



Annual Report 2002

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The MMIC Group provides medical malpractice insurance, employee benefits planning, a range of technology products and services, and human resources and strategic healthcare consulting to physicians, clinics, hospitals and health systems in the Midwest.

VISION STATEMENT

To become the most trusted business partner of healthcare providers.

MISSION STATEMENT

To provide high quality, professional liability insurance and other services to enhance the strength and security of the healthcare community.

LETTER TO SHAREHOLDERS

It is an honor and a pleasure to succeed Dr. Andrew J.K. Smith as the fourth board chair of the MMIC Group. Dr. Smith ably and faithfully served our company and policyholders for more than 12 years as a board member and the last six as board chair. During his tenure, we saw substantial growth in MMIC's core insurance business as well as the establishment of member companies Technology Solutions, Business Office Solutions and MMIC Benefits.

Dr. Smith leaves behind an MMIC Group that is stronger than ever, financially and organizationally, and better able to provide a wider range of services to physicians, clinics, hospitals and integrated healthcare systems in the upper Midwest.

As your new chair, my challenges and goals are to continue to increase and improve our services and to further strengthen the company for the future.

During my seven years on the board and more recently as chair, I have gotten to know MMIC and the industry better. I have been increasingly impressed with our company and our employees. MMIC is now the leading medical professional liability insurer in each of its five core states. Within the medical malpractice industry, MMIC is recognized as one of the top physician-owned companies. And we are one of eight companies owned by physicians to receive an A (Excellent) rating by A.M. Best. MMIC ranks first in investment returns over five years and has one of the lowest expense ratios.

Our Claim Department settles cases faster than the industry average and at lower costs. We are well known on the national level for risk management and claim prevention, something to which commercial carriers only allocate minimal resources. Two of our core states—South Dakota and Minnesota—rank first and second, respectively, in the country for having the lowest premiums for physicians.

Our investments in MMIC Benefits, Business Office Solutions and Technology Solutions not only provide MMIC with diversification and financial benefit, but also assist our



G. Richard Geier, M.D.

LEADERSHIP

policyholders by helping them stay in business in an increasingly difficult and complex time. In 2003, we plan to make these products and services available throughout our territory.

One of the greatest strengths of the MMIC Group is the experience and stability of its staff. After more than 22 years, MMIC is on its second chief executive officer and most of its vice-presidents are also second generation. A number of employees, including MMIC President Jack Kleven and Vice President of Law and Health Policy Libby Lincoln, have been with the company for more than 20 years.

In the 1996 Annual Report, Dr. Smith in his first letter to shareholders stated: “An interesting phenomenon...the rush of commercial insurance companies returning to the malpractice business. In an effort to buy into the market, these companies often offer premiums well below the true cost of the coverage. MMIC, by contrast, has maintained its long-term commitment to offering fair and sustainable rates, quality products and superior customer service, allowing us to consistently outperform our commercial counterparts.”

In the last year or two, we have seen another interesting phenomenon—the rush of commercial insurers exiting the medical malpractice business, voluntarily or by financial failure. MMIC’s financial strength, stability, integrity and six-state presence have allowed us to be there when other insurers suddenly disappeared. I can assure you that MMIC is strong and will not go away. As midwestern physicians, we are here to stay.

Finally, last year we welcomed to the board of directors Dr. Mary Carpenter. Dr. Carpenter is a family practitioner in Winner, South Dakota.



G. Richard Geier, M.D.
Chairman of the Board

PRESIDENTS' LETTER TO SHAREHOLDERS

The year 2002 was another active year for the medical malpractice industry and MMIC. The hectic pace was multifaceted, ranging from ongoing turmoil in the reinsurance market, affordability and availability crises in a growing number of states, to heated tort reform debates and unprecedented new business opportunities and challenges for MMIC.

It was a successful year for us. We believe MMIC's **Leadership, Innovation, Integrity, Quality and Stability** were key to that success. Infusing these traits into our culture is how we became the leading medical malpractice insurer in our core territory. These traits provide a framework for our diversification efforts.

