

2008 MIEC ANNUAL REPORT TO POLICYHOLDERS

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Vin K. Sawhney, MD

Steven R. Una, MD

Committee Member

Bradford P. Cohn, MD

Emeriti

Charles L. Hoffman, MD

Joseph Ross, MD

Conrad Anderson, MD

Your company had a very successful 2008 as evidenced by the fourth consecutive annual dividend distribution — \$17.25m in 2009. Dividends are the most tangible evidence of our not-for-profit philosophy and they have significantly reduced the annual cost of your insurance, especially for long-term members. Many of you received a letter this year that detailed the specific cash benefits that you personally derived from the dividend program — the scale and consistency of which is unique in the states where we operate.

The other cost component is, of course, premiums. Here again we have good news to report as we implemented rate reductions in Idaho, Hawaii and Alaska, and continue to hold rates steady in California.

This is not to say that 2008 was an easy year. While operational results were as good as they have ever been, the financial environment was challenging. MIEC has never sought to take on significant investment risk by investing for aggressive returns. However, as you know from your own portfolios, the market corrections have been across all sectors and we have not been immune.

When all the additions and subtractions of operating income, investment income, asset valuation decreases and taxation are added together, our surplus — the free capital of the company — was \$123.7m, down from 2007, but basically unchanged from year end 2006.

MIEC remains one of the most secure and well-capitalized medical professional liability (MPL) insurers in the country. On the reverse side you will see our customary summary of financial and operational highlights.

2009 is well underway and we are looking forward to the challenges and opportunities ahead. The Board Members and operational staff who serve our policyholders make daily contributions to the success of the organization and are recognized for their professionalism and hard work. We are proud of the work we do and grateful for the opportunity to serve the medical profession.

Sponsoring and Affiliated State & County Medical Societies

MIEC continues to enjoy the support and insights of our sponsoring medical societies. These organizations perform a vital function in our operations, as well as in sustaining medical practices of all types and specialties. We continue to urge all MIEC policyholders to join their local / state society if they are not already members.

Changes in the Board of Governors

At the annual meeting in December, the policyholders elected two new physicians to the Board of Governors. Their full biographies are available on our web site:

Vin K. Sawhney, MD, San Leandro, CA.
Internal Medicine/Gastroenterology

Steven R. Una, MD, Castro Valley, CA.
Internal Medicine/Infectious Diseases

Changes in Personnel

Companies like MIEC come about as a result of the vision of a few exceptional people. Previous reports have made note of several who were there at the beginning and have since retired. In 2008, three very important people retired from full-time service to MIEC.

Dr. Brad Cohn retired from the Board of Governors in December 2008. Dr. Cohn was the Chairman of the Board from the inception of the company and no individual has made a larger contribution to creating and fostering the culture of this company. He has attended literally thousands of meetings over the past 34 years and continues to provide service to the company as a member of the Governmental Affairs Committee — an area of great personal interest and value to MIEC. His retirement was recognized by a host of organizations — perhaps most notably by a resolution of the Legislative Counsel of the California State Senate.

<http://www.miec.com/docs/BradCohnResolution.pdf>

He is succeeded by Dr. Jim Gemmer.

This year's printed annual report is presented in an abbreviated form to reduce production and mailing costs. A more complete report is available on-line at www.miec.com or will be mailed to you upon request.

**Board of Directors
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of California**

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Solano County Medical
Society

Mr. James Jordan

Alaska State Medical
Association

Ms. Mary Lou Licwinko

San Francisco Medical
Society

Ms. Susie Pouliot

Idaho Medical Association

Ms. Debbie Schoenthaler

North Valley Medical
Association

Dick Mello was the CFO and Treasurer of the operating company for three decades. It is a mark of the man that literally everyone who ever met him knows we are a poorer organization for his retirement.

He is succeeded by Mr. Jim King.

Ron Neupauer is the embodiment of an insurance professional. His entire career has been committed to the welfare and well-being of MIEC's policyholders and his staff. Ron was President of the operating company when he retired and had run the underwriting operations from day one. He has an encyclopedic knowledge of this company and the MPL industry. We are delighted that he remains available to us as a part-time consultant to the Board of Governors.

He is succeeded by Mr. Andrew Firth.

**Operating Results and Finances
(see Figure 1, Five Year Chart)**

We had very strong operating results with a net underwriting gain before investment income of \$32m. This is the largest gain in the company's history and is almost entirely attributable to an extraordinary and unexpected drop in losses incurred during 2008, exceeding our excellent experience during 2007.

