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Linda A. Watters, Commissioner

REPORT OF EXAMINATION

OF

INSURANCE CORPORATION OF AMERICA

East Lansing, Michigan

As of

December 31, 2003

Examined by the
Office of Financial and Insurance Services
Lansing, Michigan

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Commissioners:

In accordance with instructions and pursuant to statutory requirements, we have examined the financial condition, management and operations of:

Insurance Corporation of America
1301 N. Hagadorn Rd.
E. Lansing, Michigan

a stock property and casualty insurer, hereinafter referred to as the "Company." Our examination report follows.

SCOPE OF EXAMINATION

The Office of Financial and Insurance Services (OFIS) conducted an examination of the Company for the period from April 1, 2000 to December 31, 2003. We conducted the examination in accordance with guidelines and procedures recommended by the Financial Condition (E) Committee of the National Association of Insurance Commissioners (NAIC) and the laws, rules and regulations prescribed by OFIS. We conducted concurrent examinations of American Physicians Assurance Corporation and APSpecialty Insurance Corporation, the Company's affiliates.

We reviewed and incorporated certain workpapers of the Company's independent auditors, PricewaterhouseCoopers LLP, into our examination workpapers where appropriate.

To determine the adequacy of the Company's reserves and related actuarial items, we hired the actuarial consulting services of Mercer Oliver Wyman Actuarial Consulting, Inc. The analysis, performed by Alan M. Crowe, FCAS, MAAA, consisted of the tests necessary to certify the adequacy of the reserves and related actuarial items. The actuarial certification is shown in the report of examination as Exhibit 1 and the detailed report is on file at our offices. We have tested the underlying data provided to the actuary for completeness and accuracy.

We verified and determined the Company's assets and liabilities as of December 31, 2003. We performed a limited review of the period between the prior examination and this December 31, 2003 examination. This review consisted mainly of an analytical review of the changes in the balance sheet, a review of the minutes of the board of directors and annual meetings of the stockholders, and a review of any items we deemed necessary. We also performed a limited market conduct review.

Our examination included a review of the following matters that have an impact on the Company's financial condition or conformity with related laws:

Conflict of Interest
Fidelity Bond and Other Insurance
Underwriting
Accounts and Records
Treatment of Policyholders
Advertising

In addition, we reviewed transactions occurring subsequent to December 31, 2003 as deemed appropriate. Comment on the findings of our examination is limited to matters involving a departure from laws, rules or regulations; a significant change in the amount of an item; or a necessary explanation. Any other adjustments or comments were discussed with Company personnel and may appear in a letter to management that was prepared in conjunction with this report of examination.

HISTORY AND PURPOSE

The Company is a Michigan domiciled property and casualty insurer, previously in receivership, acquired from the Texas receiver effective September 30, 1997. Under previous and unaffiliated ownership and management, the Company was placed into receivership and ordered liquidated by the Texas Department of Insurance on March 14, 1997. Current owners and managers have no knowledge of the Company prior to that date.

American Physicians Assurance Corporation acquired the Company in 1998. American Physicians Assurance Corporation subsequently transferred ownership of the Company in 2000 to American Physicians Capital, Inc., the Company's ultimate parent. The Company's corporate existence continued through its acquisition and the Company's certificate of authority was reinstated in Texas effective August 4, 1998. The Commissioner issued the Company's certificate of authority on March 1, 2000, and the Company has since commenced business as a Michigan domiciled company. The term of existence of the Company is in perpetuity.

CAPITAL STOCK

The Company has 50,000 shares of $100 par value common stock authorized and 25,000 shares issued and outstanding.

MANAGEMENT AND CONTROL

Holding Company Structure

The Company is owned by its parent company, American Physicians Capital, Inc. (APCapital). APCapital also owns American Physicians Assurance Corporation (APAC) and APSpecialty Insurance Corporation (APSpecialty).

An organizational chart is shown in the report of examination as Exhibit 2.