We began the year by surveying nearly 800 clinic administrator policyholders, who manage more than 10,000 physicians, to get an understanding of how we were doing and how well policyholders understand our mission to provide them with high quality coverage and other products and services needed in today's environment. Survey results showed us that more than 75 percent of clinic administrators believe MMIC has strong leadership and is highly innovative when it comes to helping them with their business needs. They were in favor of our strategic plan to diversify and grow to enhance their strength and security.

Stability and strength in the insurance company positioned us to attain record growth for the second consecutive year. New business premium in 2002 was \$18.7 million, in addition to an increase of \$13 million in 2001. After many years of fighting predatory competition, it is very rewarding to grow substantially while maintaining the integrity of our underwriting and pricing standards. We are convinced that the selectivity and pricing of our new business will enhance our long-term success.

Our reputation for high quality professional liability products and services is best affirmed by our renewal retention results. More than 98 percent of policyholders



- (L) David P. Bounk
President and Chief Executive Officer
The MMIC Group
- (R) Jack L. Kleven
President and Chief Operating Officer
Midwest Medical Insurance Company

renewed in 2002, as we outdistanced a challenging goal of 93.5 percent. Our unprecedented growth in 2001 and 2002 absolutely demands strong leadership. To uphold our quality standards, we have skilled and experienced leadership at the executive and department head levels. We have and will continue to add key management and technical staff particularly in the operational units of claim, underwriting and risk management. Our three main offices of Minneapolis, West Des Moines and Omaha provide sales and marketing, claim and risk management services. Medical liability claim specialists operating from Grand Island, Nebraska, and Sioux Falls, South Dakota, have now supplemented these local specialized services. No other company comes close to matching these services.

We are innovative in expanding and delivering our insurance products and services. A couple of years ago, we provided Physician Administrative Defense Coverage for alleged Medicare and Medicaid fraud and abuse. Similarly, we are in the process of adding defense coverage for alleged HIPAA violations. We also expanded claim, risk management and underwriting services offered online at the MMICmedportal (www.mmicmedportal.com). We will continue to expand online services during 2003.

Our leadership in tort reform efforts is well recognized in the insurance industry. We work very closely with the state medical associations on tort reform efforts. In Minnesota we were instrumental in defeating an attempt to change the Statute of Limitations to a discovery statute. In South Dakota the “loss of chance doctrine,” favorable to the plaintiffs’ bar, was abrogated. On the national level, as a member of the Health Care Liability Alliance, we contributed to the 2002 passage of HR4600, a tort reform package, in the House of Representatives. This package resembles the well-known MICRA reforms in California, which have been successful in moderating the legal climate. We will continue to strive for national reform and consider aggressive state reforms if claim frequency and severity deteriorate.

The increasing withdrawal or collapse of insurance carriers from the medical malpractice market and sharply rising rates in many areas make MMIC’s financial stability and integrity even more important. We remain very solid financially; but we have not been immune from the affects of the prior soft market, higher claim severity, shrinking case reserve redundancies, a hard reinsurance market and an unfavorable investment environment. While our operations results improved in all areas and we negotiated high quality treaty reinsurance at only a slight rate increase, the downgrading of several bonds and falling equity values resulted in a modest bottom line loss and a

reduction in surplus. However, due to our very strong surplus position at the beginning of the year, we still rank among the strongest physician-owned carriers in the country.

While addressing the dramatic opportunities and challenges in our core business, we have continued to expand our nonmedical liability insurance products and services. These new endeavors have strengthened our client loyalty and are providing important resources, such as electronic medical record systems, technology consulting and employee benefits insurance at competitive prices. These member companies benefit all shareholders and physician insureds, in part, because we have been able to allocate more than \$1.5 million of expenses out of the insurance company to these other operations. This allocation results in lower malpractice insurance rates. Long term, we believe these companies can help you improve your operational quality and efficiency, thereby, reducing your malpractice exposure.

As we look to the future, we want to build on our tradition of success and ensure both your longevity and ours. The threats and challenges of our industry are real and can be ominous as shown by numerous failures of once strong companies and marked erosion of the legal climate in many states outside our region. Strategically, even greater financial stability is paramount. Our long-range goal of attaining an A.M. Best “A+” rating expresses our commitment to strengthen the company for the benefit of the healthcare community. We plan to remain the leading medical malpractice insurance company in the upper Midwest as we realize our vision to be “the most trusted business partner of healthcare providers.”



