Financial Statements – Statutory Basis

Physicians Insurance A Mutual Company
Years Ended December 31, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

Physicians Insurance A Mutual Company

Financial Statements – Statutory Basis

Years Ended December 31, 2018 and 2017

Contents

Building a better
working world

Ernst & Young LLP
Suite 3500
999 Third Avenue
Seattle, WA 98104-4086

Tel: +1 206 621 1800
Fax: +1 206 654 7799
ey.com

Report of Independent Auditors

The Board of Directors
Physicians Insurance, A Mutual Company

We have audited the accompanying statutory-basis financial statements of Physicians Insurance, A Mutual Company, which comprise the balance sheets as of December 31, 2018 and 2017, and the related statements of income, changes in policyholders' 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 conformity with accounting practices prescribed or permitted by the Washington State Office of the Insurance Commissioner. Management also is responsible for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 opinions.

Building a better
working world

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 1, to the statutory-basis financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the Washington State Office of the Insurance Commissioner, which is a basis of accounting other than U.S. generally accepted accounting principles. The effects on the financial statements of the variances between these statutory accounting practices and U.S. generally accepted accounting principles, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter described in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the statutory-basis financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of the Company at December 31, 2018 and 2017, or the results of its operations or its cash flows for the years then ended.

Opinion on Statutory-Basis of Accounting

In our opinion, the statutory-basis financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 1.

Ernst & Young LLP

May 3, 2019

Physicians Insurance A Mutual Company

Balance Sheets – Statutory Basis

	December 31 2018	December 31 2017
Admitted assets		
Cash and investments:		
Bonds, at amortized cost (fair value of $378,870,814 and $388,350,934 at December 31, 2018 and 2017, respectively)	**$ 379,519,583**	$ 378,113,947
Common stocks, at fair value (cost of $47,010,532 and $43,827,110 at December 31, 2018 and 2017, respectively)	**72,100,957**	76,929,746
Cash of $11,869,278 and $5,319,394, and short-term investments of $4,048,742 and $3,981,849 at December 31, 2018 and 2017, respectively	**15,918,020**	9,301,243
Investments in subsidiaries and affiliates	**15,442,062**	15,406,330
Total cash and investments	**482,980,622**	479,751,266
Uncollected premiums and agents' balances in the course of collection	**13,047,471**	11,906,593
Reinsurance recoverables on paid losses	**134,678**	6,012,166
Other amounts receivable under reinsurance contracts	**141,810**	38,388
Net deferred tax assets	**1,152,726**	1,792,528
EDP equipment and software	**162,452**	155,764
Accrued interest and dividends	**3,277,913**	3,645,277
Due from affiliates	**705,356**	1,016,935
Other assets	**269,051**	178,863
Total admittede assets	**$ 501,872,079**	$ 504,497,780
Liabilities and policyholders' surplus		
Liabilities:		
Reserves for losses	**$ 140,601,499**	$ 134,822,247
Reserves for loss adjustment expenses	**50,362,157**	53,960,485
Reinsurance payable on paid losses and loss adjustment expenses	**94,351**	1,060,167
Unearned premiums	**29,376,872**	28,562,898
Premium deposits	**10,316,223**	6,472,461
Other expenses	**5,670,613**	5,171,735
Retroactive reinsurance reserves assumed	**7,271,768**	11,101,678
Taxes, licenses, and fees	**135,069**	181,582
Provision for reinsurance	**89,961**	1,138,173
Ceded reinsurance premium payable to reinsurers	**4,173,247**	11,378,770
Federal income taxes payable	**855,967**	489,420
Total liabilities	**248,947,727**	254,339,616
Policyholders' surplus	**252,924,352**	250,158,164
Total liabilities and policyholders' surplus	**$ 501,872,079**	$ 504,497,780

See accompanying notes.

Physicians Insurance A Mutual Company

Statements of Income – Statutory Basis

	Year Ended December 31	
	2018	**2017**
Revenues:		
Premiums earned	**$ 107,626,899**	$ 92,177,244
Less ceded reinsurance premiums	**14,183,963**	12,902,169
Net premiums earned	**93,442,936**	79,275,075
Losses and expenses:		
Net losses incurred	**49,570,742**	40,373,454
Net loss adjustment expenses incurred	**26,151,294**	23,875,562
Other underwriting expenses incurred	**19,367,402**	16,142,043
Total underwriting deductions	**95,089,438**	80,391,059
Net underwriting loss	**(1,646,502)**	(1,115,984)
Net investment income earned	**15,070,505**	14,669,396
Net realized capital gains, less taxes of $401,094 and $678,823 at December 31, 2018 and 2017, respectively	**1,508,879**	1,317,715
Net investment gain	**16,579,384**	15,987,111
Net gain (loss) from agents' or premium balances charged off	**3,658**	(160,871)
Finance and service charges not included in premiums	**262,345**	278,253
Other income, net	**3,001,356**	5,007
Total other income	**3,267,359**	122,389
Income before dividends to policyholders and before federal income taxes	**18,200,241**	14,993,516
Dividends to policyholders	**5,002,475**	5,001,216
Income after dividends to policyholders and before federal income taxes	**13,197,766**	9,992,300
Federal income taxes incurred	**1,668,815**	499,943
Net income	**$ 11,528,951**	$ 9,492,357

See accompanying notes.

Physicians Insurance A Mutual Company

Statements of Changes in Policyholders' Surplus – Statutory Basis

	Year Ended December 31	
	2018	**2017**
Policyholders' surplus, at beginning of year	**$ 250,158,164**	$ 232,066,326
Net income	**11,528,951**	9,492,357
Change in unauthorized reinsurance	**1,048,212**	(382,995)
Change in nonadmitted assets	**3,624,665**	5,541,433
Change in net unrealized capital (losses) gains less capital gains tax on investments	**(11,007,825)**	7,171,264
Change in net deferred tax asset	**(2,427,815)**	(4,902,421)
Cumulative effect of changes in accounting principle – surplus notes	**–**	1,172,200
Policyholders' surplus, at end of year	**$ 252,924,352**	$ 250,158,164

See accompanying notes.

Physicians Insurance A Mutual Company

Statements of Cash Flow – Statutory Basis

	Year Ended December 31	
	2018	**2017**
Operating activities		
Premiums collected, net of reinsurance	**$ 89,876,566**	$ 76,228,830
Net investment income	**17,413,484**	17,121,442
Miscellaneous income	**267,358**	122,389
Total	**107,557,408**	93,472,661
Benefits and loss-related payments	**38,965,930**	50,779,444
Expenses paid	**48,236,255**	46,767,782
Dividends paid	**5,002,475**	5,001,216
Federal income taxes paid	**1,703,362**	525,341
Total	**93,908,022**	103,073,783
Net cash provided by (used in) operating activities	**13,649,386**	(9,601,122)
Investing activities		
Proceeds from investments sold, matured, or repaid:		
Bonds	**68,827,376**	58,468,144
Common stocks	**1,955,607**	2,540,055
Total investment proceeds	**70,782,983**	61,008,199
Cost of investments acquired:		
Bonds	**72,258,713**	63,057,570
Common stocks	**3,183,421**	3,614,185
Other invested assets	**1,500,000**	200,000
Total investments acquired	**76,942,134**	66,871,755
Net cash used in investing activities	**(6,159,151)**	(5,863,556)
Financing and miscellaneous activities		
Other cash (applied) provided	**(873,458)**	9,369,167
Net change in cash and short-term investments	**6,616,777**	(6,095,511)
Cash and short-term investments at beginning of year	**9,301,243**	15,396,754
Cash and short-term investments at end of year	**$ 15,918,020**	$ 9,301,243

See accompanying notes.

