

REPORT ON EXAMINATION AS TO THE CONDITION OF

COVERYS SPECIALTY INSURANCE COMPANY

AS OF DECEMBER 31, 2018

NAIC COMPANY CODE 15686

NAIC GROUP CODE 1154

FILED

MAY 15, 2020

COMMISSIONER

**DEPARTMENT
OF
BANKING & INSURANCE**

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State of New Jersey
DEPARTMENT OF BANKING AND INSURANCE
OFFICE OF SOLVENCY REGULATION

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January 7, 2020

Honorable Marlene Caride
Commissioner of Banking and Insurance
State of New Jersey
20 West State Street
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Commissioner:

A financial examination has been made of the condition and affairs of the:

Coverys Specialty Insurance Company
67 East Park Place, Suite 703, Morristown, New Jersey 07960
NAIC GROUP CODE 1154
NAIC COMPANY CODE 15686

a property and liability insurance organization authorized to transact business in the State of New Jersey, and hereinafter referred to in this report as "CSIC" or "Company."

SCOPE OF THE EXAMINATION

The New Jersey Department of Banking and Insurance, hereafter referred to as the “NJDOBI” or “We”, participated in a full scope coordinated multi-state risk focused examination which was led by the Massachusetts Division of Insurance. This examination covers the period from the commencement of operations on April 1, 2015 through December 31, 2018, and is the first examination of Coverys Specialty Insurance Company, hereafter referred to as “CSIC” or “the Company”. The current examination includes a review of any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination. The principal portion of the examination was conducted at the Company’s main administrative office located in Boston, Massachusetts.

The current examination was conducted concurrent with the examinations of its affiliates, Medical Professional Mutual Insurance Company (“MPMIC”), ProSelect Insurance Company (“PSIC”) Preferred Professional Insurance Company (“PPIC”), Healthcare Underwriters Group, Inc. (“HUG”), Preferred Professional RRG (“PPRRG”), and Coverys RRG, Inc. (“CRRG”), (collectively, “The Group”). During the period of December 31, 2015 through December 31, 2018, the Company’s assets increased from \$56,727,598 to \$81,016,125, liabilities increased from \$6,048,272 to \$27,837,598, and surplus increased from \$50,679,326 to \$53,178,527.

The NJDOBI conducted the examination in accordance with the 2018 edition of the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (the “NAIC Handbook”). The NAIC Handbook requires the NJDOBI to plan and perform the examination in order to evaluate the financial condition and identify prospective risks of the Company. To meet these objectives, the NJDOBI obtained information regarding the Company’s corporate governance environment, identified and assessed inherent risks to which it is exposed and evaluated the Company’s system of internal controls and procedures used to mitigate identified risks. The examination also included 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.

According to the NAIC Handbook, “One of the increased benefits of the enhanced risk-focused approach is to include consideration of other than financial risks that could impact the insurer’s future solvency. By utilizing the enhanced approach, the examiner reviewed the financial and enterprise risks that existed at the examination “as of” date and will be positioned to assess financial and enterprise risks that extend or commence during the time the examination was conducted and prospective risks which are anticipated to arise or extend past the point of examination completion. Using this approach, examiners will be better positioned to make recommendations for appropriate future supervisory plans (i.e., earlier statutory exams, limited-scope exams, key areas for financial analysts to monitor, etc.) for each insurer.”

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. The examination report only addresses regulatory information revealed by the examination process in accordance with the NAIC Handbook. All other financial matters were reviewed and determined not to be material for discussion in this report.

During the course of the examination, consideration was given to work performed by the Company's Internal Audit Department and the Company's external accounting firm. Work reviewed included risk analysis, documentation, test-work and remediation efforts over weaknesses identified. Certain auditor work papers have been incorporated into the work papers of the examiners and have been utilized in determining the scope and areas of emphasis in conducting the examination.

COMPANY HISTORY

ProMutual Group, Inc., the immediate parent of Coverys Specialty Insurance Company, is itself wholly owned by MPMIC, the ultimate parent company of the Coverys insurance holding company group. MPMIC was originally organized as a Joint Underwriting Association ("JUA") established under the Massachusetts Acts of 1975. The Massachusetts legislature created the JUA to guarantee the continued availability of medical malpractice professional liability insurance within the State.