Experience tells us that this phenomenon in claims is unlikely to be permanent, therefore we are not formulating our business strategies with the expectation that we will enjoy the same results in 2009. If that happy circumstance should arise, policyholders can anticipate another large dividend and further strengthening of the balance sheet as determined by the Board of Governors.

Under normal circumstances, a large underwriting gain is compounded by gains in our investment income. While our investment portfolio produced a healthy \$16m contribution of investment income, the market valuations resulted in "realized" investment losses of \$37m. While our business model is relatively straightforward, insurance accounting is anything but. "Realized," in the accounting world, doesn't mean we actually sold these assets (at a loss). In fact, we still own many of the assets that were written down and our investment managers expect a recovery in their value in the coming months and years. Our investment managers are watching these assets very closely and will act carefully to preserve value in our portfolio; however, for purposes of our balance sheet, the combination of income and write downs

In Memoriam

We were saddened by the passing of Dr. Clarence Avery, Oakland CA, General Medicine, who contributed greatly to the success of MIEC. Our thoughts and best wishes go out to his family.

decreased our investment results by \$20m.

Combining our underwriting income, net of dividends, with investment losses, produced a net loss, before taxes, of \$5.5m.

MIEC is a taxable enterprise. With a pre-tax loss, one would expect no tax burden; instead, we incurred taxes in the amount of \$8.2m. Unfortunately, most of the "realized" investment losses could not be offset against taxes since they were not in fact realized (i.e., sold at a loss). As we said earlier, insurance accounting can be complicated!

After considering the long-term financial needs of the company, the Board of Governors felt that a declaration of a \$17m dividend provided the right balance of returning profit and sustaining the organization for the long-term. Because we had taxable income, paying a dividend reduced our tax burden by \$5.8m.

The final piece of this section is always left to update our members on the surplus of the company. Surplus is the "free" capital of the company that allows us to write insurance premiums and insulates us from unexpected losses. In the year ending 12/31/2007, the membership enjoyed a similarly large dividend of \$17m AND an increase in surplus of \$20.8m. This year we repeated the dividend distribution, but gave up much of the surplus gain from 2007 with a decline of \$19.8m to \$123m.

You can be assured that MIEC remains exceedingly well capitalized, both in real terms and by comparison to the industry.

Five Year Consolidated Financial Review

Medical Insurance Exchange of California
Claremont Liability Insurance Company

	2008	PERCENTAGE CHANGE	2007	PERCENTAGE CHANGE	2006	PERCENTAGE CHANGE	2005	PERCENTAGE CHANGE	2004	PERCENTAGE CHANGE
Net Admitted Assets	\$336,655,000	-9.61%	\$372,449,000	5.66%	\$352,486,000	6.02%	\$ 332,469,000	+4.60	\$ 317,850,000	+10.67
Direct Written Premium	\$74,852,000	-0.84%	\$75,483,000	-0.50%	\$75,861,000	3.29%	73,444,000	+6.72	68,822,000	+6.30
Net Written Premium	\$65,703,000	-4.87%	\$69,064,000	-7.56%	\$74,711,000	2.00%	73,247,000	+21.61	60,229,000	+0.37
Number of Active Policyholders	6,856	0.93%	6,793	0.38%	6,767	1.05%	6,697	-0.90	6,758	+1.69
Policyholder's Surplus	\$123,785,000	-13.81%	\$143,611,000	16.96%	\$122,782,000	13.31%	108,355,000	+8.63	99,743,000	+14.04
Ratio: Net Written Premium to Surplus	0.53:1		0.48:1		0.61:1		0.68:1		0.60:1	
Net Investment Income	\$(20,678,000)	-204.78%	\$19,734,000	18.95%	\$16,590,000	14.82%	14,449,000	-7.47	15,616,000	-2.78
Invested Assets*	\$324,848,000	-9.81%	\$360,179,000	7.29%	\$335,715,000	7.71%	311,696,000	+5.09	296,599,000	+9.18
Underwriting Gain (Loss)	\$33,681,000		\$26,391,000		\$10,860,000		1,825,000		-4,270,000	
MIEC Premium Credits Authorized	\$17,000,000		\$20,000,000		\$8,500,000		5,000,000		0	
Total Premium Credits Declared Since Inception	\$263,825,000		\$246,825,000		\$226,825,000	3.89%	218,325,000	+2.34	213,325,000	+0.00
Number of Claims Outstanding	1,552	-0.06%	1,553	-8.43%	1,696	-2.08%	1,732	-8.07	1,884	-6.03
Net Losses & Loss Expense Paid During Calendar Year	\$40,125,000	-11.29%	\$45,231,000	-0.14%	\$45,296,000	-22.84%	58,704,000	24.66	47,091,000	-4.68
Cumulative Since Inception	\$815,935,000	5.17%	\$775,810,000	6.19%	\$730,579,000	6.61%	685,283,000	+9.37	626,579,000	+8.13
Reserve for Unpaid Losses & Loss Expense**	\$139,935,000	-10.54%	\$156,415,000	-7.51%	\$169,113,000	3.94%	\$ 162,707,000	-0.99	\$ 164,340,000	+5.92

*Figure includes Bonds, Stocks, Money Market funds, value of investments in subsidiary, commercial paper, cash, and real estate. Figure excludes accrued investment income, premium in course of collection, computer equipment, and reinsurance recoverable.

