



STAYING ON COURSE

2004 Annual Report

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Letter to Shareholders

G. Richard Geier, M.D.

Board Chairman

The current medical liability crisis is reminiscent of the one 25 years ago. That crisis resulted in the creation of MMIC and many other physician-owned insurance companies. Thanks to our previous generation of leaders, physicians in the Upper Midwest are weathering the current malpractice storm better than most.

In the 1990s, the single-state, single-product companies were urged to spread their risk by expanding and diversifying their products and services. Some companies, to their regret, expanded too far from their core principles. However, MMIC grew with mergers and diversification and chose to stay close to home. We merged with physician groups in Iowa and Nebraska and grew by insuring physicians in North and South Dakota. Recently our stable reputation brought us the opportunity to develop business relationships in Wisconsin. We diversified our product offerings after policyholders began asking for assistance with their business operations. Now we offer additional insurance coverages, as well as practice- and business-related technology products and services to support our policyholders' needs.

Staying True to Our Mission

I believe we are one of the most successful and respected physician-owned insurance

companies in the country because we listen to policyholders and stay true to core principles. Staying true to our mission – *to provide high quality medical liability insurance and other services to enhance the strength and security of the health care community* – has helped MMIC become the trusted business partner of health care providers.

That strong policyholder focus made 2004 a good year for MMIC. This is despite the fact that we experienced more multimillion-dollar cases than ever before. These cases have raised some alarm; and we are working with a coalition at the national level and with state medical organizations to address these concerns.

Good Governance

We continue to strengthen our governance structures and practices. A significant step was to add an outside financial expert to the board's Audit and Budget Committee. Darrell Tukua, CPA, spent 27 years as a financial services auditor and a partner with KPMG. Darrell brings a wealth of knowledge and experience. Having him on the committee will go a long way to confirm our confidence and trust in our systems. While MMIC is not obligated to meet the requirements of a publicly traded company, we chose to add this best practice to our governance.

“I believe we are one of the most successful and respected physician-owned insurance companies in the country because we listen to policyholders and stay true to core principles.”

A Year of Leadership Changes

MMIC passed a major milestone with the retirement in 2004 of President and Chief Operating Officer Jack Kleven. Jack was one of MMIC’s first employees. He worked with MMIC (the former MMIE) when management and operations were outsourced. He became director of the Claim Department in 1982, two years after the company was founded. In 1984, Jack became vice president of claim and risk management. He was appointed chief operating officer in 1998 and president of MMIC in 1999. Jack had been a cornerstone of MMIC for almost its entire history; an entire generation of physicians is deeply indebted to him.

Drs. Bruce Trimble, Roger Meyer and Harold Miller retired from the MMIC board in 2004. Bruce Trimble from Mason City, Iowa, served on the board for 12 years. Bruce also served on the board of the Iowa Physicians Mutual Insurance Trust, before its merger with MMIC in 1993. During his tenure, Bruce served as board vice chair and he also chaired several board committees. Roger Meyer from Utica, Nebraska, retired from the board after four years of service. He is currently president of the Nebraska Medical Association. Harold Miller from Davenport, Iowa, stepped down after eight years of service; two of those years he served as chair of the Investment Committee. We thank them for their commitment and service to MMIC.

We welcomed four new board members in 2004: Drs. Robert Beattie, Kent Carr, Michael Del Core and Eugene Kerns. Robert Beattie is a family physician in Hettinger, North Dakota. He is currently president of the North Dakota Medical Association. Kent Carr is chief executive officer and chief medical officer of the Mercy Clinics in Des Moines. Michael Del Core is from Omaha and he is in charge of the Cardiac Catheterization Lab at Creighton University Medical Center. Eugene Kerns practices obstetrics and gynecology in Bettendorf, Iowa, and is on the clinical faculty at the University of Iowa. Both Dr. Kerns and Dr. Carr have business degrees.

As we continue on course, MMIC is the strongest it has ever been and is growing stronger. Faced with an extremely challenging environment, we continue to contain malpractice costs while maintaining an adequate financial safety net. Setting a true course and staying with it has allowed MMIC to build on its strengths and to successfully carry out its mission.