1. Description of the Company and Significant Accounting Policies

Physicians Insurance A Mutual Company (the Company) provides comprehensive professional liability insurance to physicians and hospitals practicing primarily in the states of Washington, Oregon, Idaho, Alaska, and Wyoming. The Company writes claims-made professional liability policies, provider excess, and medical stop-loss policies that protect medical provider organizations and self-insured employers from catastrophic losses.

The Company has one insurance subsidiary, Western Professional Insurance Company (WPIC), which has been in runoff since 2005 and the remaining liabilities are ceded to the Company. The Company has an insurance agency subsidiary that sells physicians products provided by other insurance carriers, such as business owners policies (BOPs), employment practices liability, long-term care, disability, life, and health. The Company also has subsidiaries that provide management and other services to risk retention groups.

The Company, domiciled in Washington state, prepares its statutory-basis financial statements in conformity with the National Association of Insurance Commissioners (NAIC) *Accounting Practices and Procedures Manual*, which has been adopted by the state of Washington, subject to any deviations prescribed or permitted by the Washington State Office of the Insurance Commissioner (Department). The Department has no significant accounting practices that differ from those found in NAIC statutory accounting principles.

NAIC accounting practices differ in certain respects from U.S. generally accepted accounting principles (GAAP). Significant differences are as follows:

- Acquisition expenses relating to the issuance of new policies are charged to expense as incurred. Under GAAP, certain policy acquisition costs to the extent recoverable would be deferred and amortized over the effective period of the related insurance policies.

- The Company's insurance subsidiary (WPIC) is recorded using the statutory net equity method, while investments in the Company's other subsidiaries are nonadmitted. The change in the subsidiaries' equity is included in the change in net unrealized capital gains or losses. Under GAAP, such investments would be consolidated with the accounts and operations of the Company.

1. Description of the Company and Significant Accounting Policies (continued)

- Certain assets designated as "nonadmitted" assets are excluded from the balance sheets, and the changes in such assets are credited or charged directly to unassigned surplus. These assets primarily consist of unaudited subsidiaries, the nonadmitted portion of deferred taxes, and property and equipment. Under GAAP, such assets are included on the balance sheets to the extent that those assets are not impaired.

- Investments in bonds are recorded at amortized cost or fair value based on their NAIC rating. Under GAAP, such fixed maturity investments would be designated at purchase as held to maturity, trading, or available for sale. Held-to-maturity fixed maturity investments would be reported at amortized cost, and the remaining fixed maturity investments would be reported at fair value, with unrealized holding gains and losses reported in operations for those designated as trading and as a separate component of other comprehensive income, net of the related deferred taxes, for those designated as available for sale.

- Deferred tax assets and liabilities are determined in a manner similar to GAAP; however, additional criteria are then applied to those assets that may require certain amounts to be nonadmitted. The change in net deferred tax assets is recorded as a change in policyholders' surplus. Under GAAP, a deferred tax asset is recorded for the amount of gross deferred tax assets expected to be realized in future years, and a valuation allowance is established for deferred tax assets not realizable.

- Ceded reinsurance recoverables on unpaid losses and loss adjustment expenses are recorded as a reduction to the reserves for losses and loss adjustment expenses. Additionally, the unexpired portion of ceded reinsurance premiums is recorded as a reduction of unearned premiums. Under GAAP, ceded reinsurance recoverables and ceded reinsurance premiums are reported as assets.

- A liability is provided for uncollateralized reinsurance balances of reinsurers not authorized to do business by the Department, and changes to those amounts are credited or charged directly to policyholders' surplus. Under GAAP, an allowance for amounts deemed uncollectible would be established through a charge to earnings.

- Commissions allowed by reinsurers on business ceded are reported as income when incurred to the extent the amount does not exceed actual acquisition costs rather than being deferred and amortized with deferred policy acquisition costs, as would be required under GAAP.

1. Description of the Company and Significant Accounting Policies (continued)

- The statements of cash flows differ in certain respects from the presentation required by GAAP.

- Realized gains or losses are recorded net of tax on the statements of income. Under GAAP, the tax associated with realized gains or losses is recorded as an income tax expense or benefit.

- Dividends are recorded as an expense on the statements of income when declared. Under GAAP, policyholder dividends are accrued over the term of the related policies.

The effects of the foregoing variances from GAAP on the Company's statutory-basis financial statements have not been determined, but are presumed to be material.

Other significant accounting practices are as follows:

Cash and Short-Term Investments

The Company considers all liquid instruments with a maturity of one year or less at the time of purchase to be short-term investments. The carrying amount of cash and short-term investments approximates fair value because of the short-term maturity of those instruments.

Investments

Bonds are reported at statement value as prescribed by the NAIC. Bonds that are investment grade (NAIC designation 1 or 2) are stated at cost or amortized cost. All other bonds (NAIC designations 3 to 6) are stated at the lower of amortized cost or fair value. Discount or premium on bonds is amortized using the effective-yield method.

Mortgage-backed securities are adjusted using the prospective method. Prepayment assumptions for single and multiclass mortgage-backed and asset-backed securities are initially obtained from broker/dealer statements. Updates to prepayment assumptions are obtained from independent pricing sources.

Common stocks are stated at fair value, and the related net unrealized capital gains (losses) are reported in policyholders' surplus along with any adjustment for federal income taxes.

1. Description of the Company and Significant Accounting Policies (continued)

Surplus notes with a designation of NAIC 1 or NAIC 2 are reported at amortized cost. All other surplus notes are reported at the lesser of amortized cost or fair value according to Statement of Statutory Accounting Principles (SSAP) No. 41R.

The Company uses the first-in, first-out method in determining gains and losses from the sale of investments. The Company monitors investments for other-than-temporary impairment. In determining whether the losses are temporary or other than temporary, the Company considers (1) the length of time and extent to which the fair value has been less than cost or carrying value, (2) the financial strength of the issuer, and (3) its intent to sell the security or the Company's ability to hold the security long enough to recover in value.

Interest and dividend income is recorded on the accrual basis. The Company nonadmits investment income due and accrued if amounts are more than 90 days past due.

Premiums

Premiums are earned over the terms of the related policies. The Company anticipates investment income as a factor in premium deficiency calculations. Unearned premium reserves are established to cover the unexpired portion of premiums written. Such reserves are computed by pro rata methods for direct and assumed business. Premiums related to coverages for doctors who retire, die, or are disabled are deferred as unearned premiums and are recognized as earned when an insured retires, dies, becomes disabled, or terminates coverage, whichever event occurs first; unearned premiums of $12,400,000 and $17,100,000 at December 31, 2018 and 2017, respectively, are for this coverage, which is referred to as DD&R coverage.

In determining unearned premiums related to DD&R, the Company includes an estimate for unexercised extended reporting endorsements utilizing actuarial models, including assumptions for the time value of money, loss trends, and the degree by which the loss experience of DD&R policies is likely to be below that implied by the Company's historical claims-made experience. Although the Company considers its experience and industry data in determining unearned premium related to DD&R, assumptions and projections of future events are necessary and unearned premiums may differ materially from amounts projected in the near term.

