaneous sources:		
Other cash (provided) applied	<u>(1,920,390)</u>	<u>(2,391,547)</u>
Net cash from financing and miscellaneous activities	<u>(1,920,390)</u>	<u>(2,391,547)</u>
Net (decrease) increase in cash and cash equivalents	(2,152,523)	3,206,578
Cash and cash equivalents, beginning of year	<u>13,572,794</u>	<u>10,366,216</u>
Cash and cash equivalents, end of year	<u><u>\$ 11,420,271</u></u>	<u><u>\$ 13,572,794</u></u>

The accompanying notes are an integral part of these statutory financial statements.

# **Pennsylvania Professional Liability Joint Underwriting Association**

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## ***Notes to Statutory Financial Statements***

*Years Ended December 31, 2017 and 2016*

### **1. Business and Organization**

The Pennsylvania Professional Liability Joint Underwriting Association (the “Association”) is a non-profit, unincorporated association established pursuant to Subsection C of the Medical Care Availability and Reduction of Error Act (the “Act”) to offer medical professional liability insurance covering the provision of health care services in the Commonwealth of Pennsylvania in accordance with Section 732 of the Act. Primary coverage is made available by the Association to those individuals and entities that qualify for such coverage from the Association under Section 732 of the Act.

The Insurance Commissioner of Pennsylvania (the “Commissioner”) approved the Association’s Plan of Operations on December 30, 1975. This plan was amended, restated, and approved by the Pennsylvania Insurance Department on April 10, 2005. The Association is exempt from federal income taxes under Section 501(c)(6) of the Internal Revenue Code.

### **2. Summary of Significant Accounting Policies**

#### **Basis of Presentation**

The Association prepares its statutory financial statements in conformity with accounting practices prescribed or permitted by the Insurance Department of the Commonwealth of Pennsylvania (the “Department”). Effective January 1, 2001, the Commonwealth of Pennsylvania required that insurance companies domiciled in the Commonwealth of Pennsylvania prepare their financial statements in accordance with the National Association of Insurance Commissioners (“NAIC”) Accounting Practices and Procedures Manual, subject to any deviations prescribed or permitted by the Commissioner. Practices under the NAIC Manual vary from accounting principles generally accepted in the United States of America (“GAAP”) and these differences include:

- Policy acquisition costs, such as commissions, premium taxes, and other costs incurred in connection with acquiring new and renewal business are expensed in the year incurred, rather than being deferred and amortized over the related policy term;
- Certain assets designated as non-admitted assets (principally prepaid expenses) are excluded from the statutory statements of admitted assets, liabilities, surplus by a direct charge to unassigned surplus;
- Investments in bonds, which the Association holds as available for sale, if qualified for such treatment, are carried at amortized cost rather than at fair value as would be required under GAAP;
- Bonds identified as other-than-temporarily impaired are marked to market with the impairment charge recorded in earnings, whereas under GAAP, only the credit related component of the identified bonds impairment is recorded through earnings;
- Certain reclassifications would be required with respect to the statutory statements of admitted assets, liabilities, surplus, and the statutory statements of cash flows to conform to GAAP.

#### **Use of Estimates**

The preparation of financial statements in conformity with the accounting practices prescribed or permitted by the Department requires management to make certain estimates and assumptions that affect the reported amounts of admitted assets, liabilities, revenues, expenses and disclosures during the reporting period. Actual results could differ from these estimates.