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



President's Report

David P. Bounk

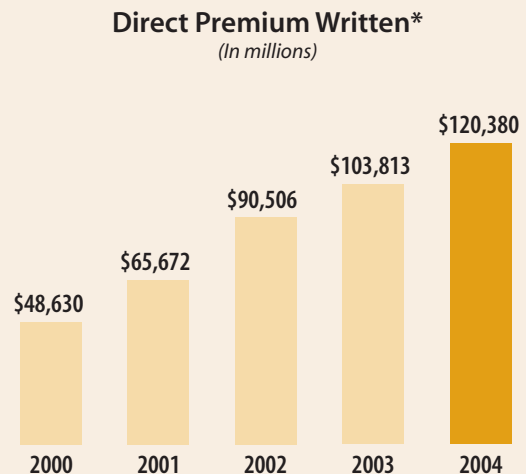
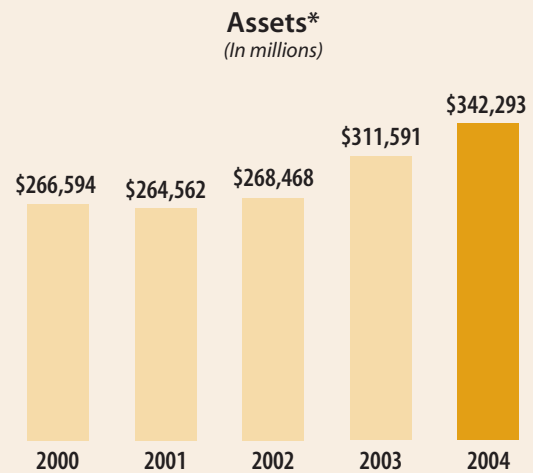
President and Chief Executive Officer, The MMIC Group

The medical liability insurance environment continued to be challenging both nationally and locally in 2004. Claim severity increased, reinsurance costs rose and the legal climate was less favorable than it had been in 2003. Working in that environment, the MMIC board of directors and staff continued to focus on the attributes that contribute to an effective physician-owned insurance company by putting the needs of its policyholders first and profits second.

Staying on Course Produces Results

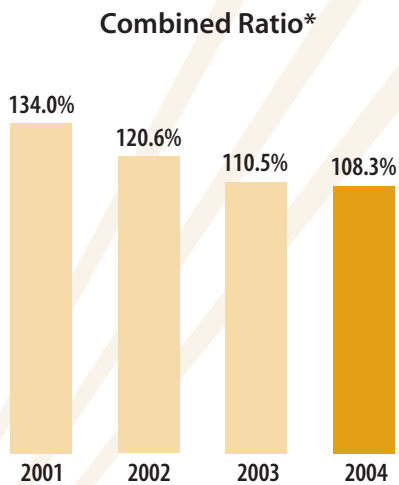
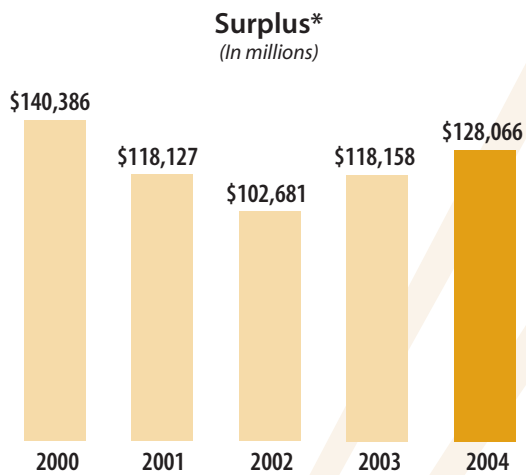
In 2004, MMIC had a year of solid premium growth, improved combined ratio and an improved bottom line. We achieved this through effective claim management, consistent and fair underwriting and focused risk management. Outstanding financial management, the sophisticated use of technology and strong human resource management also played a major role in our success.

MMIC's assets grew to \$342 million and direct written premium increased to \$120 million in 2004. New business growth of \$7.7 million was about \$1 million more than in 2003. And we achieved a renewal retention rate above 96 percent for the seventh consecutive year. Much of the recent growth and strong renewal retention was a result of the



highly qualified insurance agents and brokers we partner with. Our growth strategy is still deliberate and controlled. It takes advantage of new opportunities to grow, as long as we can do it at proper rate levels.

“2004 was a year of solid premium growth, improved combined ratio and an improved bottom line.”



* Derived from stand-alone Midwest Medical Insurance Company audited financial statements prepared on a statutory basis.