Shareholders

The bylaws provide that the annual meeting of the shareholders is to be held on the second Wednesday in May or such other day as specified in writing 21 days prior to the date of the meeting. Special meetings of the shareholders may be called at any time by the order of the president or the shareholders. Each outstanding share entitled to vote shall be entitled to one vote upon each matter submitted to a vote at a shareholder meeting. A majority of the outstanding shares of the corporation entitled to vote, represented in person or by proxy, shall constitute a quorum at a shareholder meeting.

Board of Directors

The business and affairs of the Company are managed by a board of directors who is elected at the annual meeting of the shareholders. The directors are elected for staggered terms of three years.

Vacancies occurring on the board of directors are filled by appointment by the remaining directors within six months of each vacancy. Any directors so appointed hold office until the next annual meeting of the stockholders or until their respective successors are duly elected at a special meeting of the shareholders called for that purpose. If a director is removed by a vote of the shareholders, the vacancy may only be filled by a separate vote of the shareholders.

Regular meetings of the board of directors are held immediately after and at the same place as the annual meeting of shareholders. A majority of the board constitutes a quorum.

Directors serving as of December 31, 2003 are as follows:

Name	Affiliation
William B. Cheeseman	President and CEO of the Company
Richard Kevin Clinton	Vice President of the Company
Annette E. Flood	Secretary of the Company
Frank H. Freund	Treasurer of the Company

Committees

The articles of incorporation and the bylaws provide for the appointment of an executive committee and such other standing committees as deemed necessary to the prudent operation of the Company.

The executive committee acts on behalf of the board between regular board meetings and exercises those powers prescribed by the board of directors. As of December 31, 2003, no other committees to the board of directors were appointed.

Officers

The articles of incorporation and bylaws provide that the elected officers of the Company consist of a president, who also serves as the chairman of the board of directors, one or more vice presidents, a secretary and a treasurer.

The vice president is also a member of the board of directors. The office of secretary and treasurer may be combined. Officers serve until removed or until successors are qualified.

Officers are elected by the board of directors for one-year terms. Elections take place at the first regular or special meeting of the board following the annual meeting of the shareholders.

Officers serving as of December 31, 2003 are as follows:

Name	Title
William B. Cheeseman	President, Chair
Richard Kevin Clinton	Vice President, Vice Chair
Annette E. Flood	Secretary
Frank H. Freund	Treasurer

TERRITORY AND PLAN OF OPERATION

The Company is engaged in the business of providing workers' compensation insurance in the states of Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Nevada, New Mexico, South Dakota and Tennessee.

REINSURANCE

The Company has four layers of excess of loss coverage for business classified as workers' compensation insurance and employers' liability insurance. Losses up to $4,000,000 in excess of $1,000,000 per occurrence are ceded under the first excess cover. Losses up to $5,000,000 in excess of $5,000,000 per occurrence are ceded under the second excess cover. Losses of $10,000,000 in excess of $10,000,000 per occurrence are ceded under the third excess cover. Losses of $10,000,000 in excess of $20,000,000 per occurrence are ceded under the fourth or catastrophe excess of loss layer. This arrangement also includes coverage for claims arising from terrorism. Losses of $19,000,000 in excess of $1,000,000 per occurrence and in aggregate are covered. Business under this arrangement is ceded to General Reinsurance Corporation, a company authorized in Michigan.

Excess coverage in Minnesota must be purchased from the Minnesota Workers Compensation Reinsurance Association (WCRA). The Company selected retention of $720,000 per claim. The WCRA provides statutory coverage in excess of this retention.

GROWTH OF THE COMPANY

The data below depicts the growth of the Company from March 31, 2000 to December 31, 2003.