## **Pennsylvania Professional Liability Joint Underwriting Association**

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### **Investments**

Bonds are carried at values prescribed by the NAIC, primarily book-adjusted carrying value. Bonds are amortized using the scientific method. Redeemable preferred stocks that have characteristics of debt securities and are rated as high quality or better by the NAIC are reported at costs or amortized cost. All other redeemable preferred stocks are reported at the lower of cost, amortized cost, or fair value. Nonredeemable preferred stocks are reported at lower of cost or fair value. Common stocks are carried at values prescribed by the NAIC, primarily quoted market prices. Investments with maturity dates of one year or less at acquisition are considered short-term investments. Realized investment gains and losses, computed using the specific cost method, are included in the determination of income. Changes in unrealized appreciation or depreciation on common stocks, if any, are credited or charged directly to surplus. In accordance with the Practices and Procedures Manual of the NAIC Investment Analysis Office, bonds which are below medium grade (a designation of 3, 4, 5, or 6) are stated at the lower of amortized cost or fair value. The Association periodically evaluates its investments for other-than-temporary impairment. At the time an investment is determined to be other-than-temporarily impaired, the Association records a realized loss in the statutory statements of operations. Any subsequent increase in the investment's market value would be reported as an unrealized gain.

Loan backed securities are stated and adjusted using the retrospective method. Prepayment assumptions are obtained from Bloomberg market data and the Association's investment manager's internal estimates.

### **Cash and Cash Equivalents**

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less and are carried at cost, which approximates fair value.

### **Unearned Premiums**

Unearned premiums represent the pro rata portion of premiums written which are applicable to the unexpired terms of the policies in force as of the reporting date.

### **Advanced Premiums**

Advanced premiums represent monies collected by the Association for premiums which are applicable to policies that have an inception date subsequent to the reporting period date.

### **Premium Deficiency**

A premium deficiency is generally established if the sum of expected loss and loss adjustment expenses and maintenance costs exceed the related unearned premium or advanced premiums. The Association includes anticipated future net investment income in the analysis of the necessity of such deficiency reserve, as management believes that the inclusion of anticipated future net investment income into the analysis more accurately represents the true ultimate underwriting gain or loss on the policies underwritten. Accordingly, the Association did not recognize a premium deficiency as of December 31, 2017 and 2016, respectively.

### **Unpaid Losses and Loss Adjustment Expenses**

The reserve for loss and loss adjustment expenses, which include estimates for losses incurred but not reported are determined using actuarial methods with calculations based on current claim evaluations, historical experience of the Association, and to a lesser extent, historical experience of other medical malpractice insurers in Pennsylvania.

Management continually reviews and updates its methods of making loss and loss adjustment expense reserve estimates and believes that such reserves at December 31, 2017 and 2016 are the Association's best estimate to cover the ultimate cost of claims and settlement costs. However, such liability is based on estimates of future rates of inflation and other factors; accordingly, there is no absolute assurance that the ultimate liability may not exceed such estimates. The methods of making such estimates and establishing the resulting liabilities are continually reviewed and updated and any resulting adjustments are reflected in operations in the current period.

## **Pennsylvania Professional Liability Joint Underwriting Association**

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### **Policy Limits**

The Association's maximum liability for a single claim on each policy is as follows:

January 1, 2001 to present	\$500,000
January 1, 1999 to December 31, 2000	400,000
January 1, 1997 to December 31, 1998	300,000
January 1, 1984 to December 31, 1996	200,000
January 1, 1983 to December 31, 1983	150,000
Prior to January 1, 1983	100,000

Subject to statutory provisions, claim amounts in excess of the above policy limits are the liability of the Medical Professional Liability Catastrophe Loss Fund ("MCARE") to a maximum of the following limits:

January 1, 2005 to present	\$500,000
January 1, 2001 to December 31, 2004	700,000
January 1, 2000 to December 31, 2000	800,000
January 1, 1997 to December 31, 1999	900,000
Prior to January 1, 1997	1,000,000

MCARE was created by an act of the Pennsylvania General Assembly (P.L. 154, Act No. 13) (the "MCARE Act") on March 20, 2002. Its purpose is to provide and administer sources of funds to pay judgments, awards, or settlements in medical malpractice claims against participating healthcare providers, whose primary limits of coverage provided by its primary professional liability insurance policies are less than the final judgments, awards, or settlements. The MCARE Act imposes mandatory assessments on health care providers as defined in the MCARE Act. These assessments are required to be billed, collected, and remitted to MCARE by the medical malpractice insurer that directly wrote the coverage. As such, amounts determined to be owed to MCARE, billed, and collected but not yet paid to MCARE by the Association are shown as amounts withheld for the account of others in the accompanying statutory financial statements.

