STATE OF NORTH DAKOTA

BISMARCK, NORTH DAKOTA

REPORT OF EXAMINATION

OF

HEALTH FACILITIES INSURANCE EXCHANGE
GRAND FORKS, NORTH DAKOTA

AS OF
DECEMBER 31, 2005

STATE OF NORTH DAKOTA

DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

Health Facilities Insurance Exchange

Grand Forks, North Dakota

as of December 31, 2005, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal at my office in the City of Bismarck, this 2nd day of July, 2007.

Jim Poolman
Commissioner of Insurance

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Grand Forks, North Dakota
April 16, 2007

Honorable Jim Poolman
Commissioner of Insurance
State of North Dakota
600 East Boulevard Avenue
Bismarck, ND 58505-0320

Dear Sir:

Pursuant to your instructions and in accordance with the North Dakota Insurance Code and resolutions adopted by the National Association of Insurance Commissioners (NAIC), an examination was made of the condition and affairs of the

Health Facilities Insurance Exchange
Grand Forks, North Dakota

as of December 31, 2005.

SCOPE OF EXAMINATION

This examination was a financial condition examination conducted in accordance with N.D. Cent. Code § 26.1-09-09 and observed guidelines and procedures contained in the NAIC *Financial Condition Examiners Handbook.* The examination was conducted to determine the Company's financial condition, its compliance with statutes, and to review the corporate affairs and insurance operations. The current examination covers the period January 1, 1997, through December 31, 2005, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

Examination procedures included a verification and evaluation of assets, a determination of liabilities, and review of corporate records, claim files, and other records relating to Company operating practices.

Recommendations contained in the prior examination report dated December 31, 1996, have been addressed by the Company except as follows:

Comments/Recommendations	Action/Response by Company
It was recommended that the Company file any Bylaw amendments with the North Dakota Insurance Department.	The Company amended its Bylaws on two separate occasions and failed to file either one with the North Dakota Insurance Department.
It was recommended that the Company amend its custodial agreement to include safeguards required by the NAIC.	The Company has yet to amend its custodial agreement.
It was recommended that the Company amortize bond premiums and accrue for interest due.	The Company did not amortize bond premiums nor did it accrue for interest.

HISTORY

Health Facilities Insurance Exchange (Company) was chartered on December 14, 1990, subject to N.D. Cent. Code Chapter 26.1-09. The Company is organized as an unincorporated association which is operated as a reciprocal insurance exchange. A reciprocal exchange is a group of persons, firms, or corporations commonly referred to as subscribers that exchange reciprocal contracts through an attorney-in-fact.

The Company is owned by its member subscribers which consist of 30 not-for-profit acute care hospitals located in North Dakota. The Company writes business and has the authority to write business only in North Dakota. The Company's only recent activity involves a reinsurance agreement with MHA Insurance Company under which the Company assumes a portion of the insurance coverage for medical malpractice and other professional liability that MHA insured from the Company's members on a direct basis.

MANAGEMENT AND CONTROL

Directors

The Bylaws provide that the number of directors of the reciprocal shall be eight, who shall hold office until the next annual meeting of member subscribers and until their successor shall have been elected and qualified.

The following directors were serving as of the date of this examination:

Name and Address	Business Affiliation
Dwight Thompson	Altru Health System
Richard Tschider	St. Alexius Medical Center
Kimber Wraalstad	Presentation Medical Center
Jerry Jurena	Heart of America Medical Center
Pete Antonson	Northwood Deaconess Hospital
Kathy Hoeft	Ashley Medical Center
Ron Volk	St. Aloisius Medical Center
Les Urvand	St. Luke's Hospital

Officers

The Bylaws provide that the officers of the Company shall be a President, a Vice President, and a Secretary. Officers serving as of December 31, 2005, were as follows:

David Vaaler	President
Clair Thompson	Vice President
Kathyrn Waslien	Secretary

Board of Directors and Stockholders

The minutes of the Board of Directors meetings and the Subscribers annual meetings for the period under statutory examination were read. Minutes of meetings indicate that all meetings were held in accordance with the Company's Bylaws.

Pursuant to N.D. Cent. Code § 26.1-05-18, investment transactions must be authorized prior to purchase by the Board of Directors or an Investment Committee appointed by the Board. Under the provisions of N.D. Admin. Code § 45-03-12-05, approval of investment transactions on at least a quarterly basis will be deemed in compliance if certain conditions are met. During the period under examination, the Company's investment transactions were not approved as required by the law and rules.