Year	Admitted Assets	Liabilities	Capital and Surplus
3/31/2000	$ 8,100,036	$ 196,788	$ 7,903,248
12/31/2000	$ 8,249,908	$ 156,199	$ 8,093,708
12/31/2001	$ 8,580,177	$ 320,005	$ 8,260,172
12/31/2002	$16,784,492	$ 8,995,455	$ 7,789,037
12/31/2003*	$95,554,069	$80,510,144	$15,043,925

Year	Net Premiums Written	Net Premiums Earned	Premiums Written to Surplus
3/31/2000	$ 0	$ 0	N/M
12/31/2000	$ 7,542	$ 4,697	.001:1
12/31/2001	$ 165,990	$ 60,782	.02:1
12/31/2002	$ 3,923,749	$ 2,283,313	.50:1
12/31/2003*	$92,231,360	$78,305,817	6.13:1

Year	Losses Incurred	Loss Ratio	Loss Adjustment Expense Incurred	Loss Adjustment Expense Ratio
3/31/2000	$ 0	N/M	$0	N/M
12/31/2000	$ 3,637	77.4%	$1,875	39.9%
12/31/2001	$ 41,921	69.0%	$21,934	36.1%
12/31/2002	$ 1,912,886	83.8%	$ 265,473	11.6%
12/31/2003*	$65,074,412	83.1%	$14,022,101	17.9%

Year	Underwriting Expenses Incurred	Underwriting Expense Ratio	Combined Loss and Expense Ratio
3/31/2000	$ 19,254	N/M	N/M
12/31/2000	$ 60,407	800.9%	918.2%
12/31/2001	$ 53,820	32.4%	137.5%
12/31/2002	$1,000,218	25.5%	98.0%
12/31/2003*	$7,089,465	7.7%	108.7%

* Per Report of Examination
N/M - Not Meaningful

INSURANCE CORPORATION OF AMERICA
BALANCE SHEET
As of December 31, 2003

ASSETS	
Bonds	$ 73,792,300
Common Stocks	18,910
Cash and Short-term Investments	9,916,593
Investment Income Due and Accrued	1,168,585
Uncollected Premiums and Agents' Balances in Course of Collection	1,112,179
Deferred Premiums, Agents' Balances, and Installments Booked But Deferred and Not Yet Due	9,142,178
Amounts Recoverable from Reinsurers	31,493
Current Federal and Foreign Income Tax Recoverable	173,401
Net Deferred Tax Asset	198,430
Total Assets	$95,554,069
LIABILITIES, CAPITAL AND SURPLUS	
Losses	$51,409,462
Loss Adjustment Expenses	8,028,330
Commissions Payable	69,176
Other Expenses	3,554,752
Taxes, Licenses, and Fees	6,953
Unearned Premiums	15,674,014
Advance Premiums	8,064
Ceded Reinsurance Premiums Payable	(32,026)
Payable to Parent, Subsidiaries, and Affiliates	1,791,419
Total Liabilities	$80,510,144
Common Capital Stock	$ 2,500,000
Gross Paid In and Contributed Surplus	20,000,000
Unassigned Funds	(7,456,075)
Total Surplus	$15,043,925
Total Liabilities, Capital and Surplus	$95,554,069

INSURANCE CORPORATION OF AMERICA
STATEMENT OF INCOME
For the Year Ending December 31, 2003

UNDERWRITING INCOME	
Premiums Earned	$78,305,817
Losses Incurred	65,074,412
Loss Expenses Incurred	14,022,101
Other Underwriting Expenses Incurred	7,089,465
Net Underwriting Gain (Loss)	$ (7,880,161)
INVESTMENT INCOME	
Net Investment Income Earned	$ 1,806,850
Net Realized Capital Gains	161,085
Net Investment Gain	$ 1,967,935
OTHER INCOME	
Net Gain (Loss) from Agents' or Premium Balances Charged Off	$ (595,432)
Aggregate Write-ins for Miscellaneous Income (Loss)	(754,820)
Dividends to Policyholders	(326,737)
Federal and Foreign Income Taxes Incurred	173,401
Net Income (Loss)	$(7,415,814)

INSURANCE CORPORATION OF AMERICA
STATEMENT OF CAPITAL AND SURPLUS
For the Year Ending December 31, 2003