In July 1992, the name of the JUA was changed to the Massachusetts Medical Professional Insurance Association ("MMPIA"), to reflect that the entity was no longer a joint underwriting association. In January of 1995, the MMPIA was converted to a mutual insurance company known as the Medical Professional Mutual Insurance Company ("MPMIC"), which assumed all of the assets and liabilities of the Association.

On May 2, 1995, MPMIC received its certificate to transact business in Massachusetts as a mutual insurance company, and formed a downstream holding company, ProMutual Group, Inc. Coverys Specialty Insurance Company was organized on December 19, 2014 as an excess and surplus lines insurance company domiciled in the State of New Jersey, and is a wholly owned subsidiary of ProMutual Group, Inc., itself a wholly owned subsidiary of MPMIC. The Company and other affiliated companies of MPMIC are collectively referred to as "Coverys".

CSIC is authorized to write multiple lines of business which are designated as "b" per N.J.S.A. 17:17-1 and N.J.S.A. 17:22-6.69 to entitle it to engage in the kinds of business specified on a Surplus Lines only basis.

The Company is eligible to write excess and surplus lines in all fifty states and the District of Columbia and is currently writing business, primarily medical professional liability insurance, in forty-seven states. The Company's statutory home in the State of New Jersey is located at 67 East Park Place, Suite 703, Morristown, New Jersey 07960. The Registered Agent of the Company is Joseph Murphy, Chief Operating Officer and Secretary, located at 67 East Park Place, Suite 703, Morristown, New Jersey 07960.

Capital Stock

The Capital Stock of the Company at December 31, 2018 was \$2,000,000 consisting of 200,000 authorized and outstanding shares issued with a \$10 par value per share. ProMutual Group, Inc. owns 100% of the Company's outstanding stock.

Dividends to Stockholders

The Company did not issue dividends during the examination period.

MANAGEMENT AND CONTROL

The Company's bylaws state that the number of directors who shall serve on the Board shall be three, the exact number of which shall be fixed from time to time by resolution of the Board. At December 31, 2018, there were three board members as follows:

<u>Directors</u>	<u>Principal Occupation</u>
Gregg L. Hanson	Chairman of the Board, Chief Executive Officer
Joseph G. Murphy	Chief Operating Officer, Secretary
Jose R. Zorola	Chief Underwriting Officer

MPMIC maintains an audit committee which is responsible for recommending the election of independent certified public accountants, reviewing the insurer's financial condition, the scope and results of the independent audit and any internal audit, nominating candidates for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer and recommending to the board of directors the selection and compensation, including bonuses or other special payments of the principal officers. As of December 31, 2018, the Audit Committee was comprised of the following members:

Robert K. Sheridan, Chair	Maryanne C. Bombaugh
Theodore A. Calianos	Paul J. Desjardins
Michael B. Driscoll	John H. Gillespie
Michael W. Louge	Donna M. Norris
Brenda E. Richardson	Peter T. Robertson

N.J.S.A. 17:27A-4d.(3) requires that no less than one-third of the directors be directors who are not officers or employees of the corporation or of any entity controlling, controlled by or under common control with the corporation and who are not beneficial owners of a controlling interest in the voting securities of the corporation or any such entity. The Company is also required to comply with the provisions of N.J.S.A. 17:27A-4d(4) which states that, "The board of directors of a domestic insurer shall establish one or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by, or under common control with, the insurer and who are not beneficial owners of a controlling interest in the voting securities of the insurer or any such entity. N.J.S.A. 17:27A-4d.(5) provides that the provisions of paragraphs (3) and (4) of subsection N.J.S.A. 17:27A-4d. shall not apply to a domestic insurer if the person controlling the insurer is an entity having a board of directors and committees thereof that substantially meet the requirements of those paragraphs.

MPMIC is the ultimate parent of the Company and MPMIC has a board of directors and an audit committee that substantially meet the requirements of independence as outlined in N.J.S.A. 17:27A-4d(3) (4).