Premium deposits represent premium payments received from policyholders of the Company for policies not in effect until the ensuing calendar year.

1. Description of the Company and Significant Accounting Policies (continued)

Reserves for Losses and Loss Adjustment Expenses

The reserves for losses and loss adjustment expenses are established on the basis of reported losses (case-basis method). Provision is also made for claims incurred but not reported and related loss adjustment expenses. These amounts are based on the estimates of management and are subject to risks and uncertainties. Changes in estimates of losses and loss adjustment expenses are included in income for the period in which the estimates are changed. The Company does not discount loss and loss adjustment expense reserves. The method of making such estimates and establishing the resulting reserves is based on actuarial assumptions of future contingencies and the applicability of other data sources such as recent settlements, claim frequency, and other economic and social factors. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience. Although the Company considers its experience and industry data in determining such reserves, assumptions and projections of future events are necessary, and the ultimate amounts may differ materially from the amounts recorded or disclosed.

Reinsurance

The Company protects itself from excessive losses by reinsuring certain levels of risk in various areas of exposure with reinsurers. The Company also assumes risk from other insurance entities. Reinsurance coverage is provided on both a quota share and excess of loss basis. Prospective ceded and assumed reinsurance premiums, losses, and loss adjustment expenses are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Certain ceded and assumed reinsurance premiums include adjustments based on losses incurred, subject to certain limits, and are recorded on a best-estimate basis.

Ceded and assumed reinsurance premiums payable or receivable represent actual reinsurance costs in excess of deposits made and return premiums from prior years.

Retrospective reinsurance contracts are recorded as a liability and evaluated periodically for adequacy of the reserves. Gains and losses from the contracts are recorded in other income on the income statement.

1. Description of the Company and Significant Accounting Policies (continued)

Income Taxes and Deferred Taxes

The Company accounts for income taxes under the liability method, which requires the recognition of deferred taxes and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are limited to those that will more likely than not (defined as likelihood of more than 50%) generate a tax benefit, and a valuation allowance is established if necessary to reduce the deferred tax asset to an amount that is more likely than not to be realized. No valuation allowance has been recorded as of December 31, 2018 or 2017.

Deferred income taxes are further subject to limitations as to the amount of deferred income tax assets that may be reported as "admitted assets." Admitted deferred tax assets are limited to (1) the amount of federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse within the Internal Revenue Service loss carryback provisions; (2) the lesser of the remaining gross deferred tax assets expected to be realized within one year to three years of the balance sheet date or 10% to 15% of capital and surplus, excluding surplus arising from any net deferred tax assets, electronic data processing (EDP) equipment, operating software, and net positive goodwill; and (3) the amount of remaining gross deferred tax assets that can be offset against existing gross deferred tax liabilities. The Company considers character (capital or ordinary) in admitting deferred tax assets. Deferred income taxes do not include amounts for state income taxes.

Use of Estimates

The preparation of financial statements in conformity with accounting practices prescribed or permitted by the Department 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 statutory-basis financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant accounts subject to management estimates are reserves for losses and loss adjustment expenses, reinsurance recoverables on unpaid losses and loss adjustment expenses, unearned premium reserves, other-than-temporary impairment of invested assets, and the admitted portion of deferred tax assets.

1. Description of the Company and Significant Accounting Policies (continued)

Change in Accounting Principle

Effective January 2017, SSAP No. 41R, *Surplus Notes,* establishes a new valuation method for holders of surplus notes. Under SSAP No. 41R, surplus notes with a designation of NAIC 1 or NAIC 2 are reported at amortized cost, and all other surplus notes are reported at the lesser of amortized cost or fair value. The Company's surplus note had been nonadmitted under SSAP 41; however, as a result of application of the new valuation method, the Company reported a change of accounting principle, which increased policyholders' surplus by the fair value of the surplus note of $1,172,200 as of January 1, 2017.

2. Investments

The cost or amortized cost, gross unrealized gains or losses, and fair value of investments are as follows:

	Book/Adjusted Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2018				
U.S. treasury securities and obligations of U.S. government corporations and agencies	$ 29,346,169	$ 584,939	$ (423,877)	$ 29,507,231
Obligations of states and political subdivisions	108,653,557	2,117,021	(763,721)	110,006,857
Corporate securities	123,229,943	1,575,837	(2,649,171)	122,156,609
Mortgage-backed/ asset-backed securities	118,289,914	619,970	(1,709,767)	117,200,117
Total bonds	379,519,583	4,897,767	(5,546,536)	378,870,814
Common stocks	47,010,532	25,834,924	(744,499)	72,100,957
Total bonds and common stocks	$ 426,530,115	$ 30,732,691	$ (6,291,035)	$ 450,971,771

2. Investments (continued)

	Book/Adjusted Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
U.S. treasury securities and obligations of U.S. government corporations and agencies	$ 34,721,584	$ 964,415	$ (288,011)	$ 35,397,988
Obligations of states and political subdivisions	125,825,514	4,088,279	(372,819)	129,540,974
Corporate securities	126,950,677	5,574,101	(246,864)	132,277,914
Mortgage-backed/ asset-backed securities	90,616,172	1,087,718	(569,832)	91,134,058
Total bonds	378,113,947	11,714,513	(1,477,526)	388,350,934
Common stocks	43,827,110	33,124,518	(21,882)	76,929,746
Total bonds and common stocks	$ 421,941,057	$ 44,839,031	$ (1,499,408)	$ 465,280,680

The Company's subsidiary, WPIC, and other affiliates, had a carrying value of $15,442,062 and $15,406,330 at December 31, 2018 and 2017, respectively. Certain other subsidiaries and affiliates with a total carrying value of $2,172,560 and $5,487,567 at December 31, 2018 and 2017, respectively, are nonadmitted. Equity in earnings (losses) of subsidiaries is included in the change in unrealized capital gains (losses) and was $(4,674,659) and $(4,249,474) for the years ended December 31, 2018 and 2017, respectively.

The cost or amortized cost and fair value of bonds by contractual maturity at December 31, 2018, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Cost or Amortized Cost	Fair Value
Due in one year or less	$ 8,734,543	$ 8,835,692
Due between one year and five years	97,810,418	98,973,076
Due between five years and ten years	101,518,721	99,966,673
Due after ten years	53,165,987	53,895,256
Mortgage-backed/asset-backed securities	118,289,914	117,200,117
	$ 379,519,583	$ 378,870,814

2. Investments (continued)

Provided below is a summary of securities that were in an unrealized loss position as of December 31, 2018 and 2017. Management does not believe any individual unrealized loss as of December 31, 2018 or 2017, represents an other-than-temporary impairment, as the quantitative and qualitative criteria used by management to determine other-than-temporary impairment have not been met. The Company does not have the intent to sell and has the intent and ability, at the reporting date, to hold these investments until maturity or until fair value recovers above cost or amortized cost. In 2018 and 2017, there were no realized losses due to other-than-temporary impairments in value.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
December 31, 2018						
U.S. treasury and obligation of U.S. government	**$ 5,528**	**$ 19**	**$ 6,600**	**$ 405**	**$ 12,128**	**$ 424**
Obligations of states and political subdivisions	**17,449**	**186**	**18,080**	**578**	**35,529**	**764**
Corporate securities	**62,511**	**1,777**	**14,669**	**872**	**77,180**	**2,649**
Mortgage-backed/asset-backed securities	**39,045**	**490**	**40,759**	**1,220**	**79,804**	**1,710**
Common stocks	**10,168**	**686**	**268**	**58**	**10,436**	**744**
Temporarily impaired securities	**$ 134,701**	**$ 3,158**	**$ 80,376**	**$ 3,133**	**$ 215,077**	**$ 6,291**