It is recommended that the Company implement procedures to conform to the requirements in N.D. Admin. Code § 45-03-12-05 that provide for quarterly authorization of investment transactions by the Board of Directors or the Investment Committee. It is recommended that Board minutes and Investment Committee minutes reflect approval of all investment transactions.

This examination found that the Board of Directors did not comply with the following Bylaw provisions:

- Appointment of officers on an annual basis under Article V, Section 2
- Election of directors under Article III, Section 3
- Designation of an executive committee under Article IV, Section 1
- Allocation of all profits among subscribers no later than March 15 of the following calendar year under Article 8, Section 3

It is recommended that the Board of Directors comply with the provisions of the Bylaws.

Corporate Records

The Board of Directors authorized revisions to the Company's Bylaws on January 8, 1998, to change the number of directors from 12 to 8 and specifying 4 directors to represent subscribers with annual premiums of $100,000 or more. The Board also authorized revisions to the Bylaws on November 14, 2003, to provide for approval of eligible subscribers by the Board and to provide for allocation of profit and loss.

The amended Bylaws were not submitted to the North Dakota Insurance Department.

It is again recommended that the Company file all Bylaw amendments with the North Dakota Insurance Department.

Conflict Of Interest

The Company maintains a formal conflict of interest policy and an established procedure for disclosure of any material interest or affiliations that might tend to influence a board member, officer, or employee in the performance of their duties. Conflict of interest statements were reviewed for the years 2004 and 2005, with no material conflicts noted.

MANAGEMENT AGREEMENT

The affairs of the Company are under the direction of the Attorney-in-Fact, as authorized by the Board of Directors and approved by the subscribers. As of December 31, 2005, the Attorney-in-Fact was Insurance Management Services, Inc.

The Company and Insurance Management Services, Inc. entered into a management agreement effective July 1, 1990, whereby the Attorney-in-Fact has the responsibility for all of the accounting and managerial responsibility of the business of the Company.

It is recommended that the Company update the Attorney-In-Fact Agreement to address the changes in the Company's operations.

FIDELITY BOND

The Company is required to carry fidelity bond coverage as protection against acts of theft or dishonesty by individuals who have access to the cash and investments of the Company. Based on guidance in the NAIC *Financial Examiners Handbook,* the minimum amount of fidelity bond coverage the Company should carry is $25,000.

It is recommended that the Company obtain Fidelity Bond coverage in the amount of at least $25,000.

TERRITORY AND PLAN OF OPERATION

The Company is currently licensed and qualified to transact business in the State of North Dakota. The Certificate of Authority issued by this state was reviewed and found to be in proper order and effect.

The Company operated as a primary insurer providing general liability, hospital and physician medical malpractice from July 1, 1990, to December 31, 1996, which business was in run-off during the period under examination. From January 1, 1997, through December 31, 2003, the Company was inactive, writing no direct insurance business. Beginning January 1, 2004, the Company has been active as a reinsurer as described under the Reinsurance caption below.

REINSURANCE

Beginning January 1, 2004, and continuing through December 31, 2005, the Company entered into a reinsurance arrangement under which the Company assumes a portion of the insurance coverage for medical malpractice and other professional liability that the primary carrier, MHA Insurance Company, writes for the Company's subscribers on a direct basis.

Type:	Casualty Quota Share
Cedent:	MHA Insurance Company
Scope:	Medical malpractice and professional liability
Assumes:	10% of the first $1,000,000 any one claim.
Commissions:	30% Commission will be paid to cedent
Effective Date:	January 1, 2004
Termination:	Annual Renewal

The foregoing cedent is licensed in the State of Michigan. The agreement contains an insolvency clause.

ACCOUNTS AND RECORDS

The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the course of the examination. A trial balance as of December 31, 2004, and December 31, 2005, was traced to the appropriate schedules of the Company's 2004 and 2005 Annual Statements without significant difference.

The following deficiencies were noted during the examination:

1. Cash controls - The Company does not require two signatures for issued checks.

   It is recommended that the Company establish a procedure to provide for two signatures on each check or, at a minimum, two signatures for checks over a predetermined amount.