The executive officers of the Company as of December 31, 2018, were as follows:

<u>Officer</u>	<u>Title</u>
Gregg Lee Hanson	Chief Executive Officer and Chairman
Joseph G. Murphy	Chief Operating Officer and Secretary
Jose R. Zorola	Chief Underwriting Officer
Todd C. Mills	Chief Financial Officer and Treasurer
Erin B. Bagley	Vice President and Assistant Secretary
Simeon J. Mezzich	President
Edward T. Lyons	Senior Vice President

CONFLICT OF INTEREST PROCEDURES

The Company has established a procedure for disclosure to its Board of any material interest or affiliation on the part of its officers, directors and employees that are in conflict with the official duties of such individuals.

Each year, the Company requires its directors, officers and employees to sign a conflict of interest questionnaire and to divulge any potential conflicts of interest that could have an impact on the way they conduct the Company's business. The completed Disclosure Statements are reviewed by the Compliance Manager, in consultation with the Legal Department.

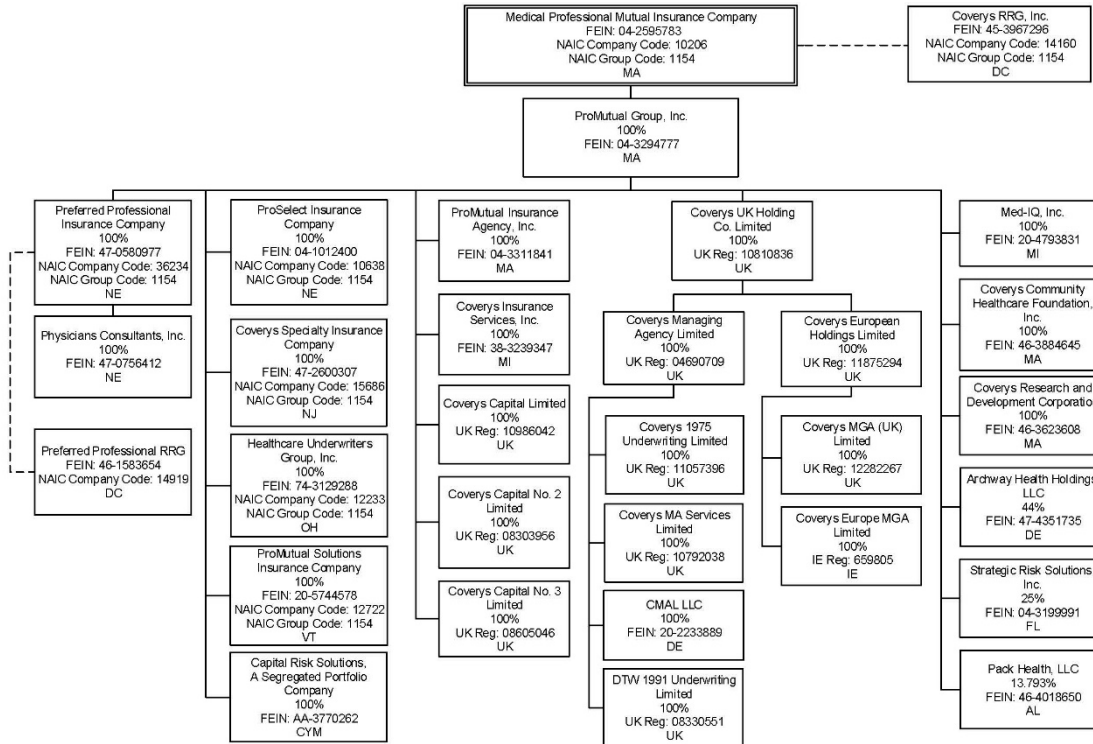
CORPORATE RECORDS

A review was made of the Board minutes and committee minutes for the period of examination. This examination determined that the minutes adequately approve and support the Company's transactions and events.

PARENT, SUBSIDIARIES, AND AFFILIATES

The Company is a member of an insurance company holding system as defined in N.J.S.A. 17:27A-1 et seq. Accordingly, the Company has filed with the State of New Jersey an insurance holding company registration as is required under N.J.S.A. 17:27A-3.