David P. Bounk
President and Chief Executive Officer
The MMIC Group



Jack L. Kleven
President and Chief Operating Officer
Midwest Medical Insurance Company

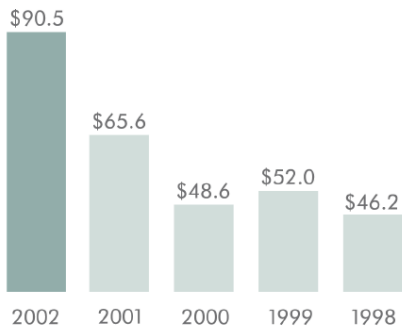
2002 HIGHLIGHTS

Exceptional Premium Growth—Expense Moderation

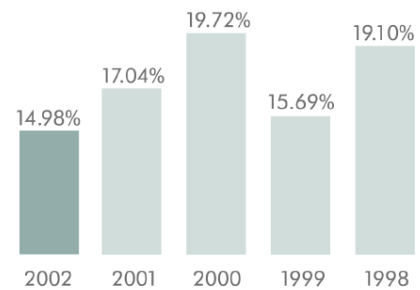
Premium growth continued at a record-breaking pace in 2002. Much of it was due to the St. Paul and other insurers exiting our territory or the medical malpractice industry. We held to responsible and adequate pricing standards on new and renewal business, ensuring that we will maintain our financial stability. Independent agents and brokers played a significant role in new business growth. More than 50 percent of our business is now written through independent agents and brokers.

WRITTEN PREMIUM

In Millions

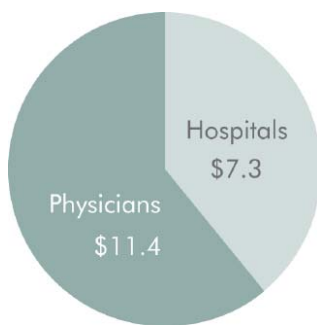


UNDERWRITING EXPENSE RATIO



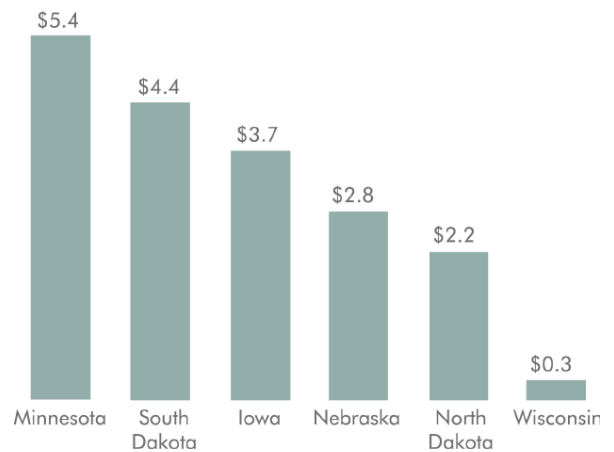
2002 NEW BUSINESS PREMIUM

In Millions



2002 NEW BUSINESS PREMIUM BY STATE

In Millions

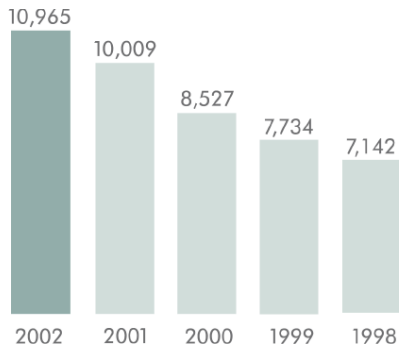


QUALITY

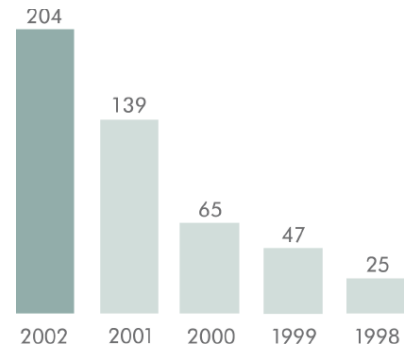
Market Share

In 2002, MMIC was the leader in market share in its five-core states—Minnesota, South and North Dakota, Nebraska and Iowa. Our strategy is to remain the leader based on our quality coverage, responsible pricing, exceptional customer services and technical expertise.