In our territory, we are still seeing aggressive pricing by some competitors, with rates that are reminiscent of the late 1990s. Responsible pricing and selective underwriting is important to ensure our future financial stability. While we have had to increase our rates in our core states over the past five years, we continue to price our coverage competitively, but reasonably, while exercising underwriting discipline. Our rates continue to be some of the lowest in the country.

We believe we are at a proper balance of affordable pricing and reasonable profit. The improved combined ratios of the past four years indicate our strategy is working.

Using Technology to Work Efficiently and Effectively

Working with our Information Systems Department, MMIC continued to make exciting technological improvements throughout the organization with great results. Our administrative expense on a dollar per insured physician basis continues to be one of the lowest in the nation. Our employee count in each department ranks in the top quartile for efficiency among physician-owned companies, according to a recent Physician Insurers Association of America (PIAA) survey.

The efforts of the Human Resource Department and the entire management staff have resulted in MMIC employing one of the most experienced and dependable staffs in the industry. Our expanded training and employee development programs allow us to fill the majority of job vacancies through promotions from within the company and to limit employee turnover.

The MMIC Group Web site (www.mmicgroup.com), designed by our communication group, is a resource of comprehensive information. Updated regularly, it provides useful insurance and technology information to board members, policyholders, staff, agents and brokers. The Web site gives clients 24-hour access to loss history and credentialing reports, which the Claim Department added to the Web site last year for the convenience of policyholders, agents and brokers.

The Underwriting Department enhanced dramatically the use of the Delphi database system to improve its response time to clients. In 2005, they will extend web-based underwriting services to include interactive applications and policy forms. The Risk Management Department continued to update policyholder resources on the Web site in 2004. These resources include information about the latest risk management services, publications such as *Partners in Prevention* and *Perspectives on Prevention*, risk management Tips of the Week,

seminar materials, malpractice claim reviews and a variety of other risk management tools for clinics and hospitals.

Strong Claim Management

To be an industry leader, any insurance company must have a strong commitment to a well-structured claim management program. MMIC's strong defense-minded way of handling claims and its practice of timely disposition of meritorious cases is well known in the industry.

MMIC's claim results continued to be strong last year, even though the average paid claim rose substantially to \$268,878. We attributed this to handling a large number of very high valued cases. Despite our strong defensive posture, last year we saw higher jury verdicts, which drove up settlement costs as well. It is likely this increase in claim cost will continue into 2005. However, despite the higher claim severity, we were able to achieve a combined ratio of 108.3, a respectable decrease from 110.5 in 2003. The improvement resulted from the early recognition of this trend and the establishment of adequate rates to cover this increased exposure.

Even with a record number of 59 trials last year, we obtained defense verdicts in

“Even with a record number of 59 trials last year, we obtained defense verdicts in 81 percent of these trials.”

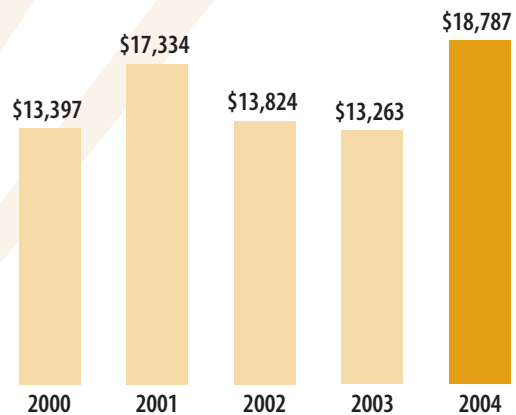
81 percent of these trials. Cases that require final resolution with a trial require substantial defense costs. Although excellent work was done defending these claims and all other claims incurred, our average allocated loss adjustment expense increased to \$18,787. However, it continues to be substantially below the PIAA average of \$26,049 (PIAA data calculated through June 30, 2004).

Partially offsetting the adverse trend in paid loss cost was a continued moderation in claim frequency. We believe our risk management efforts combined with our strong defense of claims drove this tremendous control of claims frequency.

The following charts show some MMIC claim results from 2000 to 2004.