The following abbreviated organizational chart at December 31, 2017, identifies the insurance companies within the holding company organization:



Intercompany Agreements

Management Services Agreement

The Company entered into a Management Services Agreement with its affiliated company PSIC effective January 1, 2017. Under the terms of the agreement, PSIC provides services including, but not limited to: underwriting, policy issuance and administration, risk management claims management and financial administration to the Company. In return, the Company pays PSIC a pro-rata share of Group expenses per the terms of the agreement. The management fee expense paid to PSIC under this agreement was \$13,744,743 and \$5,416,541 in 2018 and 2017, respectively.

Reinsurance Agreement

CSIC entered into a 100% quota share reinsurance agreement with MPMIC effective January 1, 2015, which was revised on April 17, 2015. Under the terms of this agreement, CSIC cedes, and MPMIC reinsures, a one hundred percent (100%) quota share of the net underwriting assets and liabilities of the Company under all insurance business written by the Company, net of third-party reinsurance, including any reserve development.

Tax Allocation Agreement

The Company and its affiliates, along with the ultimate parent, MPMIC, file a consolidated federal income tax return. Effective June 30, 2013, MPMIC and certain affiliates entered into the original Tax Allocation Agreement, which covers the allocation, settlement, and financial statement presentation of current federal income taxes among companies in the consolidated income tax return of MPMIC and its subsidiaries. The Company entered into the Tax Allocation Agreement through a Consolidated Agreement effective June 12, 2015.

The Company reported \$72,260 due to and \$34,682 due from Medical Professional Mutual Insurance Company at December 31, 2018 and 2017, respectively, related to the federal tax sharing agreement.

FIDELITY BOND AND OTHER INSURANCE COVERAGE

The Company maintains fidelity coverage with limits of \$10,000,000 and a \$100,000 deductible. The aggregate limit of liability exceeds the NAIC suggested minimum. All employees are covered by the fidelity bond.

The Company has further protected its interests and property by policies of insurance covering other insurable risks.

TERRITORY AND PLAN OF OPERATION

The Company is 100% owned by ProMutual Group, Inc. and is eligible to write excess and surplus lines in all fifty states, and the District of Columbia. CSIC is currently writing business, principally medical professional liability insurance, in forty-eight states, excluding Montana, North Dakota and Wyoming.

As a New Jersey Domestic Surplus Lines insurer, the Company has a network of licensed, independent surplus lines brokers with expertise in medical professional liability insurance across the United States to offer Coverys Specialty's products. In addition, CSIC's existing broker relationships are utilized where appropriate and when approved for Excess and Surplus business. At year-end 2018, about 12% of business was produced by MGAs and the remaining amount, approximately 88%, was procured by other independent producers.

REINSURANCE

Reinsurance Agreements with Affiliates

The Company entered into a 100% quota share reinsurance agreement with MPMIC effective January 1, 2015 and revised as of April 17, 2015. As noted above, under the terms of the agreement, CSIC cedes, and MPMIC reinsures, a one hundred percent (100%) quota share of the net underwriting assets and liabilities of the Company under all insurance business written by the Company, net of third-party reinsurance, including any reserve development.

Reinsurance Agreements with Non-Affiliates

The Company cedes a relatively small amount of business to U.S. and Non-U.S. authorized reinsurers, which is primarily comprised of Excess of Loss reinsurance agreements.

ACCOUNTS AND RECORDS

The Company's accounting books and records are maintained at its main administrative office located at One Financial Center, Boston, Massachusetts 02111.

The Company's financial statements are manually prepared by the Coverys Finance Department. The trial balances are prepared utilizing data from the PRO Financial general ledger system. Pro Financial is the financial reporting and general ledger system utilized by CSIC to record, analyze and report financial results. On a quarterly basis, key accounting personnel reconcile all subsidiary ledgers, subsystem activity and supporting documents to the general ledger and produce the Company's trial balances. The trial balances are then utilized to produce the financial statements.