### **Subsequent Events**

The Association has evaluated known recognized and non-recognized subsequent events through April 26, 2018, which is the date these financial statements were available to be issued.

## Pennsylvania Professional Liability Joint Underwriting Association

### 3. Investments

The NAIC carrying value for bonds or cost for preferred stocks and estimated fair value of investments at December 31, are as follows:

	2017			
	NAIC Carrying Value or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Bonds:				
U.S. government	\$ 34,255,618	\$ 339,959	\$ (368,759)	\$ 34,226,818
State, territories, possessions and political subdivisions	10,768,284	1,585,057	-	12,353,341
Special revenue and special assessments	21,670,173	1,062,815	(97,565)	22,635,423
Industrial and miscellaneous	116,374,724	3,708,466	(536,894)	119,546,296
Mortgage/asset-backed	100,934,454	1,118,347	(942,634)	101,110,167
Total bonds	<u>284,003,253</u>	<u>7,814,644</u>	<u>(1,945,852)</u>	<u>289,872,045</u>
Preferred stocks	409,825	26,462	-	436,287
Common stocks	1,034	932	-	1,966
Total investments	<u>\$ 284,414,112</u>	<u>\$ 7,842,038</u>	<u>\$ (1,945,852)</u>	<u>\$ 290,310,298</u>
	2016			
	NAIC Carrying Value or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Bonds:				
U.S. government	\$ 31,309,444	\$ 73,734	\$ (487,833)	\$ 30,895,345
State, territories, possessions and political subdivisions	12,026,806	1,606,062	-	13,632,868
Special revenue and special assessments	14,968,791	919,000	(6,851)	15,880,940
Industrial and miscellaneous	95,217,447	2,546,650	(821,412)	96,942,685
Mortgage/asset-backed	121,213,331	1,561,049	(1,190,244)	121,584,136
Total bonds	<u>274,735,819</u>	<u>6,706,495</u>	<u>(2,506,340)</u>	<u>278,935,974</u>
Preferred stocks	670,041	16,413	-	686,454
Common stocks	1,033	-	(283)	750
Total investments	<u>\$ 275,406,893</u>	<u>\$ 6,722,908</u>	<u>\$ (2,506,623)</u>	<u>\$ 279,623,178</u>

## Pennsylvania Professional Liability Joint Underwriting Association

The NAIC carrying value and fair value of bonds are shown by contractual maturity as of December 31, 2017. Expected maturities could differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	NAIC Carrying Value	Fair Value
Due to mature:		
One year or less	\$ 5,414,416	\$ 5,595,832
Over one year through five years	70,371,328	71,737,829
Over five years through ten years	70,675,169	71,718,979
Over ten years	36,607,886	39,709,238
Mortgage/asset-backed	100,934,454	101,110,167
Total bonds	<u>\$ 284,003,253</u>	<u>\$ 289,872,045</u>

Proceeds from the sale of bonds during the years ended December 31, 2017 and 2016, were \$48,551,037 and \$62,089,634, respectively. Gross realized gains on investments were \$1,682,142 and \$1,022,930 for the years ended December 31, 2017 and 2016, respectively. Gross realized losses on investments were \$221,907 and \$345,210 for the years ended December 31, 2017 and 2016, respectively.