Average Allocated Loss Adjustment Expense (ALAE)

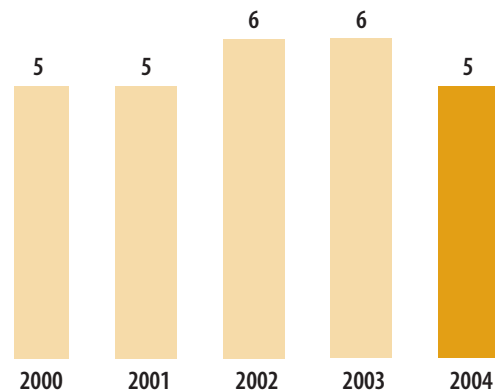
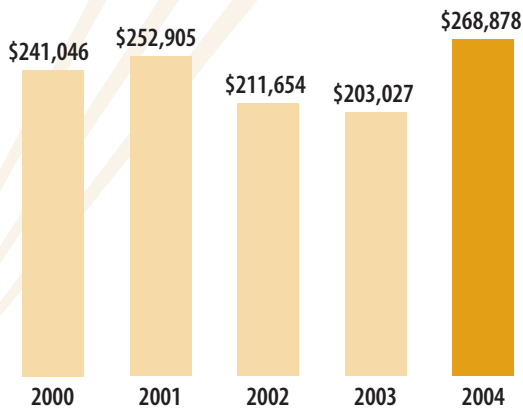
(Physician and Clinic Professional Liability Closed Cases)
(In dollars)



Loss Frequency – Medical Liability Claims Reported Per 100 Physicians and Clinics

Average Indemnity Paid

(Physician and Clinic Professional Liability Closed Cases)
(In dollars)

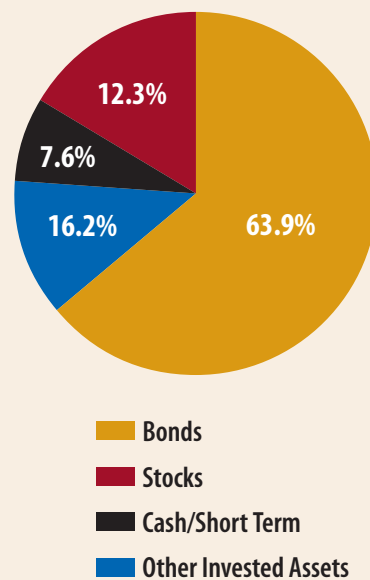


Strong Financial Management Focus

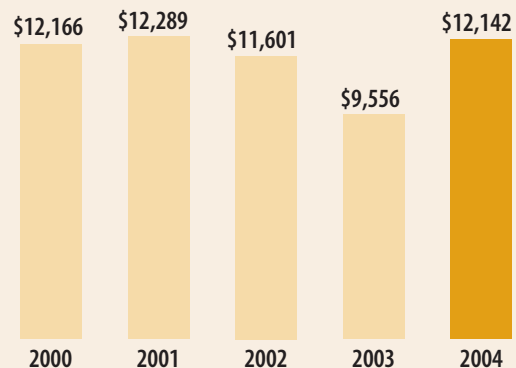
While the Sales and Marketing, Underwriting, Claim and Risk Management departments were concentrating on developing revenues and controlling losses and expenses last year, the Finance Department focused on managing the company's overall financial position. Investments were a key focus in 2004. Over the past 15 months, the board's Investment Committee, with the support of the Finance Department, restructured our investment portfolio to reduce volatility and to improve results.

The new structure will provide increased investment income that will allow us to control rate increases, achieve operating profits and grow policyholder surplus. These charts show how we diversified our portfolio, reduced our equity representation and improved our investment income last year. With these changes, our overall investment return of 7.6 percent was one of the higher rates of return among medical specialty insurance companies.

2004 Assets by Class*



Investment Income*
(In millions)



* Derived from stand-alone Midwest Medical Insurance Company audited financial statements prepared on a statutory basis.

“MMIC continued its advocacy work for health care providers by working closely with various medical societies and health care-related interest groups in 2004.”

High Compliance Standards Pass Regulatory Scrutiny

In 2004, the Minnesota Department of Commerce examined MMIC’s operations in various areas including financial integrity, investments, information technology security and regulatory compliance. After a demanding and lengthy examination, MMIC received a clean review. The examination acknowledged MMIC’s decision to be ahead of the curve in meeting stricter new compliance standards for the industry.