**Includes reserves for incurred but not reported cases and for reinsurance ceded and assumed.

Statements of financial condition, policyholders surplus, underwriting expenses, and operations, audited by Ernst & Young LLP, will be provided to policyholders on request.

Figure 1

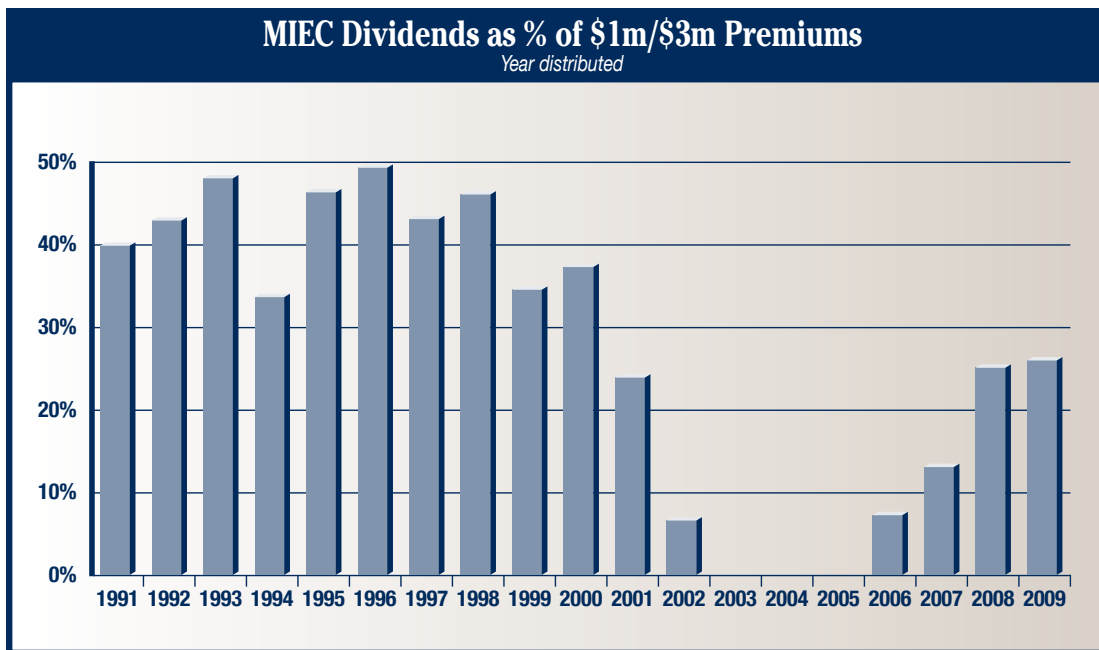
Dividends

MIEC has a track record, virtually unmatched in the industry, to consistently return large dividends to its members. This is a major value proposition to long-term MIEC policyholders:

Over a career in medicine, given its lower operational overheads and a proven track record of returning profits to policyholders, MIEC will not only be the most stable option but it will also be the least expensive.

The size and scope of MIEC's dividend program is essentially unique in our industry and certainly in our states of operation.

The graph illustrates the historical benefit the average MIEC policyholder has enjoyed in reduced pricing since 1991 for basic limits of \$1m/\$3m.



Claims

For 34 years, our primary mission has been to vigorously defend our insured physician-policyholders against claims without merit, and to fairly compensate injured patients with meritorious claims. Our commitment to this mission has served our policyholders well as evidenced by some of the following statistics:

We continue to close about 90% of the claims reported by our policyholders without paying any money to plaintiffs or their attorneys.

This doesn't mean that 90% of our cases were closed without any payment at all—it costs money to defend and protect doctors.

In fact, in the past 7 years, 42% of all the money paid in claims was paid to defend our insured policyholders. In cases that were either judged to

have no merit or were dropped, the average cost of defense was just over \$9,300 and ranged from \$100 to over \$500,000.