As of December 31, 2017 and 2016, the Association's investments with unrealized losses by length of time they have been in an unrealized loss position are as follows:

	2017					
	12 Months or Less		Greater than 12 Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Bonds:						
U.S. government	\$ 16,640,913	\$ (17,135)	\$ 2,956,740	\$ (351,624)	\$ 19,597,653	\$ (368,759)
Special revenue and special assessments	2,067,060	(73,529)	5,481,466	(24,036)	7,548,526	(97,565)
Industrial and miscellaneous	14,371,780	(95,739)	17,072,758	(441,155)	31,444,538	(536,894)
Mortgage/asset-backed	45,153,536	(141,490)	20,973,481	(801,144)	66,127,017	(942,634)
Total bonds	78,233,289	(327,893)	46,484,445	(1,617,959)	124,717,734	(1,945,852)
Preferred stocks	-	-	-	-	-	-
Common stocks	-	-	-	-	-	-
Total investments	<u>\$ 78,233,289</u>	<u>\$ (327,893)</u>	<u>\$ 46,484,445</u>	<u>\$ (1,617,959)</u>	<u>\$ 124,717,734</u>	<u>\$ (1,945,852)</u>

## Pennsylvania Professional Liability Joint Underwriting Association

	2016					
	12 Months or less		Greater than 12 Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Bonds:						
U.S. government	\$ 11,434,815	\$ (338,449)	\$ 11,430,085	\$ (149,384)	\$ 22,864,900	\$ (487,833)
Special revenue and special assessments	-	-	2,114,000	(6,851)	2,114,000	(6,851)
Industrial and miscellaneous	13,592,924	(408,599)	15,983,680	(412,813)	29,576,604	(821,412)
Mortgage/asset-backed	1,690,432	(468,802)	46,334,775	(721,442)	48,025,207	(1,190,244)
Total bonds	26,718,171	(1,215,850)	75,862,540	(1,290,490)	102,580,711	(2,506,340)
Preferred stocks	-	-	321,144	-	321,144	-
Common stocks	750	(283)	-	-	750	(283)
Total investments	<u>\$ 26,718,921</u>	<u>\$ (1,216,133)</u>	<u>\$ 76,183,684</u>	<u>\$ (1,290,490)</u>	<u>\$ 102,902,605</u>	<u>\$ (2,506,623)</u>

At December 31, 2017, 119 securities are in an unrealized loss position. The Association considers both quantitative and qualitative factors when evaluating individual securities for other-than-temporary impairment, including but not limited to the amount and length of time a security is in an unrealized loss position, general credit quality of the issuer including third party credit ratings, and any adverse changes in estimated cash flows. Based on the above factors and because the Association has the intent and ability to hold these investments until a market price recovery, which may be maturity, the Association does not consider these investments to be other-than-temporarily impaired at December 31, 2017.

Components of investment income earned for the years ended December 31, are as follows:

	2017	2016
Bonds	\$ 8,771,795	\$ 8,695,175
Cash and cash equivalents	-	16,313
Net investment income earned	8,771,795	8,711,488
Less: investment expenses	(441,247)	(443,696)
Net investment income	<u>\$ 8,330,548</u>	<u>\$ 8,267,792</u>

#### 4. Fair Value Measurements

The Association maximizes the use of observable inputs in its valuation techniques and applies unobservable inputs only to the extent that observable inputs are unavailable.

The Association must establish the appropriate input level in the fair value hierarchy for each fair value measurement. The hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). An asset's or liability's classification within the fair value hierarchy is based on the lowest level of significant input to its valuation. The Association recognizes transfers between levels at the beginning of the reporting period.

Pricing Level 1 – Valuations based on unadjusted quoted prices in active markets for identical assets that the Association's pricing sources have the ability to access. Since the valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant amount or degree of judgment.

## Pennsylvania Professional Liability Joint Underwriting Association

Pricing Level 2 – Valuations based upon quoted prices for similar assets in active markets, quoted prices for identical or similar assets in inactive markets, or valuations based on models where the significant inputs are observable (e.g., interest rates, yield curves, prepayment speeds, default rates, loss severities) or can be corroborated by observable market data. The Association utilized the market approach for the bonds measured at fair value as of December 31, 2017 and 2016.

Pricing Level 3 – Valuations that are derived from techniques in which one or more of the significant inputs are unobservable, including broker quotes, which are non-binding.