PHYSICIAN POLICYHOLDER GROWTH



HOSPITAL POLICYHOLDER GROWTH



POLICYHOLDERS BY STATE

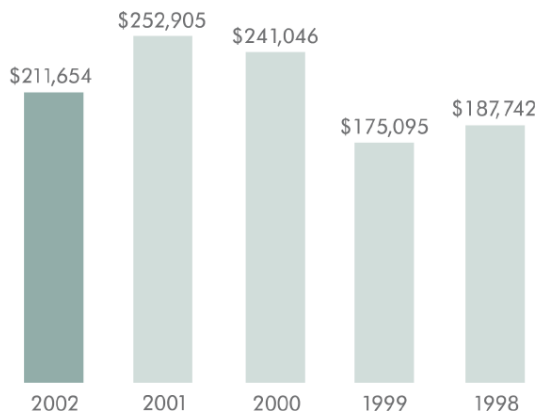
	Physicians	Clinics	Hospitals
Minnesota	5,201	438	30
Iowa	1,704	261	38
South Dakota	1,481	151	73
Nebraska	1,415	163	54
North Dakota	818	23	7
Wisconsin	346	39	2
Total	10,965	1,075	204

INTEGRITY

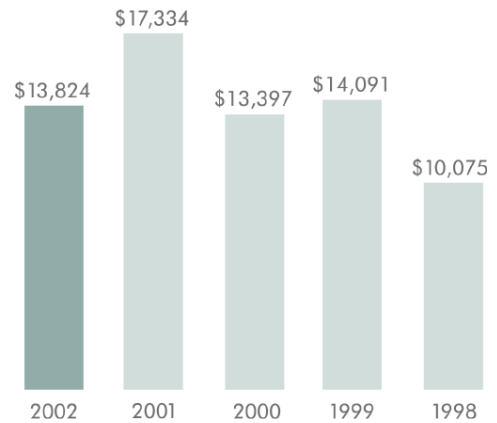
Claim Results

After a sharp rise in average indemnity in 2000 and 2001, we experienced a reduction to \$211,654 in 2002. However, as shown, 2002 averages are still distinctly higher than 1998 and 1999. While we are encouraged by a one-year rebound, claim severity is still a primary concern. National trends are extremely discouraging, but we remain cautiously optimistic that claim severity will be comparatively moderate in our region. Also, claim frequency increased after a couple of years of record lows.

AVERAGE INDEMNITY PAID
(Physician and Clinic Professional Liability Closed Cases)
In Dollars



AVERAGE ALLOCATED LOSS ADJUSTMENT EXPENSE (ALAE)
(Physician and Clinic Professional Liability Closed Cases)
In Dollars



LOSS FREQUENCY – PROFESSIONAL LIABILITY CLAIMS REPORTED PER 100 PHYSICIANS AND CLINICS



MMIC Rates Are Some of the Lowest in the Country

Last year, like many regions across the country, the Midwest saw a rise in medical malpractice rates. However, the increases experienced in the Midwest were some of the lowest in the country. The following charts compare MMIC's basic rates for internal medicine, general surgery, and obstetric/gynecology with a sampling from states across the country.

The rates below range from the lowest to the highest listed for all insurance companies in that state. All rates are at a \$1 million/\$3 million limit, mature claims-made. MMIC rates remain on the lower end of the countrywide rate spectrum. Our goal is to keep that position in the future.