Advocate for Physicians

MMIC continued its advocacy work for health care providers by working closely with various medical societies and health care-related interest groups in 2004. Here is a brief list of our activities:

- Helped the Iowa Medical Society support the passage of a \$250,000 cap on non-economic damages in Iowa. Although the governor ultimately vetoed the cap, IMS has other initiatives in progress. We hope to continue our support in 2005 or 2006.
- Fought all the way to the Minnesota Supreme Court a very damaging interpretation of the Minnesota statute of limitations. In the 2005 legislative session we will work to correct the problem created.
- Worked with the Nebraska Insurance Department to more efficiently implement changes to the Nebraska Patient Compensation Fund. We continue our work with them to ensure the transition to a higher limit of primary insurance coverage is as seamless as possible.
- Continued working nationally with the American Medical Association and other health care groups to push for the passage of a tort reform package similar to the one in California, which has been effectively controlling liability premiums since 1975.
- Provided funding for the implementation of the Minnesota Adverse Healthcare Event Reporting System; the first report from the system was released this January. The report included both aggregate data and information about individual hospital experience.

Financial Strength through Multiple Relationships

Why buy from others when you can benefit by buying from companies in which you have a stake? That has been our philosophy since introducing a multiple relationship approach in our 1998 strategic plan. The approach: ask policyholders what their practice needs are; add a wide range of products and services to the MMIC brand to support their needs; encourage policyholders to buy from a company they know and trust.

Multiple relationships are created when policyholders buy a product or service from more than one of the MMIC Group members or its business partners. Members of the Group are MMIC, the MMIC Agency and MMIC Technology Solutions. Our business partners are Partners Healthcare Consulting Inc. and Langan and Flynn Human Resource Consulting, LLC.

Last year 66 policyholders purchased an additional MMIC Group product or service. Now, 270 policyholders have purchased more than one MMIC Group product or service.

Buying from the MMIC Group and its partners strengthens MMIC financially. These profits flow to the holding company and eventually support MMIC.

A Good Year for Subsidiaries

The MMIC Agency provides a variety of property and casualty products from some of the most respected insurance companies in the United States to our direct written policyholders. The Agency also continues to seek new products to increase its offerings to policyholders. In 2004, the Agency produced a bottom line profit of \$225,000, which helped offset other company costs.

MMIC Technology Solutions established operations in 1999; however, it did not begin selling its main products and supporting services – the NextGen electronic medical records and practice management systems – until 2001. As with any new business, especially in the technology sector, start-ups take time and money. During 2003, an outside business consultant evaluated Technology Solutions' progress and recommended changes. After reviewing the recommendations, senior

“When health care providers use EMRs, there is the potential for improving patient care and reducing errors that over time will aid in controlling insurance costs and the overall cost of health care.”

management restructured and downsized staff levels, and made major changes to their sales and marketing strategy. The efforts resulted in an improvement in sales, expense management, cash flow and the bottom line. The last six months of 2004 were the best consecutive sales months in Technology Solutions’ history; recurring revenue grew to more than \$1.5 million. The number of physicians using Technology Solutions products and services is approaching 500. The 2005 business plan anticipates continued improvement in all of these key areas.

We continue to see a strategic fit for the use of electronic medical records in MMIC’s core medical liability business. When health care providers use EMRs, there is the potential for improving patient care and reducing errors that over time will aid in controlling insurance costs and the overall cost of health care.

Our Future

As we closed the books on 2004, I can see that by always remembering the primary mission of a physician-owned carrier – to provide

affordable and secure medical liability protection to its physician owners – MMIC has stayed on course. This is especially important now as we begin to see more troubling signs that concern us – higher claim severity and a tougher legal climate – in the Upper Midwest. We have done well for our policyholders and I am certain MMIC is in an excellent position for continued success.



David Bounk
President and Chief Executive Officer

Midwest Medical Insurance Holding Company and Subsidiaries

Condensed Consolidated Financial Information

(Unaudited, In Thousands)

Balance Sheets

	December 31	
	2004	2003
Assets		
Invested assets	\$328,457	\$294,420
Other assets	47,956	44,530
Total assets	<u>\$376,413</u>	<u>\$338,950</u>
Liabilities and shareholders' equity		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$188,946	\$166,411
Other liabilities	54,405	47,799
Total liabilities	<u>243,351</u>	<u>214,210</u>
Shareholders' equity	133,062	124,740
Total liabilities and shareholders' equity	<u>\$376,413</u>	<u>\$338,950</u>