The Association's investments are comprised of a variety of different securities, which are classified into levels based on the valuation technique and inputs used in their valuation. The valuation of cash equivalents, common stocks and U.S. Treasury securities are generally based on Level 1 inputs, which use unadjusted quoted market prices in active markets. The valuation of the Association's U.S. Government and Agency securities, state and political subdivision securities, corporate debt, non-agency mortgage, asset-backed securities, preferred stocks and other invested assets generally incorporate significant Level 2 inputs using the market and income approach techniques. The Association may assign a lower level to inputs typically considered to be Level 2 based on its assessment of liquidity and relative level of uncertainty surrounding inputs. At December 31, 2017 and 2016, the Association did not have any investments classified within Level 3. The Association did not have any liabilities measured at fair value as of December 31, 2017 and 2016.

The following table presents the carrying amounts and fair value of the Association's financial instruments as of December 31, 2017 and 2016:

	2017				
	Fair Value	Admitted Assets	Level 1	Level 2	Level 3
Assets:					
Bonds	\$ 289,872,045	\$ 284,003,253	\$ 34,226,818	\$255,645,227	\$ -
Preferred stocks	436,287	409,825	-	436,287	-
Common stocks	1,966	1,966	1,966	-	-
Cash and cash equivalents	11,420,271	11,420,271	11,420,271	-	-
Other invested asset	1,125,770	1,003,596	-	1,125,770	-
	2016				
	Fair Value	Admitted Assets	Level 1	Level 2	Level 3
Assets:					
Bonds	\$ 278,935,974	\$ 274,735,819	\$ 30,895,345	\$248,040,629	\$ -
Preferred stocks	686,454	670,041	-	686,454	-
Common stocks	750	750	137,189	-	-
Cash and cash equivalents	13,572,794	13,572,794	13,572,794	-	-
Other invested asset	994,880	1,003,662	-	994,880	-

## Pennsylvania Professional Liability Joint Underwriting Association

The methods and assumptions used in estimating the fair values of financial instruments are as follows:

The fair values of bonds, preferred stocks and other invested assets are based on fair values that reflect the price at which a security would sell in an arm's length transaction between a willing buyer and seller. As such, sources of valuation include third party pricing sources and exchanges. The carrying value of all other financial instruments approximates fair value.

### 5. Unpaid Losses and Loss Adjustment Expenses

Activity in the reserve for unpaid losses and loss adjustment expenses is summarized as follows:

	<u>2017</u>	<u>2016</u>
Balance at January 1	\$ 21,481,595	\$ 22,592,054
Incurred related to:		
Current year	4,441,355	4,798,691
Prior years	<u>(2,053,082)</u>	<u>(1,192,699)</u>
Total net incurred	<u>2,388,273</u>	<u>3,605,992</u>
Paid related to:		
Current year	(81,868)	(91,502)
Prior years	<u>(4,557,741)</u>	<u>(4,624,949)</u>
Total net paid	<u>(4,639,609)</u>	<u>(4,716,451)</u>
Balance at December 31	<u>\$ 19,230,259</u>	<u>\$ 21,481,595</u>

As a result of changes in estimates of insured events of prior years, the Association decreased losses and loss adjustment expenses incurred by \$2,053,082 and \$1,192,699 in 2017 and 2016, respectively, due to a combination of lower than expected claim frequency, several favorable indemnity loss settlements, and lower than expected changes in indemnity loss case reserves on open claims.

### 6. Leases

The Association entered into a lease agreement on October 1, 2005. The lease was renewed on April 27, 2011, for an additional five years through September 2016. Effective October 1, 2016, the Association entered into a new lease agreement with Sentry KPG III, L.P, through September 30, 2022. The lease agreement is subject to a renewal option at market rates prevailing at the time of renewal. At December 31, 2017, future minimum rental payments under this non-cancelable lease are as follows:

2018	\$ 66,264
2019	68,232
2020	70,258
2021	72,362
2022	73,984
Thereafter	<u>-</u>
Total	<u>\$ 351,100</u>

Rent expense was \$68,324 and \$54,672 for 2017 and 2016, respectively.