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
December 31, 2017						
U.S. treasury and obligation of U.S. government	$ 11,887	$ 94	$ 3,315	$ 194	$ 15,202	$ 288
Obligations of states and political subdivisions	12,858	119	11,546	253	24,404	372
Corporate securities	11,458	74	7,102	173	18,560	247
Mortgage-backed/asset-backed securities	33,226	171	14,941	399	48,167	570
Common stocks	227	1	354	21	581	22
Temporarily impaired securities	$ 69,656	$ 459	$ 37,258	$ 1,040	$ 106,914	$ 1,499

2. Investments (continued)

Proceeds from sales of bonds during 2018 and 2017 were $39,599,817 and $24,927,013, respectively. Gross gains of $178,717 and $258,228 and gross losses of $137,515 and $57,440 were realized on those sales during 2018 and 2017, respectively. Gross gains of $5,288 and $199 and gross losses of $92,124 and $0 were realized from other transactions during 2018 and 2017, respectively.

The number of CUSIPs and aggregate amount of investment income generated as a result of a prepayment penalty and/or acceleration fee during 2018 and 2017 were 4 and $63,943, and 1 and $37,167, respectively.

Gross gains of $1,955,607 and $1,795,551 were realized on equity securities during 2018 or 2017. No gross losses were realized during 2018 and 2017.

The Company has the following restricted securities:

Certain bonds were on deposit with the Washington Office of the Insurance Commissioner for the protection of policyholders. The amortized cost of these securities at December 31, 2018 and 2017, was $2,506,387 and $2,511,664, respectively.

Certain bonds were designated as collateral to satisfy a claim in 2015. In accordance with a court order, the Company established a segregated custodial brokerage account as collateral for a judgment pending appeal. The amortized cost of these securities at December 31, 2017 was $19,248,333. In January 2018, the court denied the appeal and released the designated securities, ordering the Company to satisfy the judgment. The Company paid $18.6 million in the settlement.

Net investment income is summarized as follows:

	2018	2017
Interest and dividend income	**$ 13,900,593**	$ 13,689,634
Dividends from affiliates	**2,154,000**	1,979,000
Less investment expenses	**(984,088)**	(999,238)
	$ 15,070,505	$ 14,669,396

2. Investments (continued)

No amounts of investment income due and accrued have been excluded from surplus.

Credit risk is managed by entering into transactions with creditworthy counterparties and obtaining collateral where appropriate and customary. Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of corporate debt securities. As the portfolio is well diversified and issuers of securities are dispersed throughout many industries and geographies, the concentrations of credit risk are limited.

3. Fair Value of Financial Instruments

The following methods and assumptions were used by the Company in estimating the fair value of financial instruments in the accompanying financial statements and notes:

Cash and short-term investments: The carrying amounts reported on the accompanying balance sheets for these financial instruments approximate fair value.

Investment securities: Fair values for investment securities are primarily based on prices received from a third-party pricing service that uses observable market information in determining the fair value. Fair values for private placement securities are based on unit prices published by the Securities Valuation Office (SVO), or in the absence of SVO published unit prices, observable market inputs other than quoted market prices. See Note 2 for additional fair value information.

For all other financial instruments (payables and receivables), carrying value approximates fair value.

Financial assets and liabilities carried at fair value have been classified, for disclosure purposes, based on a fair value hierarchy. The three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies, is as follows:

Level 1 – Valuations based on quoted prices for identical assets and liabilities in active markets.

Level 2 – Valuations based on observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

3. Fair Value of Financial Instruments (continued)

Level 3 – Valuations based on unobservable inputs reflecting the Company's own assumptions, consistent with reasonably available assumptions made by other market participants. These valuations require significant judgment.

The aggregate fair values of all financial instruments and their level within the fair value hierarchy at December 31, 2018 and 2017, are as follows:

Type of Financial Instrument	Aggregate Fair Value	Admitted Assets	Level 1	Level 2	Level 3	Net Asset Value	Not Practical (Carrying Value)
2018							
Common stocks*	**$ 72,100,957**	**$ 72,100,957**	**$ 72,100,957**	**$ –**	**$ –**	**$ –**	**$ –**
Bonds	**378,870,814**	**379,519,583**	**24,250,606**	**354,620,208**	**–**	**–**	**–**
Short-term investments*	**4,048,742**	**4,048,742**	**4,048,742**	**–**	**–**	**–**	**–**
Surplus notes or debentures*	**1,169,600**	**1,169,600**	**–**	**–**	**1,169,600**	**–**	**–**
2017							
Common stocks*	$ 76,929,746	$ 76,929,746	$ 76,929,746	$ –	$ –	$ –	$ –
Bonds	388,350,934	378,113,947	27,562,138	360,788,796	–	–	–
Short-term investments*	3,981,849	3,981,849	3,981,849	–	–	–	–
Surplus notes or debentures*	1,287,400	1,287,400	–	–	1,287,400	–	–

*Measured at fair value on a recurring basis.

Fair Value Measurements in Level 3 of the Fair Value Hierarchy

2018

Description	Beginning Balance at January 1, 2018	Transfers Into Level 3	Transfers Out of Level 3	Total Gains (Losses) Included in Net Income	Total Gains (Losses) Included in Surplus	Purchases	Issuances	Sales	Settlements	Ending Balance at December 31, 2018
a) Assets:										
Surplus debentures – affiliate	**$ 1,287,400**	**$ –**	**$ –**	**$ –**	**$ (117,800)**	**$ –**	**$ –**	**$ –**	**$ –**	**$ 1,169,600**
Total assets	**$ 1,287,400**	**$ –**	**$ –**	**$ –**	**$ (117,800)**	**$ –**	**$ –**	**$ –**	**$ –**	**$ 1,169,600**

3. Fair Value of Financial Instruments (continued)

2017

Description	Beginning Balance at January 1, 2017	Transfers Into Level 3	Transfers Out of Level 3	Total Gains (Losses) Included in Net Income	Total Gains (Losses) Included in Surplus	Purchases	Issuances	Sales	Settlements	Ending Balance at December 31, 2017
a) Assets:										
Surplus debentures – affiliate	$ 1,172,200	$ –	$ –	$ –	$ 115,200	$ –	$ –	$ –	$ –	$ 1,287,400
Total assets	$ 1,172,200	$ –	$ –	$ –	$ 115,200	$ –	$ –	$ –	$ –	$ 1,287,400

The surplus note is included in investments in subsidiaries and affiliates on the balance sheet and valued based on the income approach per SSAP 100, *Fair Value*. The income approach uses a valuation technique to convert the future amounts (interest cash flows for the surplus note) to a single present value amount (discounted). The annual coupon rate of 1.25%, maturity date of May 1, 2035, and the annual required return of 5.04% were used to calculate the value. The amortized cost of the surplus note is $2,000,000.