2002 Other States

	Internal Medicine	General Surgery	OB/GYN
Colorado*	\$ 8,876 – \$ 9,845	\$32,657 – \$ 34,644	\$30,905 – \$ 39,494
Florida	\$15,460 – \$56,153	\$54,677 – \$174,268	\$77,949 – \$210,576
Illinois	\$ 9,038 – \$31,722	\$28,921 – \$ 65,536	\$46,544 – \$110,091
Missouri	\$ 7,655 – \$11,572	\$34,953 – \$ 41,266	\$49,634 – \$ 60,548
Texas	\$10,183 – \$26,334	\$33,141 – \$ 71,200	\$42,710 – \$ 97,830

2002 MMIC Base Rates

	Internal Medicine	General Surgery	OB/GYN
Iowa	\$6,168	\$18,607	\$37,883
Minnesota	\$3,803	\$10,142	\$17,431
North Dakota*	\$5,430	\$14,479	\$24,886
South Dakota*	\$2,907	\$ 7,753	\$13,325
Nebraska*	\$3,470	\$12,319	\$18,854
Wisconsin*	\$5,993	\$15,980	\$27,466

* These states have tort reform, including a cap on damages

Source for other states: *Medical Liability Monitor*, 2002

MMIC Noninsurance Products and Services

Physicians, clinics and hospitals are finding it to their advantage to come to us for technology needs. In 2002, Technology Solutions had \$1.9 million in revenue. This 100 percent revenue increase was mainly driven from the sales of seven practice management systems, four electronic medical records systems, and numerous computer networks and Web site engagements last year. Business Office Solutions (BOS), our complete billing office outsourcing solution and the newest member of the MMIC Group, began operations in the second half of 2002 and had four clients by year end.

Our employee benefits agency, MMIC Benefits, generated revenue of \$2.4 million, which represents an 8 percent growth. This was notable considering the difficult economic environment last year. Many customers had fewer employees due to layoffs or made changes to their benefit plans to reduce cost. Revenue from new business was outstanding and totaled more than \$300,000. After a small loss in 2001, Benefits returned a modest profit in 2002. We are encouraged by their growth and profitability and expect better results in the future.

Practice Management Systems

Electronic Medical Records

Employee Benefits

Web Site Design and Development

Billing Office Solutions

Network Design and Support

More Healthcare Providers Using Our Other Products and Services

Our multiple relationship strategy is to help our customers see the advantage of purchasing many of their healthcare business products and services from the MMIC Group and its strategic partners.

During 2002, 603 physicians, clinics or hospitals developed a new customer relationship with the MMIC Group by buying a new product or service. Nearly 21 percent of our policyholders are now using more than one of our products and services. Our long-term goal is for 50 percent of all policyholders to use more than one of our products and services.

MMIC Group Customer Relationships

	New in 2002	Total
Medical Malpractice Insurance (physicians, clinics, hospitals and health systems)	496	2,342
MMIC Benefits	32	244
Technology Solutions	44	88
Langan and Flynn (human resources)	12	15
Partners Healthcare Consulting (strategic healthcare consulting)	19	39
Total	603	2,728

“Over the years, we have always had great success with MMIC as our medical malpractice carrier. Their commitment to customer service and the attention to detail are exceptional. After we had an opportunity to research their other product lines, the decision to use their other services was easy. We have purchased and implemented the NextGen practice management system. And we are in the process of implementing the electronic medical records system. We have used the company as a resource for our computer and networking configurations, human resource issues and employee benefit analysis. We continue to have many positive experiences and are looking forward to our continued relationship with the entire MMIC group.”



Robert C. Nuffort
Chief Executive Officer

Melanie (Mel) Sullivan
Chief Operating Officer

St. Croix Orthopaedics, Stillwater, Minnesota

Policyholders find HIPAA Resources Useful

We have been involved in shaping HIPAA policy and activity at the national level since early 2001. MMIC was one of the first insurers to recognize the significance of HIPAA for physician practices. Last year, our Law and Health Policy Department closely monitored developments on all HIPAA regulations and worked with the Department of Health and Human Services policymakers to clarify how HIPAA applies to professional liability situations. During 2002, hundreds of healthcare personnel from various healthcare organizations attended our HIPAA seminars and workshops. As a service to policyholders, we will continue to be involved with HIPAA on the state, regional and national levels. Our HIPAA resources on the Medportal, www.mmicmedportal.com, are regularly updated with the latest HIPAA information, tools and resources.