## **Pennsylvania Professional Liability Joint Underwriting Association**

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### **7. Retirement Plan**

The Association sponsors a defined contribution retirement plan (“Retirement Plan”) designed to provide benefits upon retirement, disability, death, or termination of employment. The Retirement Plan requires the Association to contribute 3% of the respective participant’s compensation under the safe harbor provision. An employee receives the Safe Harbor Non-Elective Contribution beginning on the first day of the month following the 90<sup>th</sup> day after the employee begins working for the Association. The employee becomes eligible to participate in the Association’s Profit Sharing Contributions after completing one year of service or one thousand hours of service prior to the date of the annual eligibility computation. Participants are fully vested after completing three years of service with the Association or upon attaining age 65, death or disability. The Association contributed \$32,520 and \$31,622 to the Retirement Plan during the years ended December 31, 2017 and 2016, respectively. As of December 31, 2017 and 2016, there was \$33,726 and \$32,530 payable to the retirement plan, respectively.

### **8. Surplus**

Under the Act, in any calendar year in which the Association experiences a deficit, the Association is required to file the deficit with the Commissioner for approval. The Act defined a deficit as the amount, if any, of the net loss which exceeds the sum of earned premiums and investment income.

In such event, and with the Commissioner’s approval of the deficit, the Association is authorized to borrow funds sufficient to satisfy the deficit. Additionally, the Association will file a rate filing with the Department in order to generate sufficient income for the Association to avoid a deficit during the following 12 month period and to repay any principal and interest on any money borrowed. The Association did not incur a deficit for the years ended December 31, 2017 and 2016.

### **9. Appropriated Surplus**

The Association has voluntarily appropriated \$3 million of surplus as of December 31, 2017 and 2016, for contingencies related to the indemnification of the Association and its officers and directors from any liability from claims against them which may arise in the future.

### **10. Commitment and Contingencies**

The Association is involved in legal proceedings which arise in the ordinary course of business. In the opinion of management, the ultimate liability with respect to these legal proceedings will not have a material effect on the results of operations or financial position of the Association.

On October 30, 2017, the Commonwealth of Pennsylvania signed into law Act No. 2017-44, which required the Association to transfer \$200,000,000 of its surplus to Pennsylvania’s General Fund, or face the legislature’s attempt to dissolve the Association. The Association filed a complaint in federal court in which it seeks to enjoin the enforcement of Act 44 of 2017. The court granted the Association’s request for a preliminary injunction enjoining the immediate transfer of the \$200,000,000 by order entered November 22, 2017. Dispositive motions have been filed before the court to resolve the Association’s request for a permanent injunction and related declarations of rights, with both the Association and the defendants seeking summary judgment in their favor. In the event the case is not resolved, trial is scheduled for May 2018. Based in part upon the opinion of legal counsel, the ultimate outcome of this matter is not presently determinable. As of December 31, 2017, there is no payable for the transfer of surplus and no amounts have been transferred to the Commonwealth of Pennsylvania as of April 26, 2018.



# Pennsylvania Professional Liability Joint Underwriting Association

## Investment Risk Interrogatories

December 31, 2017

Provided below are management's responses to the Investment Risk Interrogatories and Summary Investment Schedule required by NAIC SAP. Questions/Categories not applicable to the Company have not been included below.

1. Reporting entity's total admitted assets as of December 31, 2017 were: \$ 298,882,386

2. The Company's ten largest exposures to a single issuer/borrower/investment, excluding U.S. government, U.S. government agency securities, and U.S. government money market funds, are as follows:

Issuer	Description of Exposure	Amount	Percentage of Total Admitted Assets
1 The Government National Mortgage	MBS/CMO	\$ 2,578,835	0.86%
2 Federal Home Loan Mortgage Corporation	MBS/CMO	2,561,967	0.86%
3 The Government National Mortgage	MBS/CMO	2,481,704	0.83%
4 Federal National Mortgage Association	MBS/CMO	2,407,231	0.81%
5 Synchrony Credit Card Master Note Trust	Bonds	2,211,287	0.74%
6 GS Mortgage Securities Trust 2011-GC5	MBS/CMO	2,135,511	0.71%
7 Federal Home Loan Mortgage Corporation	MBS/CMO	2,111,948	0.71%
8 Anheuser-Busch Inbev Finance Inc.	Bonds	2,005,364	0.67%
9 Federal National Mortgage Association	MBS/CMO	2,004,948	0.67%
10 Federal National Mortgage Association	MBS/CMO	2,000,341	0.67%