Capital and Surplus, December 31, 2002	$ 7,789,037
Net Income (Loss)	(7,415,814)
Change in Net Capital Gains (Losses)	(1,584)
Change in Net Deferred Income Tax	7,590,038
Change in Provision for Reinsurance	(7,917,752)
Paid in Surplus	15,000,000
Change in Policyholders Surplus	$ 7,254,888
Capital and Surplus, December 31, 2003	$15,043,925

INSURANCE CORPORATION OF AMERICA
STATEMENT OF CASH FLOWS
For the Year Ending December 31, 2003

OPERATIONS	
Premiums Collected Net of Reinsurance	$ 84,005,322
Net Investment Income	841,024
Miscellaneous Income	(1,350,252)
Benefits and Loss Related Payments	14,485,624
Commissions, Expenses Paid, and Aggregate Write-ins for Deductions	10,001,679
Dividends Paid to Policyholders	326,737
Federal and Foreign Income Taxes Paid	42,918
Net Cash from Operations	$ 58,639,136
INVESTMENTS	
Proceeds from Investments Sold or Repaid	$ 5,607,933
Cost of Investments Acquired	
Bonds	(71,662,464)
Stocks	(18,910)
Net Cash from Investments	$(66,073,441)
FINANCING AND MISCELLANEOUS SOURCES	
Capital and Paid in Surplus, Less Treasury Stock	$ 15,000,000
Other Cash Provided	98,004
Net Cash from Financing and Miscellaneous Sources	$ 15,098,004
Net Increase (Decrease) in Cash and Short-Term Investments	$ 7,663,699
Cash and Short-Term Investments at December 31, 2002	$ 2,252,894
Cash and Short-Term Investments at December 31, 2003	$ 9,916,593

NOTES TO FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

The Company prepares its statutory financial statements in accordance with accounting practices prescribed or permitted by the State of Michigan Office of Financial and Insurance Services (OFIS). Prescribed statutory accounting practices include a variety of publications of the NAIC, as well as state laws, rules, regulations, and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed.

The principal differences between statutory accounting practices and accounting principles generally accepted in the United States of America (GAAP) are: (a) deferred income taxes are calculated in accordance with Statement of Statutory Accounting Principles (SSAP) No. 10 as opposed to in conformity with Statement of Financial Accounting Standards (SFAS) No. 109; (b) certain assets designated as "nonadmitted assets" are excluded from the balance sheet by direct charges to unassigned surplus; (c) acquisition costs relating to acquiring insurance business are charged to income as incurred rather than being deferred and amortized; (d) liabilities for losses and loss adjustment expenses and unearned premiums are presented net of the impact of reinsurance rather than reporting the gross amounts and recording the assets for the amounts related to reinsurance ceded as required by SFAS No. 113; (e) bonds are reported principally at amortized costs rather than reporting certain bonds at fair value as required by SFAS No. 115; (f) the statement of cash flows is presented in accordance with NAIC guidelines as opposed to SFAS No. 95; (g) comprehensive income is not required and, therefore, is not presented in the accompanying financial statements, in accordance with SFAS No. 130; (h) goodwill is evaluated for other than temporary impairment in accordance with SSAP No. 68 rather than the fair value approach required by SFAS No. 142; and (i) equity in earnings of unconsolidated subsidiaries is credited to surplus rather than the accounts being included in consolidated financial statements.

Significant statutory accounting policies include:

<u>*Codification Adoption*</u>
Effective January 1, 2001, OFIS required that insurance companies domiciled in the State of Michigan prepare their statutory basis financial statements in accordance with the NAIC *"Accounting Practices and Procedures Manual"—Effective January 1, 2001* subject to any deviations prescribed or permitted by OFIS. The cumulative effect of the change in accounting principles is reported as an adjustment to unassigned surplus in the period of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principles had been applied retroactively for all prior periods. As a result of these changes, the Company

reported a change of accounting principle as an adjustment that increased unassigned funds (surplus) by $221 as of January 1, 2001. This amount is attributable to deferred tax assets.