4. Reinsurance

Under reinsurance agreements, the Company cedes various amounts of risk to other insurance companies. The professional liability reinsurance agreements that became effective July 1, 2016, provide for an initial retention by the Company of the first $2,000,000 of loss per event, with coverage of the excess up to $35,000,000. Prior to July 1, 2016, the Company retained the first $3,000,000 with respect to individual incidents. The stop-loss liability insurance coverage business was reinsured in 2018 and 2017 through a 50% quota share reinsurance arrangement. In 2018 and 2017, cyber liability coverage was reinsured at 100%. D&O coverage, which was reinsured 100% in 2014, was not reinsured in 2015. It has been reinsured since July 1, 2016, under the same reinsurance agreements as the Company's professional liability agreements.

4. Reinsurance (continued)

	Direct Business	Reinsurance Assumed Affiliated	Reinsurance Assumed Nonaffiliated	Reinsurance Ceded Nonaffiliated	Net Reported
Year ended December 31, 2018					
Premiums written	**$ 94,442,985**	**$ 11,311,735**	**$ 3,330,085**	**$ (14,827,895)**	**$ 94,256,910**
Premiums earned	**98,417,978**	**6,156,819**	**3,052,102**	**(14,183,963)**	**93,442,936**
Losses (recoveries)	**55,697,605**	**2,907,076**	**1,596,623**	**(10,630,562)**	**49,570,742**
Loss adjustment expenses (recoveries)	**24,794,493**	**1,741,586**	**82,043**	**(466,828)**	**26,151,294**
Underwriting expenses	**16,802,182**	**3,112,920**	**1,128,287**	**(1,675,987)**	**19,367,402**
Year ended December 31, 2017					
Premiums written	$ 91,739,916	$ 1,094,551	$ 2,270,535	$ (13,974,730)	$ 81,130,272
Premiums earned	89,067,041	851,292	2,258,911	(12,902,169)	79,275,075
Losses (recoveries)	53,131,871	(729,952)	1,297,746	(13,326,211)	40,373,454
Loss adjustment expenses (recoveries)	27,446,078	139,591	65,060	(3,775,167)	23,875,562
Underwriting expenses	16,431,164	1,089,316	96,371	(1,474,808)	16,142,043

Reinsurance recoverables from unauthorized reinsurers in excess of applicable letters of credit are considered nonadmitted assets. The amounts of nonadmitted reinsurance recoverables as of December 31, 2018 and 2017, were $89,961 and $1,138,173, respectively.

A contingent liability exists with respect to reinsured losses that would become an actual liability of the Company in the event that the reinsurers are unable to meet the obligations assumed by them under the reinsurance agreements as the reinsurance does not relieve the Company from the responsibility to the policyholders. The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from activities or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

There were no unsecured reinsurance recoverables in excess of 3% of surplus as of December 31, 2018 or 2017. There would be no commissions due if reinsurance were canceled.

Contingent commissions of $756,830 and $240,923 were accrued as of December 31, 2018 and 2017, respectively.

4. Reinsurance (continued)

Assumed retroactive reinsurance as of December 31, 2018 and 2017, is $7,271,768 and $11,101,678, respectively. In January 2017, the Company received approximately $12 million as part of a loss portfolio transfer agreement entered into in December 2016. The cash received increased financing and miscellaneous activities cash flows. There were $2,812,262 and $1,283,952 of loss and loss adjustment expenses paid as of December 31, 2018 and 2017, respectively. In 2018, favorable development of $3,000,000 in reserves related to retroactive reinsurance in assumed business was recognized in other income.

5. Reserves for Losses and Loss Adjustment Expenses

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

	2018	**2017**
Balance – January 1, net of reinsurance recoverables of $36,545,090 and $32,681,924	**$ 188,782,732**	$ 203,631,083
Incurred related to:		
Current year	**93,150,568**	85,199,286
Prior years	**(17,428,532)**	(20,950,270)
Total incurred	**75,722,036**	64,249,016
Paid related to:		
Current year	**9,572,117**	13,293,785
Prior years	**63,968,995**	65,803,582
Total paid	**73,541,112**	79,097,367
Balance – December 31, net of reinsurance recoverables of $22,791,438 and $36,545,090	**$ 190,963,656**	$ 188,782,732

As a result of changes in estimates of insured events in prior years, the provision for losses and loss adjustment expenses decreased by $17,428,532 and $20,950,270 in 2018 and 2017, respectively, due to lower than anticipated losses on professional liability claims. Positive reserve development came principally from accident years 2014 through 2016, this was partially offset by reserve strengthening for accident year 2017.

The Company has purchased annuities from life insurers under which the claimants are payees. The Company has obtained a release of liability from the claimants and, therefore, has no contingent liability if these annuities fail to perform under their terms.

6. Federal Income Taxes

The Company has no admitted deposits under Section 6603 of the Internal Revenue Code. As of December 31, 2018, the Company is subject to federal examination in the United States from 2015 to present.

The Company's federal income tax return is consolidated with its subsidiaries:

- Western Professional Insurance Company
- Association Insurance Services, Inc.
- PHYSIS Corporation
- Washington State Physicians Insurance Association, Inc.
- EMPAC Managers, Inc.

The Company has a written agreement that sets forth the manner in which the total combined federal income tax is allocated to each entity that is party to the consolidation. Allocation is based on separate return calculations with credit for losses/credits where losses/credits result in an actual reduction of the tax liability of the consolidated group.

The components of the Company's deferred tax assets (DTAs) and deferred tax liabilities (DTLs) at December 31 are as follows:

	2018			2017			Change		
	Ordinary	**Capital**	**Total**	**Ordinary**	**Capital**	**Total**	**Ordinary**	**Capital**	**Total**
Gross deferred tax assets	**$ 8,171,905**	**$ –**	**$ 8,171,905**	$ 10,200,450	$ –	$ 10,200,450	$ (2,028,545)	$ –	$ (2,028,545)
Statutory valuation allowance adjustments	**–**	**–**	**–**	–	–	–	–	–	–
Adjusted gross deferred tax assets	**8,171,905**	**–**	**8,171,905**	10,200,450	–	10,200,450	(2,028,545)	–	(2,028,545)
Deferred tax assets nonadmitted	**–**	**–**	**–**	–	–	–	–	–	–
Subtotal net admitted deferred tax asset	**8,171,905**	**–**	**8,171,905**	10,200,450	–	10,200,450	(2,028,545)	–	(2,028,545)
Deferred tax liabilities	**1,750,190**	**5,268,989**	**7,019,179**	1,456,368	6,951,554	8,407,922	293,822	(1,682,565)	(1,388,743)
Net admitted deferred tax asset (net deferred tax liability)	**$ 6,421,715**	**$ (5,268,989)**	**$ 1,152,726**	$ 8,744,082	$ (6,951,554)	$ 1,792,528	$ (2,322,367)	$ 1,682,565	$ (639,802)

6. Federal Income Taxes (continued)

The admission calculation components are as follows:

	2018			2017			Change		
	Ordinary	**Capital**	**Total**	**Ordinary**	**Capital**	**Total**	**Ordinary**	**Capital**	**Total**
(a) Federal income taxes paid in prior years recoverable through loss carrybacks	**$ 3,419,212**	**$ –**	**$ 3,419,212**	$ 2,497,433	$ –	$ 2,497,433	$ 921,779	$ –	$ 921,779
(b) Adjusted gross deferred tax assets expected to be realized after application of the threshold limitation	**632,315**	**–**	**632,315**	608,809	–	608,809	23,506	–	23,506
1. Adjusted gross DTA expected to be realized following the balance sheet date	**632,315**	**NA**	**632,315**	608,809	NA	608,809	23,506	NA	23,506
2. Adjusted gross deferred tax assets allowed per limitation threshold	**NA**	**NA**	**37,741,376**	NA	NA	37,231,481	NA	NA	509,895
(c) Adjusted gross deferred tax assets offset by gross deferred tax liabilities	**4,120,378**	**–**	**4,120,378**	7,094,208	–	7,094,208	(2,973,830)	–	(2,973,830)
(d) Deferred tax assets admitted as the result of application of SSAP No. 101 Total (2)(a) + 2(b) + 2(c)	**$ 8,171,905**	**$ –**	**$ 8,171,905**	$ 10,200,450	$ –	$ 10,200,450	$ (2,028,545)	$ –	$ (2,028,545)

	2018	**2017**
(a) Ratio percentage used to determine recovery period and threshold limitation amount	**1,135%**	1,216%
(b) Amount of adjusted capital and surplus used to determine recovery period and threshold limitation in 2(b)2 above	**$ 251,609,174**	$ 248,209,872

6. Federal Income Taxes (continued)

The Company did not utilize any reinsurance tax planning or any other tax planning strategies in 2018 or 2017 that had an impact on gross and net deferred tax assets.

There are no temporary differences for which deferred tax liabilities are not recognized.

Current income taxes incurred consist of the following major components:

	2018	2017	Change
1. Current income tax:			
(a) Federal	**$ 1,756,696**	$ 598,842	**$** 1,157,854
(b) Foreign	–	–	–
(c) Subtotal	**1,756,696**	598,842	1,157,854
(d) Federal income tax on net realized capital gains	**401,094**	678,823	(277,729)
(e) Other, including prior year adjustment	**(87,881)**	(98,899)	11,018
(f) Federal and foreign income taxes incurred	**$ 2,069,909**	$ 1,178,766	**$** 891,143

6. Federal Income Taxes (continued)

The main components of deferred tax amounts are as follows:

	December 31 2018	December 31 2017	Change
2. Deferred tax assets:			
(a) Ordinary:			
Loss reserve discounting	**$ 3,453,330**	$ 2,863,263	$ 590,067
Unearned premium reserves and premium deposits	**1,667,110**	1,471,485	195,625
Investments	**450,684**	2,429,494	(1,978,810)
Fixed assets	**232,688**	268,964	(36,276)
Deferred compensation and benefits accrual	**206,879**	238,591	(31,712)
Tax credit	–	108,290	(108,290)
Receivable – nonadmitted	**7,134**	32,816	(25,682)
Other	**2,154,080**	2,787,547	(633,467)
Subtotal gross ordinary deferred tax assets	**8,171,905**	10,200,450	(2,028,545)
(b) Statutory valuation allowance adjustment – ordinary	**–**	–	–
(c) Nonadmitted deferred tax assets – ordinary	**–**	–	–
(d) Admitted deferred tax assets – ordinary	**8,171,905**	10,200,450	(2,028,545)
(e) Capital:			
Investments	**–**	–	–
Other	**–**	–	–
Subtotal gross capital deferred tax assets	**–**	–	–
(f) Statutory valuation allowance adjustment – capital	**–**	–	–
(g) Nonadmitted deferred tax assets – capital	**–**	–	–
(h) Admitted capital deferred tax assets	**–**	–	–
(i) Total admitted deferred tax assets	**8,171,905**	10,200,450	(2,028,545)
3. Deferred tax liabilities:			
(a) Ordinary:			
Depreciation	**97,945**	77,140	20,805
Tax Reconciliation Act Limited Risk Distributor	**1,652,245**	1,379,228	273,017
Subtotal ordinary deferred tax liabilities	**1,750,190**	1,456,368	293,822
(b) Capital:			
Tax effect of unrealized capital gains	**5,268,989**	6,951,554	(1,682,565)
Subtotal capital deferred tax liabilities	**5,268,989**	6,951,554	(1,682,565)
(c) Total	**7,019,179**	8,407,922	(1,388,743)
4. Net deferred tax assets	**$ 1,152,726**	$ 1,792,528	**$** (639,802)

6. Federal Income Taxes (continued)

The change in deferred net income taxes comprises the following, exclusive of nonadmitted DTAs:

	December 31 2018	December 31 2017	Change
Total deferred tax assets	**$ 8,171,905**	$ 10,200,450	$ (2,028,545)
Total deferred tax liabilities	**(7,019,179)**	(8,407,922)	1,388,743
Net deferred tax asset	**1,152,726**	1,792,528	(639,802)
Net deferred tax assets/liabilities after valuation allowance	**$ 1,152,726**	$ 1,792,528	(639,802)
Tax effect of unrealized gains			(1,788,013)
Statutory valuation allowance on unrealized gains			–
Change in net deferred income tax			$ (2,427,815)

The federal income tax expense incurred differs from the amount computed by applying the expected U.S. corporate income tax rate of 21% and 34% to income before taxes for the years ended December 31, 2018 and 2017, respectively. The significant items causing this difference were the change in dividends from affiliates, tax on capital gains, tax-exempt income, the nondeferrable portion of change in unearned premium, and the discounting of loss reserves. Additionally, on December 22, 2017, the Tax Cuts and Jobs Act was enacted, which significantly revised U.S. corporate income tax law by, among other things, reducing the corporate statutory income tax rate from 34% to 21% beginning January 1, 2018. As a result, the Company remeasured the deferred tax assets and liabilities, and recorded a reduction to surplus of $1.2 million for the year ended December 31, 2017. As of December 31, 2018, the Company has completed its accounting for the effects of the Tax Cuts and Jobs Act, and there were no material adjustments to the amounts shown above during the measurement period.

The Company has no capital loss carryforwards as of December 31, 2018 or 2017.

The Company has alternative minimum (AMT) tax credit carryforwards of $0 and $108,290 as of December 31, 2018 and 2017, respectively. Of AMT credit, $160,770 was recognized as current year recoverable.

6. Federal Income Taxes (continued)

The following represents income tax expense that is available for recoupment in the event of future net losses:

	Ordinary	Capital	Total
2018	**$ 1,756,696**	**$ 401,095**	**$ 2,157,791**
2017	582,599	678,823	1,261,422
2016	NA	554,153	554,153
	$ 2,339,295	$ 1,634,071	$ 3,973,366

7. Commitments and Contingencies

The Company leases office facilities and certain equipment under noncancelable operating leases through 2022, with certain leases having renewal options for two five-year periods. Annual rental expense under these lease agreements was $914,987 and $928,387 in 2018 and 2017, respectively.

Future minimum commitments under these leases as of December 31, 2018 are as follows:

2019	$ 795,035
2020	822,195
2021	849,391
2022	716,028
Thereafter	–
	$ 3,182,649

Lawsuits against the Company for matters other than insurance claims occasionally arise in the ordinary course of business. Management believes that losses to the Company resulting from such matters, if any, will not have a material adverse effect on the Company's financial condition or results of operations.