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

Rating	Amount	Percentage of Total Admitted Assets
Bonds:		
NAIC-1	\$ 227,227,973	76.03%
NAIC-2	49,940,329	16.71%
NAIC-3	5,237,784	1.75%
NAIC-4	1,399,998	0.47%
NAIC-5	177,609	0.06%
NAIC-6	19,560	0.01%
Preferred Stocks:		
P/RP-1		0.00%
P/RP-2		0.00%
P/RP-3	409,825	0.14%
P/RP-4		0.00%
P/RP-5		0.00%
P/RP-6		0.00%

# Pennsylvania Professional Liability Joint Underwriting Association

## Summary Investment Schedule December 31, 2017

Investment Categories	Gross Investment Holdings		Admitted Asset	
	Amount	Percentage	Value	Percentage
U.S. Treasury securities	\$ 34,255,618	11.54%	\$ 34,255,618	11.54%
U.S. government agency obligations: Issued by U.S. government sponsored agencies	2,091,096	0.70%	2,091,096	0.70%
Securities issued by states, territories, and possessions and political subdivisions of the U.S.:				
States, territories and possessions	4,070,878	1.37%	4,070,878	1.37%
Political subdivisions of states, territories and possessions	5,347,406	1.80%	5,347,406	1.80%
Revenue and assessment obligations	19,579,077	6.60%	19,579,077	6.60%
Industrial development and similar obligations	1,350,000	0.45%	1,350,000	0.45%
Mortgage-backed securities:				
Pass-through securities:				
Guaranteed by GNMA	802,104	0.27%	802,104	0.27%
Issued or guaranteed by FNMA and FHLMC	27,930,414	9.41%	27,930,414	9.41%
All other MBS	19,560	0.01%	19,560	0.01%
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC or VA	39,101,001	13.17%	39,101,001	13.17%
All other	33,081,375	11.14%	33,081,375	11.14%
Other debt and other fixed income securities (excluding short-term):				
Unaffiliated domestic securities	90,636,910	30.53%	90,636,910	30.53%
Unaffiliated Non-U.S. securities	25,737,814	8.67%	25,737,814	8.67%
Preferred stocks	409,825	0.14%	409,825	0.14%
Publicly traded equity securities (excluding preferred stocks):	1,966	0.00%	1,966	0.00%
Receivables for securities	201	0.00%	201	0.00%
Cash and cash equivalents	11,420,271	3.85%	11,420,271	3.85%
Other Invested assets	1,003,596	0.34%	1,003,596	0.34%
	<u>\$ 296,839,112</u>	<u>100.00%</u>	<u>\$ 296,839,112</u>	<u>100.00%</u>

## *Reinsurance Interrogatories*

*December 31, 2017*

Provided below are management's responses to certain reinsurance interrogatories required by NAIC Statutory Accounting Principles:

Has the reporting entity reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)?

Yes ( ) No ( X )

Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

- (a) A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;
- (b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
- (c) Aggregate stop loss reinsurance coverage;
- (d) A unilateral right by either (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;
- (e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
- (f) Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

Yes ( ) No ( X )

Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member, where:

- (a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
- (b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in a separate reinsurance contract.

Yes ( ) No ( X )

Except for transactions meeting the requirements of paragraph 31 of SSAP No. 62R—Property and Casualty Reinsurance, disclose if the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

- (a) Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles ("SAP") and as a deposit under generally accepted accounting principles ("GAAP"); or
- (b) Accounted for that contract as reinsurance under GAAP and as a deposit under SAP?

Yes ( ) No ( X )

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