Investment in Bonds, Stocks and Short-term Investments

Bonds and stocks are recorded in accordance with rules promulgated by the NAIC. Investment grade bonds (NAIC designation 1 or 2) not backed by other loans are stated primarily at amortized cost using the scientific interest method. Below investment grade bonds (NAIC designation 3 or higher) not backed by other loans are stated at the lesser of fair value or amortized cost with any write-down in the carrying value of the bond being treated as an unrealized loss and charged directly to surplus, net of deferred income tax. Common stocks of non-affiliates are stated at NAIC market value, which approximates fair value. Unrealized gains and losses resulting from differences between the cost and fair value of stocks are credited or charged directly to surplus, net of deferred income tax. Short-term investments are stated at cost, which approximates fair value, and include all investments whose maturities, at the time of acquisition, are one year or less. Due and accrued income that is 90 days past due is non-admitted and excluded from surplus. Realized gains or losses on sales on investments are determined on the basis of specific costs of the investments and are credited or charged to income.

Acquisition Costs

Costs and expenses of acquiring business are charged to expense when incurred, while the related premium income is earned over the periods covered by the policies.

Loss and Loss Adjustment Expenses

Unpaid loss and loss adjustment expenses are estimated actuarially using the Company's past claims experience. These estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes that the reserves for loss and loss adjustment expenses are adequate. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in current earnings. Unpaid losses and loss adjustment expenses are not discounted and are presented net of reinsurance. Losses and loss adjustment expenses are charged to income as incurred.

Premiums

Premiums are earned in accordance with the terms of the related policies and reinsurance agreements. Unearned premiums represent the portion of premiums written that are applicable to the unexpired terms of policies in force, which are calculated by the application of daily pro rata fractions.

Premium Deficiency Reserves

Premium deficiency reserves are required for the amount of the anticipated losses, loss adjustment expenses, commissions, and other acquisition costs and maintenance costs that have not previously been expensed in excess of the recorded unearned premium reserve and anticipated investment income on existing policies. The results of this calculation did not indicate a deficiency at December 31, 2003.

Reinsurance

Reinsurance premiums and reserves related to reinsured business are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums ceded to other companies have been reported as a reduction of premium income. Amounts applicable to reinsurance ceded for unearned premiums and loss and loss adjustment expenses have been reported as reductions of these items.

Income Taxes

The Company files a consolidated federal income tax return with APCapital and its direct subsidiaries, which is subject to a written tax sharing agreement. Income taxes are allocated based upon separate return calculations giving current credit for net losses. Intercompany tax balances are settled annually in the first quarter.

Non-admitted Assets

Certain assets designated as non-admitted assets have been excluded from the balance sheet and are charged directly to surplus.

Use of Estimates

The preparation of financial statements in conformity with statutory accounting practices requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. INVESTMENTS IN STOCKS AND BONDS

The estimated fair value of bonds is based on published market quotations and other sources and is not materially different from the NAIC market values. The fair value of bonds at December 31, 2003 was $79,063,282. The fair value of stocks as of December 31, 2003 was $18,910. Bonds with fair values of $2,272,539 were on deposit with various states as of December 31, 2003.

Net gains of $161,085 were realized in 2003 on disposal of investments in bonds. Proceeds on disposal of investments in bonds totaled $5,446,848 in 2003.

3. NON-ADMITTED ASSETS

Non-admitted assets consist of the following at December 31, 2003:

Uncollected Premiums	$ 9,055
Deferred Premiums	335,592
Net Deferred Tax Assets	7,691,988
Commissions Receivable	5,126
Security Deposit	36,709
Total	$8,078,470

4. LOSS AND LOSS ADJUSTMENT EXPENSES

Management believes the estimate for the ultimate liability for loss and loss adjustment expenses at December 31, 2003 is reasonable and reflective of anticipated ultimate experience. However, it is possible that the Company's actual incurred loss and loss adjustment expenses will not conform to the assumptions inherent in the determination of the liability. Accordingly, it is reasonably possible that the ultimate settlement of losses and the related loss adjustment expenses may vary significantly from the estimated amounts included in the accompanying financial statements.