2. 2005 Annual Statement reporting exceptions:

   a. Jurat page – Officers listed should be for Company not Insurance Management Services.

   b. Accrued liabilities – Did not accrue a liability for the final payment of premium taxes due March 15, 2006, that was an incurred expense as of December 31, 2005.

   c. Other expenses liability – A net payable of $9,552 to MHA Insurance Company was misclassified as "Other expenses". Assumed reinsurance premiums receivable are to be reported as uncollected premiums on page

2, line 13.1. Assumed reinsurance payable on paid losses and LAE are to be reported on page 3, line 2.

d. The Notes to Financial Statements were not completed.

e. Summary Investment Schedule, Line 3.3 – Entry for mutual funds was double counted as both affiliated and unaffiliated.

f. General Interrogatories, incomplete entries for Line 1.3 (state regulator), Lines 3.2 & 3.3 (exam report dates), and Line 24.05 (central registration depository number for Alerus Financial).

g. Schedule F, Part 1 – Assumed reinsurance receivable and payable balances were not properly reported.

h. Schedule T – The IBNR reserve was not included in Column 7.

i. Schedule D, Part 1A – Sections 1 and 2 were not completed.

j. Schedule D, Part 1 - The rate used to obtain Fair Value was not entered in column 8. Book value at cost adjusted for amortization (accretion) of premium (discount) was not reported in column 11. The months that interest payments are received were not entered in column 18. Interest due and accrued on a bond was incorrectly reported as interest received.

k. Schedule D, Part 2, Section 2 – The rate used to obtain Fair Value was not entered in column 7.

l. Schedule D, Part 4 – The current year's amortization/accretion were not entered in column 12.

m. Schedule E, Part 2 – Incorrectly reported the Alerus Financial Money Market account in this schedule as cash on deposit instead of common stock in Schedule D, Part 2, Section 2.

It is again recommended that the Company complete its statutory annual statement in strict compliance with the NAIC's *Annual Statement Instructions*.

FINANCIAL STATEMENTS

The financial statements of the Company and supporting reconciliations are presented on the following pages in the sequence listed below:

Statement of Assets, Liabilities, Surplus, and Other Funds, December 31, 2005

Summary of Operations for the Year Ended December 31, 2005

Reconciliation of Capital and Surplus Account, January 1, 2000, through December 31, 2005

Analysis of Examination Changes, Year Ended December 31, 2005

Health Facilities Insurance Exchange
Statement of Assets, Liabilities, Surplus, and Other Funds
as of December 31, 2005

	Ledger Assets	Nonledger Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$940,896			$940,896
Common Stock	251,577			251,577
Cash	24,767			1,019
Cash Equivalents	24,767			24,767
Inv. Inc. Due & Accrued	5,094			5,094
Totals	$1,223,353			$1,223,353

Health Facilities Insurance Exchange
Statement of Assets, Liabilities, Surplus, and Other Funds
as of December 31, 2005

Losses		$276,700
Loss Adjustment Expenses		20,833
Other Expenses		12,643
Unearned Premiums		4,032
Total Liabilities		$314,208
Aggregate Write-ins for Special Surplus Funds	$ 811,500	
Unassigned Surplus	97,645	
Surplus as Regards Policyholders		$ 909,145
Total Liabilities, Surplus, and Other Funds		$1,223,353

Health Facilities Insurance Exchange
Summary of Operations
for the Year Ended December 31, 2005

Underwriting Income

Premiums Earned		$ 268,942
Deductions:		
Losses Incurred	$ 162,245	
Loss Expenses Incurred	28,178	
Other Underwriting Expenses Incurred	115,203	
Total Underwriting Deductions		305,626
Net Underwriting Gain or (Loss)		$ (36,684)

Investment Income

Net Investment Income Earned	$ 33,000	
Net Realized Capital Gains or (Losses)	24,136	
Net Investment Gain or (Loss)		57,136
Net Income Before Federal Income Taxes		$ 20,452
Federal Income Taxes Incurred		(0)
Net Income		$ 20,452

Health Facilities Insurance Exchange
Reconciliation of Capital and Surplus Account
January 1, 2000, Through December 31, 2005

	2000	2001	2002	2003	2004	2005
Capital and Surplus, December 31, Previous Year	$1,027,847	$ 998,091	$ 958,838	$ 919,205	$ 935,477	$ 825,527
Examination Adjustment						(18,057)
Net Income	(29,756)	(39,253)	(39,632)	16,272	2,264	20,452
Net Unrealized Capital Gains or (Losses)						81,223
Aggregate Write-Ins					(112,215)	
Net Change in Capital and Surplus for the Year	(29,756)	(39,253)	(39,632)	16,272	(109,951)	83,618
Capital and Surplus, December 31, Current Year	$ 998,091	$ 958,838	$ 919,206	$ 935,477	$ 825,527	$ 909,145

Health Facilities Insurance Exchange
Analysis of Examination Changes
Year Ended December 31, 2005