8. Information Concerning Parent, Subsidiaries, and Affiliates

The Company is a mutual insurance company that owns 100% of the equity interests (either stock or units) of each of its subsidiaries. The Company performs substantially all management services for WPIC and other subsidiaries, and is reimbursed based on management services agreements. Costs are shared based on an analysis of the cost of services provided. The Company also reinsures 100% of risks up to the $5,000,000 policy limits of WPIC's professional liability policies and 100% of the risks of WPIC's BOP and stop-loss policies. During 2004, WPIC discontinued writing hospital professional liability by allowing the existing policies to terminate at their natural expiration dates. Stop-loss insureds were offered renewal with the Company at their policy expiration dates. The Company's future liability for professional liability losses assumed from WPIC is limited to risks assumed prior to January 1, 2005. The amount due from affiliates at December 31, 2018 and 2017, primarily represents reimbursements owed to the Company by its subsidiaries. Substantially all of the insurance activities of WPIC are conducted by the Company.

9. EDP Equipment and Software

EDP equipment and operating and nonoperating system software are carried at cost less accumulated depreciation. Depreciation expense for EDP equipment and operating system software is computed using the double-declining-balance method over the lesser of the estimated useful life of the related asset or three years. Depreciation expense for nonoperating system software is computed using the double-declining-balance method over the lesser of its estimated useful life or five years.

EDP equipment and operating and nonoperating system software at December 31, consist of the following:

	2018	2017
EDP equipment	**$ 1,109,816**	$ 1,063,295
Accumulated depreciation	**(947,364)**	(907,531)
Balance, net	**$ 162,452**	$ 155,764

Depreciation expense related to EDP equipment and operating and nonoperating system software, including nonadmitted assets, totaled $214,793 and $186,814 for the years ended December 31, 2018 and 2017, respectively.

10. Employee Benefit and Deferred Compensation Plans

The Company's employees are covered by two defined contribution plans. One plan requires no employee contribution, and the Company contributes 10.0% of eligible compensation to the plan. The second plan allows employee contributions, and 100.0% of those contributions are matched by the Company up to a maximum of 6.6% of eligible compensation. Employees vest 20.0% per year in employer contributions over the first five service years and vest immediately in all employer contributions upon completion of five service years. The Company's contribution to these plans was $1,690,343 and $1,702,469 for 2018 and 2017, respectively.

Deferred compensation agreements have been entered into with certain members of the Board of Directors and nondirector committee members. Amounts recorded as a liability in accordance with those agreements as of December 31, 2018 and 2017, were $270,097 and $279,247, respectively.

11. Policyholders and Surplus, Dividend Restrictions, and Risk-Based Capital

The following table shows the cumulative increase (reduction) of unassigned funds related to the following items:

	As of December 31	
	2018	**2017**
Unauthorized reinsurance	**$ (89,961)**	$ (1,138,173)
Nonadmitted assets and other	**(4,272,212)**	(7,896,877)
Unrealized capital gains on investments, net of taxes	**7,246,340**	18,359,613

The directors of a domestic mutual insurer may from time to time apportion and pay dividends to its members only out of that part of its surplus funds that are in excess of its required minimum surplus and that represent net realized savings and net realized earnings from its business. Without the prior written consent of the Department, dividends in 2019 are limited to approximately $10 million. Dividends declared and paid were $5,002,475 and $5,001,216 during 2018 and 2017, respectively.

The Company is subject to risk-based capital (RBC) requirements of the NAIC, which require that certain amounts of capital be maintained. As of December 31, 2018 and 2017, the Company's RBC exceeded the required amount.

12. Subsequent Events

On February 27, 2019, the Board of Directors of Western Professional Insurance Company declared an extraordinary dividend in the amount of $6,088,177 to its sole shareholder, Physicians Insurance, as permitted under the laws and regulations applicable to the Company in the State of Washington, payable on or after March 28, 2019.

Supplementary Information – Statutory Basis

Ernst & Young LLP
Suite 3500
999 Third Avenue
Seattle, WA 98104-4086

Tel: +1 206 621 1800
Fax: +1 206 654 7799
ey.com

Report of Independent Auditors on Supplementary Information

The Board of Directors
Physicians Insurance, A Mutual Company

We have audited, in accordance with auditing standards generally accepted in the United States, the statutory-basis financial statements of Physicians Insurance, A Mutual Company for the years ended December 31, 2018 and 2017, and have issued an adverse opinion with respect to conformity with U.S. generally accepted accounting principles and an unmodified opinion with respect to conformity with accounting practices prescribed or permitted by the Washington State Office of the Insurance Commissioner thereon dated May 3, 2019. Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplemental investment and reinsurance disclosures are presented to comply with the National Association of Insurance Commissioners' Annual Statement Instructions and the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and 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. In our opinion, the information is fairly stated, in all material respects, in relation to the statutory-basis financial statements as a whole.

This report is intended solely for the information and use of the Company and state insurance departments to whose jurisdiction the Company is subject and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

May 3, 2019

Physicians Insurance A Mutual Company

Summary Investment Schedule

	Gross Investment Holdings*		Admitted Assets as Reported in the Annual Statement	
Fixed	Amount	Percentage	Amount	Percentage
1. Bonds:				
1.1 U.S. treasury securities	$ 24,011,831	4.949%	$ 24,011,831	4.972%
1.2 U.S. government agency obligations (excluding mortgage-backed securities):				
1.22 Issued by U.S. government-sponsored agencies	5,334,338	1.100	5,334,338	1.104
1.3 Non-U.S. government (including Canada, excluding mortgage-backed securities)	–	–	–	–
1.4 Securities issued by states, territories, and possessions, and political subdivisions in the U.S.:				
1.41 States, territories, and possessions general obligations	3,366,203	0.694	3,366,203	0.697
1.42 Political subdivisions of states, territories, and possessions, and political subdivisions general obligations	10,782,587	2.223	10,782,587	2.233
1.43 Revenue and assessment obligations	92,341,470	19.032	92,341,470	19.121
1.44 Industrial development and similar obligations	2,163,297	0.446	2,163,297	0.448
1.5 Mortgage-backed securities (includes residential and commercial MBS):				
1.51 Pass-through securities:				
1.511 Issued or guaranteed by GNMA	2,045,119	0.422	2,045,119	0.423
1.512 Issued and guaranteed by FNMA and FHLMC	88,989,847	18.343	88,989,847	18.425
1.52 CMOs and REMICs:				
1.521 Issued or guaranteed by GNMA, FNMA, FHLMC, or VA	2,508,501	0.517	2,508,501	0.519
1.523 All other	16,174	0.003	16,174	0.003
2. Other debt and other fixed-income securities (excluding short-term):				
2.1 Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	109,594,774	22.590	109,594,774	22.691
2.2 Unaffiliated non-U.S. securities (including Canada)	38,365,440	7.908	38,365,440	7.943
3. Equity interests:				
3.1 Investments in mutual funds	72,100,957	14.861	72,100,957	14.928
3.4 Other equity securities				
3.41 Affiliated	13,845,761	2.854	13,588,177	2.813
10. Cash, cash equivalents, and short-term investments	15,918,020	3.281	15,918,020	3.296
11. Other invested assets	3,768,862	0.777	1,853,885	0.384
12. Total invested assets	$ 485,153,183	100.000%	$ 482,980,622	100.000%

* Gross investment holdings as valued in compliance with the NAIC *Accounting Practices and Procedures Manual*.

Note – Categories not displayed indicate that the Company has no such investment holdings.