Midwest Medical Insurance Holding Company and Subsidiaries
Condensed Consolidated Financial Information
(Unaudited, In Thousands)

Balance Sheets

	December 31	
	2002	2001
Assets		
Invested assets	\$255,702	\$247,293
Other assets	48,616	40,112
Total assets	<u>\$304,318</u>	<u>\$287,405</u>
Liabilities and shareholders' equity		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$148,763	\$118,574
Other liabilities	44,540	41,944
Total liabilities	<u>193,303</u>	<u>160,518</u>
Shareholders' equity	111,015	126,887
Total liabilities and shareholders' equity	<u>\$304,318</u>	<u>\$287,405</u>

Statements of Income

	Year Ended December 31	
	2002	2001
Revenues:		
Net premiums earned	\$70,472	\$50,097
Net investment income	11,404	12,341
Realized capital gains	1,358	6,571
Other	3,782	2,637
	<u>87,016</u>	<u>71,646</u>
Losses and expenses:		
Losses and loss adjustment expenses	74,819	58,299
Underwriting, acquisition, and insurance expenses	10,203	8,844
Other operating expenses	8,114	6,901
	<u>93,136</u>	<u>74,044</u>
Operating margin	(6,120)	(2,398)
Policyholder dividends	—	4,050
Loss from continuing operations before tax	(6,120)	(6,448)
Income tax benefit	(2,564)	(2,222)
Loss from continuing operations after tax	(3,556)	(4,226)
Discontinued operations, net of tax	—	(375)
Net loss	<u>\$ (3,556)</u>	<u>\$ (4,601)</u>

The foregoing unaudited condensed consolidated financial information has been derived from the audited consolidated financial statements, which are available upon request from the Finance Department or on our Web site: www.midmedical.com.

BOARD OF DIRECTORS



First Row (l to r): Mark D. Odland, M.D., Minnesota; Patricia J. Lindholm, M.D., Minnesota; G. Richard Geier, M.D. (Chair), Minnesota; David P. Bounk, President & CEO, MMIC Group, Minnesota; Jack L. Kleven, President, MMIC, Minnesota; William L. Youmans, M.D., Minnesota.

Second Row (l to r): Anthony C. Jaspers, M.D., Minnesota; Roger H. Meyer, M.D., Nebraska; James R. Bishop, M.D., Minnesota; Wayne F. Leebaw, M.D. (Vice Chair), Minnesota; Terence P. Cahill, M.D., Minnesota; T. Michael Tedford, M.D., Minnesota; Mary S. Carpenter, M.D., South Dakota.

Third Row (l to r): Stephen A. McCue, M.D., Minnesota; Michael D. Abrams, Executive Director Iowa Medical Society; Paul S. Sanders, M.D., CEO Minnesota Medical Association; Harold W. Miller, M.D., Iowa; R. Bruce Trimble, M.D., Iowa; Gail P. Bender, M.D., Minnesota; Russel J. Kuzel, M.D., North Dakota; Peter J. Daly, M.D., Minnesota; John R. Balfanz, M.D., Minnesota

Not Pictured: Mark O. Liaboe, M.D., Iowa; and Tom D. Throckmorton, M.D., Iowa.

SENIOR MANAGEMENT

David P. Bounk – MMIC Group
President and Chief Executive Officer

Jack L. Kleven – MMIC
President and Chief Operating Officer

Niles A. Cole – MMIC Group
Chief Financial Officer/Vice President of Finance

Thomas H. Lee – Technology Solutions
Vice President

Elizabeth S. Lincoln – MMIC Group
Vice President of Law and Health Policy

Debra L. McBride – MMIC
Vice President of Risk Management

Gerald M. O’Connell – MMIC Group
Vice President of Sales and Marketing

Julie J. Stafford – MMIC
Vice President of Underwriting

Jerry A. Zeitlin – MMIC
Vice President of Claim

Stephanie A. Kroeger – MMIC Group
Assistant Vice President of Human Resources

Rosalind M. Miller – MMIC Group
Communications Manager