Description	Annual Statement	Per Examination	Surplus Change Increase	Surplus Change Decrease
Assets:				
Bonds	$964,047	$ 940,896		$ (23,151)
Investment Income Due & Accrued	0	5,094	$ 5,094	
Total Examination Adjustments			$ 5,094	$ (23,151)
Capital and Surplus Per Annual Statement		$ 927,202		
Capital and Surplus Per Examination		909,145		
Decrease Per Examination		$ 18,057		

COMMENTS TO THE FINANCIAL STATEMENTS

Financial statement balances at December 31, 2005, are commented upon only if financial changes, recommendations, or special explanations are considered necessary.

Bonds $940,896

The admitted value of bonds was determined by this examination to be $940,896 or $23,151 less than the amount as reported by the Company in its 2005 Annual Statement. The Company made an amortization adjustment for all bonds to equate book value with market value. The examiner made an adjustment of $23,151 to adjust the carrying value back to cost.

The NAIC *Accounting Practices and Procedures Manual* requires insurers to report the carrying value of bonds at cost adjusted for amortization (accretion) of premium (discount). This examination noted that the Company was reporting a carrying value equivalent to the market value.

It is recommended that the Company report the carrying value of bonds as the cost adjusted for premium amortization if the bond is investment grade. If the bond is not investment grade, report the carrying value equal to the lower of market or book value (i.e., cost adjusted for amortization/accretion).

The Company's bonds are held under a custodial agreement at Alerus Financial in Grand Forks, North Dakota. All bonds held by the Company are obligations of the U.S. Treasury.

The custodial agreement does not contain the following safeguards as required by the NAIC *Financial Examiners Handbook*:

1. Custodian will indemnify the insurance company for any loss caused by negligence or dishonesty of the bank or trust company while securities are in its custody; and
2. The securities will be promptly replaced if there is a loss for which the bank or trust company is obligated to indemnify the insurance company.

It is again recommended that the Company amend its custodial agreement to include the safeguards required by the NAIC.

The Company used the settlement date rather than the trade date in reporting security transactions.

It is recommended that the Company use the trade date rather than the settlement date to report all bond and stock transactions in the annual statement.

Investment Income Due & Accrued $5,094

The admitted value of investment income due and accrued was determined by this examination to be $5,094 or $5,094 more than the amount reported by the Company in its 2005 Annual Statement.

It is recommended that the Company accrue interest due on bonds.

CONCLUSION

The financial condition of the Company, as of December 31, 2005, as determined by this examination is summarized as follows:

Admitted Assets		$1,223,353
Total Liabilities	$314,208	
Surplus as Regards Policyholders	909,145	
Liabilities, Surplus, and Other Funds		$1,223,353

The courteous cooperation extended by the officers of the Company during the course of the examination is gratefully acknowledged.

Respectfully submitted,

Chad Myhre

Chad Myhre
Examiner
North Dakota Insurance Department

COMMENTS AND RECOMMENDATIONS

It is recommended that the Company implement procedures to conform to the requirements in N.D. Admin. Code § 45-03-12-05 that provide for quarterly authorization of investment transactions by the Board of Directors or the Investment Committee. It is recommended that Board minutes and Investment Committee minutes reflect approval of all investment transactions.

It is recommended that the Board of Directors comply with the provisions of the Bylaws.

It is again recommended that the Company file all Bylaw amendments with the North Dakota Insurance Department.

It is recommended that the Company update the Attorney-In-Fact Agreement to address the changes in the Company's operations.

It is recommended that the Company obtain Fidelity Bond coverage in the amount of at least $25,000.

It is recommended that the Company establish a procedure to provide for two signatures on each check or, at a minimum, two signatures for checks over a predetermined amount.

It is again recommended that the Company complete its statutory annual statement in strict compliance with the NAIC's *Annual Statement Instructions*.

It is recommended that the Company report the carrying value of bonds as the cost adjusted for premium amortization if the bond is investment grade. If the bond is not investment grade, report the carrying value equal to the lower of market or book value (i.e., cost adjusted for amortization/accretion).

It is again recommended that the Company amend its custodial agreement to include the safeguards required by the NAIC.

It is recommended that the Company use the trade date rather than the settlement date to report all bond and stock transactions in the annual statement.

It is recommended that the Company accrue interest due on bonds.

SUBSEQUENT EVENT

Effective December 31, 2006, the Company terminated its reinsurance agreement with MHA Insurance Company and changed its status from active to inactive.