NetCore is the primary policy administration system, and processes policy billings, claims, accounts receivable and payables. NetCore is a fully integrated system, with Policy and Claims data automatically feeding the accounting systems for billing and disbursement purposes. Premiums are received through a lockbox. If physical checks are received at the Coverys offices, the checks are sent to the finance department directly from the mailroom for recording and processing.

CSIC utilizes an Enterprise Data Warehouse that stores policy, billing and claims information which is loaded daily. The Company uses Tableau, Excel and Power BI to query the data, and SSRS is used to generate reports for operational purposes. For reinsurance, activity is exported from NetCore into an Excel file which is uploaded into FRS, the reinsurance administration system.

Coverys outsources its investment accounting function to FIS Computer Services. FIS is a multi-basis investment accounting system that supports the investment accounting, compliance, risk and performance reporting. It produces monthly, quarterly and annual Schedule BA, D, DA and E parts, as well as performing downloads to statutory statements software packages. FIS posts all transactions via automation tools, fed directly from the Company's custodial bank.

FINANCIAL STATEMENTS

The following pages contain financial statements showing the Company's financial position as of December 31, 2018, (Exhibit A), and the results of its operations since the commencement of operations to December 31, 2018, (Exhibit B), including capital and surplus (Exhibit C).

Exhibit A - Balance Sheet as of December 31, 2018

Comparative Statement of Assets, Liabilities and
Other Funds at December 31, 2018

Assets :	Balance per Examination as of 12/31/18	Balance per Company as of 12/31/18	Examination Change	Note
Bonds	\$ 45,968,561	\$ 45,968,561	\$ 0	1
Cash, cash equivalents & short-term investments	6,514,206	6,514,206	0	
Investment income due and accrued	329,964	329,964	0	
Uncollected premium and agents' balances in the course of collection	11,362,312	11,362,312	0	
Amounts recoverable from reinsurers	11,220,786	11,220,786	0	
Net deferred tax asset	123,248	123,248	0	
Receivable from parent, subsidiaries and affiliates	18,345	18,345	0	
Aggregate write-ins for other than invested assets	5,478,703	5,478,703	0	
Total Assets	<u>\$ 81,016,125</u>	<u>\$ 81,016,125</u>	<u>\$ 0</u>	
Liabilities :				
Losses	\$ 0	\$ 0	\$ 0	2
Loss adjustment expenses	0	0	0	2
Commission payable, contingent commissions and other similar charges	1,082,826	1,082,826	0	
Other expenses	14,627	14,627	0	
Taxes, licenses and fees	(748)	(748)	0	
Current federal and foreign income taxes	72,260	72,260	0	
Ceded reinsurance premiums payable	19,114,091	19,114,091	0	
Provision for reinsurance	7,301	7,301	0	
Payable to parent, subsidiaries and affiliates	7,547,241	7,547,241	0	
Total Liabilities	<u>\$ 27,837,598</u>	<u>\$ 27,837,598</u>	<u>\$ 0</u>	
Capital and Surplus :				
Common capital stock	\$ 2,000,000	\$ 2,000,000	\$ 0	
Gross paid in and contributed surplus	48,000,000	48,000,000	0	
Unassigned funds (surplus)	3,178,527	3,178,527	0	
Surplus as regards policyholders	<u>\$ 53,178,527</u>	<u>\$ 53,178,527</u>	<u>\$ 0</u>	
Total Liabilities and Surplus and Other Funds	<u>\$ 81,016,125</u>	<u>\$ 81,016,125</u>	<u>\$ 0</u>	

Exhibit B – Underwriting and Investment Exhibit

Underwriting and Investment Exhibit
for the four year period ending December 31, 2018 *