Physicians Insurance A Mutual Company

Supplemental Investment Risks Interrogatories

December 31, 2018

1. The Company's total admitted assets as reported on page two of its Annual Statement are $501,872,079.

2. Following are the Company's 10 largest exposures to a single issuer/borrower/investment, by investment category, excluding: (i) U.S. government, U.S. government agency securities and those U.S. government money market funds listed in the Appendix to the *SVO Practices and Procedures Manual* as exempt, and (ii) property occupied by the Company:

Issuer	**Description of Exposure**	**Amount**	**Percentage of Total Admitted Assets**
Federal Home Loan Mortgage Corp	Bond	$ 48,240,670	9.6%
Federal National Mortgage Association	Bond	45,144,935	9.0
Western Professional Insurance Co	Equity	13,588,177	2.7
American Express Credit Acct Mstr Trust	Bond	4,077,912	0.8
City of New York	Bond	3,254,002	0.6
BA Credit Card Trust	Bond	3,025,338	0.6
Citibank Credit Card Issuance Trust	Bond	2,978,262	0.6
Missouri Joint Municipal Electric Utility	Bond	2,789,057	0.6
City of Baltimore	Bond	2,719,191	0.5
American Municipal Power, Inc	Bond	2,633,701	0.5

3. The Company's total admitted assets held in bonds and preferred stocks, by NAIC rating, are:

Bonds			**Preferred Stocks**		
NAIC Rating	**Amount**	**Percentage of Total Admitted Assets**	**NAIC Rating**	**Amount**	**Percentage of Total Admitted Assets**
NAIC-1	$ 330,165,964	65.8%	P/RP-1	$ –	–%
NAIC-2	49,143,953	9.8	P/RP-2	–	–
NAIC-3	209,666	0.0	P/RP-3	–	–
NAIC-4	–	–	P/RP-4	–	–
NAIC-5	–	–	P/RP-5	–	–
NAIC-6	–	–	P/RP-6	–	–
	$ 379,519,583	75.6%		$ –	–%

4. Total admitted assets held in foreign investments are $30,447,149 or 6.1%.

5. Aggregate foreign investment exposure categorized by NAIC sovereign rating is as follows:

NAIC Rating	Amount	Percentage of Total Admitted Assets
Countries Rated NAIC–1	$ 29,447,149	5.9%
Countries Rated NAIC–2	1,000,000	0.2
Countries Rated NAIC–3 or below		

6. Two largest foreign investment exposures to a single country, categorized by the country's NAIC sovereign ratings are as follows:

Countries Rated NAIC–1:	Amount	Percentage of Total Admitted Assets
Country 1: United Kingdom	$ 6,826,962	1.4%
Country 2: Australia	6,477,523	1.3

Countries Rated NAIC–2:	Amount	Percentage of Total Admitted Assets
Country 1: Italy	$ 1,000,000	0.2%

7. There are no investments with unhedged foreign currency exposure.

8. There are no investments with unhedged foreign currency exposure.

9. There are no investments with unhedged foreign currency exposure.

Physicians Insurance A Mutual Company

Supplemental Investment Risks Interrogatories (continued)

10. The ten largest non-sovereign foreign issues are as follows:

Issuer	NAIC Rating	Amount	Percentage of Total Admitted Assets
Unilever Capital Corp	1FE	$ 2,540,248	0.5%
HSBC Holdings PLC	1FE	1,814,340	0.4
Credit Suisse AG (New York Branch)	1FE	1,534,978	0.3
Rabobank Nederland NV	1FE	1,500,673	0.3
Daimler Finance North America LLC	1FE	1,493,444	0.3
WestPac Banking Corp	1FE	1,490,431	0.3
National Australia Bank LTD (NY Branch)	1FE	1,478,263	0.3
Anheuser-Busch INBEV Finance Inc	2FE	1,238,106	0.2
Sydney Airport Finance CO Pty LTD	2FE	1,009,135	0.2
Heathrow Funding LTD	1FE	1,000,379	0.2

11. Assets held in Canadian investments are less than 2.5% of the Company's total admitted assets.

12. Assets held in investments with contractual sales restrictions are zero.

13. The Company's admitted assets held in the largest ten equity interests (including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other equity securities (including Schedule BA equity interests), and excluding money market and bond mutual funds listed in the Appendix to the *SVO Practices and Procedures Manual* as exempt or Class 1) are:

Issuer	**Amount**	**Percentage of Total Admitted Assets**
Fidelity Tot MK; PR	$ 22,980,882	4.6%
Vanguard INSTL Index Fund	18,443,188	3.7
Western Professional Insurance Co.	13,588,177	2.7
Principal Midcap Inst.	9,077,828	1.8
Vanguard Mid Cap Adm.	6,532,507	1.3
Schwab Cap S&P 500 IDX	4,550,171	0.9
Dodge & Cox Intl Stk Fd	3,850,724	0.8
Franklin Str: SCG; Adv	3,383,301	0.7
Tweedy Browne Global Value Fund	3,282,357	0.7
MedChoice Risk Retention Group, Inc.	1,169,600	0.2

14. Assets held in investments with nonaffiliated privately placed equities are less than 2.5% of the Company's total admitted assets.

15. Assets held in investments with general partnership interests are less than 2.5% of the Company's total admitted assets.

16. The Company does not hold any investments in mortgage loans.

17. The Company does not hold any investments in mortgage loans.

18. The Company does not hold any investments in real estate.

19. The Company does not hold any investments in mezzanine real estate loans.

20. The Company does not hold any assets subject to the following types of agreements – security lending, repurchase, reverse, or dollar reverse repurchase agreements.

21. The Company does not hold assets subject to warrants not attached to other financial instruments, options, caps, or floors.

22. The Company does not have any exposure (as defined in accordance with NAIC *Annual Statement Instructions*) to collars, swaps, or forwards.

23. The Company's potential exposure (as defined in accordance with NAIC *Annual Statement Instructions*) for future contracts is none.

Physicians Insurance A Mutual Company

Supplemental Reinsurance Disclosures

December 31, 2018

1. 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]

2. If yes, indicate the number of reinsurance contracts containing such provisions. N/A

3. If yes, does the amount of reinsurance credit taken reflect the reduction in quota share coverage caused by any applicable limiting provision(s)? N/A

4. Has the reporting entity reinsured any risk with any other entity and agreed to release such entity from liability, in whole or in part, from any loss that may occur on this risk, or portion thereof, reinsured? Yes [ ] No [X]

5. 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 noncancelable 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) An unconditional or unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions that 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]

6. 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 to policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves greater than 5% of prior year-end surplus as regards to 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]

7. If yes to 5 or 6, please provide the following information:

   (a) The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income;

   (b) A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting the criteria in 5 or 6; and

   (c) A brief discussion of management's principal objectives in entering into the reinsurance contract, including the economic purpose to be achieved.

8. Except for transactions meeting the requirements of paragraph 30 of SSAP No. 62R, *Property and Casualty Reinsurance*, has 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]

9. If yes to 8, explain why the contract(s) is (are) treated differently for GAAP and SAP. NA

Basis of Presentation

The accompanying supplemental schedules present selected statutory-basis financial data as of December 31, 2018, and for the year then ended for purposes of complying with the NAIC *Annual Statement Instructions* and *Accounting Practices and Procedures Manual*, and agree to or are included in the amounts reported in Physicians Insurance A Mutual Company's 2018 Statutory Annual Statement as filed with the Department.

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

ey.com