We continue to prevail in over 80% of the cases that we take to trial. This year we took 12 cases to trial; 10 of these resulted in defense verdicts. We tried one case twice: the first trial resulted in a mistrial because the jury was unable to reach a verdict. We took the case to trial again, and this resulted in a defense verdict. Taking a case to trial is costly and trying a case two times is doubly so, but this is money well spent to protect our insured's reputation and to remind plaintiffs counsel that they have to have a case with merit if they want compensation.

The number of cases taken to trial has trended downward over the years. From 1992 through

2008, MIEC has taken over 450 cases to trial and more than 375 resulted in defense verdicts. From 1992 to 1999, we took 278 cases to trial, averaging almost 35 trials per year. From 2000 to 2007, we took 179 cases to trial, which averages about 22 cases per year. This is a 37% drop in the average number of cases tried per year.

MIEC, like most Medical Professional Liability (MPL) carriers, has experienced similar trends or changes: **A**

decrease in the frequency and an increase in the severity of claims. Practically speaking, this means that our policyholders are reporting fewer claims than in years past, but the cost of those claims has increased.

The decrease in frequency is undoubtedly related to several factors; our general expectation is that claims frequency will not continue to fall.

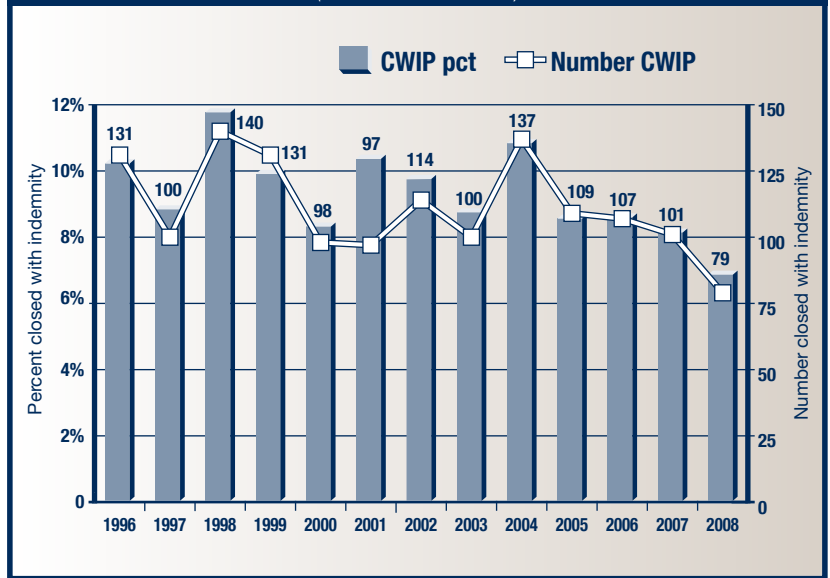
Increased severity is a result of increases in the cost to defend our insureds and indemnify patients. There are many reasons for this trend. In cases where a plaintiff sustains catastrophic debilitating injuries as a result of alleged negligence, the cost of compensating the plaintiff for medical expenses has increased. For example, patients with chronic serious injuries live longer as a result of advances in medical technology and pharmacology.

Cases that resulted in any sort of indemnity payment (compensation to an injured patient) cost a lot more to resolve, but obviously the key issue with these cases is the amount of money it takes to settle a matter. This is where the extreme severity of our business is most clear. In the past 7 years, 29.7% of all of the dollars we spent on indemnity arose from only 15 (2%) of our paid claims.

Statistics and trends don't tell the whole story; they are the result of many factors, both small

MIEC Claims Closed with Indemnity Payments (CWIP)

(MIEC Data: Past 10 Years)



and large, that have contributed to our success in claims. These include:

- 1) Experienced and knowledgeable claims staff. Our supervisory claims staff has an average of over 14 years experience in this industry.
- 2) We are privileged to work with the medical societies in the counties and states where we are sponsored. We benefit from our close relationship with the medical societies and the local peer review committees.
- 3) Top notch defense counsel. We only work with experienced trial attorneys who specialize in medical malpractice defense.
- 4) Effective tort reform in three of the four states where we insure physicians.
- 5) Hard work, commitment and dedication to protect our insured.

Underwriting

We ended 2008 with 6853 policyholders, up slightly from the beginning of the year. We have year-to-date net gains in nearly every state. The mix of policyholders by state has remained constant with California representing about 58% of policyholders, Hawaii 19%, and Idaho and Alaska 12% and 11%, respectively.