Statements of Income

	Year Ended December 31	
	2004	2003
Revenues:		
Net premiums earned	\$ 96,026	\$ 77,854
Net investment income	11,883	9,657
Realized capital gains	4,532	6,275
Other	3,246	7,325
	<u>115,687</u>	<u>101,111</u>
Losses and expenses:		
Losses and loss adjustment expenses	90,173	75,176
Underwriting, acquisition and insurance expenses	13,548	10,086
Other operating expenses	5,978	9,834
	<u>109,699</u>	<u>95,096</u>
Income before income taxes	5,988	6,015
Income tax expense	1,752	1,725
Net income	<u>\$ 4,236</u>	<u>\$ 4,290</u>

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

Board of Directors



First Row: (l to r)

Terence P. Cahill, M.D.
United Clinics of Faribault
Blue Earth, Minnesota

James R. Bishop, M.D., *Secretary*
Director of Medical Affairs
Fairview Southdale Hospital
Edina, Minnesota

David P. Bounk
President & CEO – The MMIC Group
Minneapolis, Minnesota

G. Richard Geier, Jr., M.D., *Chairman*
Olmsted Medical Center
Rochester, Minnesota

Wayne F. Leebaw, M.D., *Vice Chair*
Endocrinology Clinic of Minneapolis
Edina, Minnesota

Michael D. Abrams
Executive Director, Iowa Medical Society
West Des Moines, Iowa

Second Row: (l to r)

Patricia J. Lindholm, M.D.
Fergus Falls Medical Group
Fergus Falls, Minnesota

Tom D. Throckmorton, M.D.
Northwest Iowa Surgeons
Spencer, Iowa

T. Michael Tedford, M.D.
The Ear, Nose and Throat Clinic
Minneapolis, Minnesota

Anthony C. Jaspers, M.D.
Lake Crystal Clinic
Lake Crystal, Minnesota

Robert K. Meiches, M.D.
Chief Executive Officer
Minnesota Medical Association
Minneapolis, Minnesota

Mark D. Odland, M.D.
Hennepin County Medical Center
Minneapolis, Minnesota

Robert W. Beattie, M.D.
United Clinics, P.C.
Hettinger, North Dakota

Gail P. Bender, M.D.
Oncologist, P.A.
St. Louis Park, Minnesota

Darrell Tukua
Retired Partner, KPMG, LLP

Mark O. Liaboe, M.D.
Dubuque Internal Medicine, P.C.
Dubuque, Iowa

Third Row: (l to r)

William L. Youmans, M.D.
Camden Physicians
Minneapolis, Minnesota

John R. Balfanz, M.D.
Pediatrics & Young Adults
St. Paul, Minnesota

Stephen A. McCue, M.D.
Metropolitan Obstetrics & Gynecology
St. Paul, Minnesota

Mary S. Carpenter, M.D.
Family Practice Associates of Winner
Winner, South Dakota

Michael G. Del Core, M.D.
Creighton Cardiac Center
Omaha, Nebraska

Peter J. Daly, M.D.
Summit Orthopedics, Ltd.
St. Paul, Minnesota

Eugene L. Kerns, M.D.
Obstetrics and Gynecology
Davenport, Iowa

Not Pictured:

Kent E. Carr, M.D.
Mercy Clinics, Inc.
Des Moines, Iowa

Senior Management

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

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

Jay A. Koespell – The MMIC Group
Controller/Assistant Vice President, Finance

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

Thomas H. Lee – MMIC Technology Solutions
Vice President

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

Rosalind M. Miller – The MMIC Group
Communications Manager

Gerald M. O’Connell – The MMIC Group
Vice President, Sales and Marketing
President, MMIC Agency Inc.

Julie J. Stafford – Midwest Medical Insurance Company
Vice President, Underwriting

Peggy A. Wagner – Midwest Medical Insurance Company
Vice President, Risk Management

Thomas M. Youngblom – The MMIC Group
Assistant Vice President, Information Services

Jerry A. Zeitlin – Midwest Medical Insurance Company
Vice President, Claim

Corporate Office

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MMIC Technology Solutions

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Telephone: 800-328-5532

www.MMICGroup.com

Auditors

Ernst & Young LLP

Actuarial Consultant

Bickerstaff, Whatley, Ryan & Burkhalter
Consulting Actuaries

Corporate Counsel

Charles A. Geer

Headquartered in Minneapolis, Minn., the MMIC Group provides medical liability insurance, property and casualty insurance products and a range of technology, human resources and strategic health care consulting products and services to physicians, clinics, hospitals and health systems in the Upper Midwest.

Vision Statement

To become the most trusted business partner of health care providers.

Mission Statement

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