5. REINSURANCE

Ceded reinsurance arises from the Company seeking to reduce its loss exposure on the workers' compensation insurance policies it writes.

The Company's policy is to enter into reinsurance contracts only with highly rated insurers. Reinsurance contracts do not relieve the Company from its obligations to policyholders. If the reinsuring company is unable to meet its obligations under existing reinsurance agreements, the Company would be liable for such defaulted amounts, which have been deducted from the liability for loss and loss adjustment expenses.

As of December 31, 2003, the Company had no reinsurance recoverables in dispute or deemed to be uncollectible and had not written off any balances during 2003.

While the Company did not commute any reinsurance contracts during 2003, a novation of certain balances was consummated effective August 1, 2003. This novation resulted in APAC and APSpecialty transferring substantially all workers' compensation business to the Company. Prior to the novation, the Company participated in an 80/20 quota share reinsurance treaty with its affiliate, APAC. Balances previously ceded by the Company and assumed by APAC were also novated.

6. INCOME TAXES

The Company reported a net admitted deferred tax asset of $198,430 at December 31, 2003. The Company non-admitted $7,691,988 of deferred tax assets in accordance with SSAP No. 10. The Company has no unrecognized deferred income tax liabilities.

The Company records the tax effects of temporary differences that give rise to significant portions of its deferred tax assets and liabilities. The change in net deferred income taxes is comprised of changes in gross deferred tax assets less gross deferred tax liabilities, including the tax effect of changes in unrealized losses. The Company's change in net deferred income taxes as of December 31, 2003 was $7,590.036.

The provision for federal income taxes incurred is different from that which would be obtained by applying the statutory federal income tax rate to loss before income taxes. The significant items causing this difference were tax exempt interest, the change in nonadmitted assets, the reduction in deferred taxes related to novated balances and the 2002 return to provision adjustment.

The following are income taxes incurred in the current and prior years that will be available for recoupment in the event of future net losses: 2002-$130,061, 2001-$68,369 and 2000-$138,275.

7. RELATED PARTY TRANSACTIONS

The Company has no employees. Management services are provided to the Company by APAC. The Company incurred expenses of $9,807,085 related to management services during 2003.

8. CONTINGENT LIABILITIES

The Company participates in the guaranty associations of the various states in which premiums are written. Guaranty fund assessments are accrued at the time of the insolvency. Other assessments are accrued either at the time of the assessments, or in the case of premium based assessments, at the time the premiums were written, or in the case of loss based assessments, at the time the losses are incurred.

EXAMINATION FINDINGS AND RECOMMENDATIONS

1. Supporting Documentation for Claims

The Company did not have proper documentation supporting individual workers' compensation loss and loss expense payments. Claim forms supporting individual loss and loss expense payments were not retained in the claim files. Additionally, the Company did not have documentation in the workers' compensation claim files supporting individual reserves at year-end.

We recommend the Company retain proper documentation supporting loss and loss expense payments. We also recommend the Company keep documentation in the claim files supporting year-end reserves for each claim.

2. Business Contingency and Disaster Recovery Plans

The Company has not developed a business contingency plan or a disaster recovery plan. It is a good business practice to develop such plans to mitigate the impact of disruptions resulting from disasters. The Company is currently working on a plan which it intends to implement in 2004.

We recommend the Company fully develop, test, and implement a business contingency and disaster recovery plan.

CONCLUSION

As of our December 31, 2003 examination, we determined the Company to have admitted assets of $95,554,069, liabilities of $80,510,144, and capital and surplus of $15,043,925.

We appreciate the cooperation and assistance extended by the officers and employees of the Company.

In addition to the undersigned, Jay L. Mertz, Elisha M. Pierce, and Laura L. Strank, examiners of OFIS; and Mercer Oliver Wyman Actuarial Consulting, Inc., consulting actuaries, participated in the examination.

Respectfully submitted,

John C. Sands, CFE
Examiner-in-Charge
Office of Financial and Insurance Services