We continue to enjoy an extraordinarily high retention of policyholders from year to year. Less

than 1% of our insureds left us for a competitor in each of the past several years. We believe that this has as much to do with the stability and economic value we bring to policyholders, as it has to do with the personal service we provide. Many policyholders know their underwriter by name and know that if they call our office, their underwriter will be able to assist them. At the very least, another human being will answer the phone and not an automated phone “personality.”

We made several improvements to our policy form this year which we explained in our cover letter sent in February, 2009. If you have questions, contact the Underwriting Department.

Loss Prevention

Our Loss Prevention department acknowledges the fact that you can never know how much money you save on claims that never happen. This doesn't deter us from doing everything we can to decrease our policyholders' liability exposure. The following is a list of the a free services that are available upon request.

Surveys: An in-depth assessment of your existing internal operations and systems, including a review of your record-keeping practices, office policies, quality assurance programs and critical care areas of operation. These surveys are tailored to your practice and are followed by a written report to summarize practice strengths and to recommend improvements.

Seminars: For physicians, office staff and nurses. MIEC's Loss Prevention specialists present seminars on many topics, including medical record documentation, medications and medication-related claims, doctor patient communication and relationships, and how physicians and their spouses can survive malpractice litigation. MIEC Loss Prevention staff members also present specialty-specific programs and seminars tailored to topics the group may wish to discuss.

Practice Forms and Policies: MIEC's Loss Prevention specialists will review and provide advice on a variety of office templates, patient information brochures, patient education materials, patient surveys, follow-up systems and practice policies.

Telephone Advice Line: Loss Prevention specialists will advise you on many topics, including informed consent, medical record maintenance and retention, emergency call situation and other critical areas.

Newsletters: The Loss Prevention Department has published numerous publications that address changes in state law, update readers on issues or trends that may affect physician liability, advise physicians and staff on practice management issues, review protective documentation practices (in the context of claims that were negatively impacted by poor record-keeping practices), and more. Many of MIEC's Loss Prevention Department's publications, articles and office practice forms are available in both HTML and PDF format at MIEC's website.

During 2008 we visited sixty-four office practices, serving one hundred and sixteen physicians and their medical office staffs; conducted twenty-four seminars; and responded to approximately 650 telephone advice calls.

Call the Loss Prevention Department!

Acupuncture

Eight years ago, we started an insurance program for a group of acupuncturists we believed were being treated unfairly by their (for profit) insurance carriers. We have approached this business cautiously - relying upon the expertise of their professional organizations and applying the same principals that guided us in 1975 when MIEC was formed. As far as we know, MIEC is the only not-for-profit company serving acupuncturists and certainly the only one that distributes dividends.

Communications

Web Site. In 2008 we have been reworking our web site to provide a much higher degree of functionality to policyholders and administrators. In addition group policyholders will have all the same functionality as individual policyholders. There are many more helpful features our members can access at any time of the day or night at your own convenience. This in no way replaces our commitment to the human and personal touch that has been the hallmark of the organization from its inception.

Meet & Greet. We have embarked on a number of evening meetings that have taken place from time to time in various locations where our policyholders practice. There were two events in both Alaska and Idaho in 2008, where policyholders had the opportunity to come together for an hour or so to meet with friends and colleagues and hear some news from their insurance company. We hope you will join us when we come to your area.

Reaching out to Residents and Acupuncture Students. We believe that it's never too early to explain some of the mysteries of MPL to doctors. With this goal as a motivator, we offered a number of presentations over the past several years at medical schools and acupuncture schools in our territories, programs that were well received by the attendees. If you are on

faculty and would like to help your residents or students have a better understanding of MPL as they prepare to enter private practice, please call and let us know how we can help.

Subsidiaries

- Claremont Liability Insurance Company (CLIC). CLIC wrote its last policy in 2007 and continues to produce positive returns to MIEC's financial results as it runs off its remaining obligations.
- MIEC Investment Company, Inc. (ICI). ICI invested in a number of Lloyd's syndicates and discontinued active operations in 2004. At the end of 2008 we executed a reinsurance contract to extinguish further changes in ICI's underwriting results and it is now in the process of being closed down.

MIEC's Business Philosophy

- Doctors first
- Clear, unambiguous and transparent rates set at a level to break even (i.e., we do not attempt to profit from operations)
- Low overheads – among the lowest in the industry
- Quality risk selection and careful underwriting
- Professional and uncompromising claims defense
- Thoughtful and practical Loss Prevention programs which are provided free to policyholders
- Collaborative relationships with organized medicine / medical societies
- Conservative investment philosophy with emphasis on investment income to further offset overheads
- Resilient balance sheet to insulate policyholders from unrelated events causing changes in the cost of MPL insurance
- Long-term approach to business initiatives
- Alignment of our operations and services to match those of our policyholders