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
<u>Underwriting Income</u>				
Total underwriting deductions	0	0	0	0
Net underwriting income (loss)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<u>Investment Income</u>				
Net investment income earned	797,871	1,195,721	1,288,477	1,428,966
Net realized capital gains	138,075	142,548	22,502	(131,084)
Net investment gain	935,946	1,338,269	1,310,979	1,297,882
<u>Other Income</u>				
Net gain or loss from agents' or premium balances charged off	0	0	0	0
Finance and service charges not included in premiums	0	0	0	0
Aggregate write-ins for miscellaneous income	<u>0</u>	<u>15</u>	<u>0</u>	<u>0</u>
Total other income	0	15	0	0
Net income, before dividends to policyholders , after capital gains tax and before all other federal and foreign income taxes	935,946	1,338,284	1,310,979	1,297,882
Dividends to policyholders	0	0	0	0
Net income after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	935,946	1,338,284	1,310,979	1,297,882
Federal and foreign income taxes incurred	<u>329,420</u>	<u>370,295</u>	<u>238,516</u>	<u>251,437</u>
Net income	<u>606,526</u>	<u>967,989</u>	<u>1,072,463</u>	<u>1,046,445</u>

Coverys Specialty Insurance Company was organized on December 19, 2014 and wrote its first policies in 2015. As a result, the above Underwriting and Investment Exhibit reflects the period of operation of January 1, 2015 through December 31, 2018.

Exhibit C – Capital and Surplus

Capital and Surplus

for the four year period ending December 31, 2018

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Capital and Surplus Account				
Net income or (loss)	606,526	967,989	1,072,463	1,046,445
Change in net unrealized capital gains or losses				
Change in net deferred income tax	59,608	485,132	(158,387)	(263,104)
Change in non-admitted assets		(1,342,977)	(555,289)	1,254,230
Change in provision for reinsurance		(1,838)	1,838	(7,301)
Cumulative effect of changes in accounting principles				
Capital changes - Paid in				
Surplus adjustments - Paid in				
Dividends to stockholders				
Aggregate write-ins for gains and losses in surplus				
Change in Surplus as regards to policyholders for the year	<u>666,134</u>	<u>108,306</u>	<u>360,625</u>	<u>2,030,270</u>
Surplus December 31 previous year	<u>50,013,192</u>	<u>50,679,326</u>	<u>50,787,632</u>	<u>51,148,257</u>
Surplus December 31 current year	<u>50,679,326</u>	<u>50,787,632</u>	<u>51,148,257</u>	<u>53,178,527</u>

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – Special Deposits

The Company's reported Special Deposits held on behalf of the State of New Jersey which totaled \$122,728 (book value) and \$121,123 (fair value).

NOTE 2 – Losses and Loss Adjustment Expenses

The Company's reported liabilities at December 31, 2018, for unpaid losses and unpaid loss adjustment expenses amounted to \$0.00 since the Company cedes 100% of its business to its ultimate parent, Medical Professional Mutual Insurance Company. The Massachusetts Division of Insurance contracted with the consulting firm INS Consultants, Inc. to perform a review of the group loss reserves, including a review of the controls used to develop the reserves.

CONCLUSION

The undersigned hereby certifies that an examination has been made of Coverys Specialty Insurance Company and the foregoing report is true to the best of my knowledge and belief.

Respectfully submitted,

Patrick R. White

Patrick White,
Examiner-in-Charge
Representing the State of New Jersey
INS Consultants, Inc.

Under the supervision of:

Robert Pietras

Robert Pietras, CFE
CFE Reviewer – Supervising Examiner
New Jersey Department of Banking and Insurance

AFFIDAVIT

I, Patrick R. White, the undersigned, hereby certify that foregoing Report of Examination accurately discloses, to the best of my knowledge, all material and relevant information related to the financial condition of Coverys Specialty Insurance Company in accordance with the NAIC Financial Condition Examiners Handbook and New Jersey State Regulations.

Respectively submitted,

Patrick R. White

Patrick White, CFE
Examiner in Charge
Representing the State of New Jersey
INS Consultants, Inc.

Under the Supervision of:

Robert Pietras

Robert Pietras, CFE
CFE Reviewer- Supervising Examiner
New Jersey Department of Banking and Insurance

State of New Jersey
County of Mercer

Subscribed and sworn to before me, Sheila M. Tkacs, on this
7th day of April, 2020.

Sheila M. Tkacs

Notary Public of New Jersey

My commission expires: July 2025