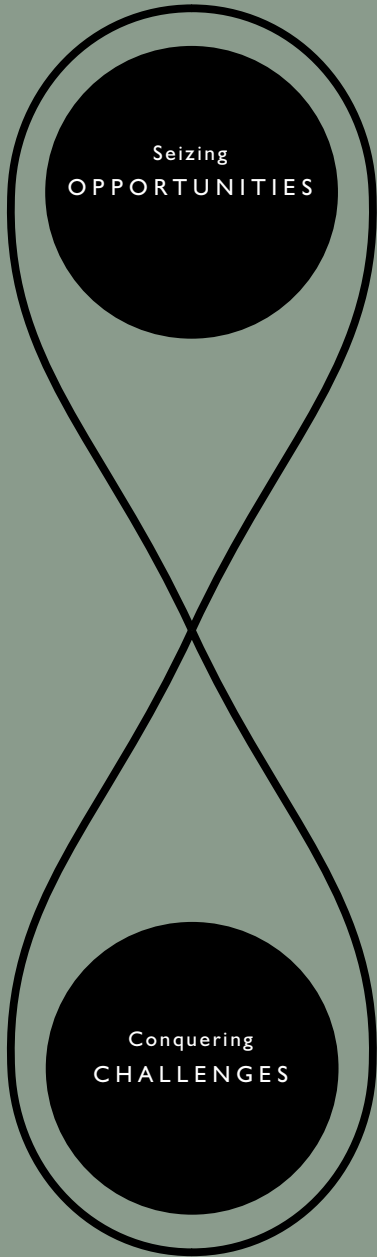


ANNUAL REPORT 2001



Midwest Medical  
Insurance Holding Company

## TABLE OF CONTENTS

LETTER TO SHAREHOLDERS	2
2001 HIGHLIGHTS	5
CONDENSED FINANCIAL INFORMATION	10
BOARD OF DIRECTORS	11
SENIOR MANAGEMENT	12

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

## 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

# Seizing Opportunities, Conquering Challenges



ANDREW J.K. SMITH, MD  
MMIHC Board Chair



DAVID P. BOUNK  
MMIHC President & CEO



JACK L. KLEVEN  
MMIC President

Two thousand and one was an extraordinary year for MMIC, a year of opportunities and challenges.

2001 was a year of turmoil in the insurance industry in general; the medical malpractice sector was no exception. Severity in all areas increased dramatically and put considerable pressure on reinsurance pricing, which was further impaired by the September 11 tragedy and by Enron's bankruptcy. In the medical malpractice industry we saw huge severity increases that caused "crisis warnings" in states such as Texas, Pennsylvania, Florida and West Virginia. Phico, the fifth largest writer of medical malpractice in our core states, was placed in liquidation and The St. Paul announced its withdrawal from the healthcare market.

As a result of the exiting of The St. Paul and Phico, MMIC had an unprecedented opportunity to write new business. We were able to capitalize on these circumstances to expand our market share and add solid new business in a very short period of time.

While continuing our strategy of selective underwriting and appropriate pricing, we had excellent growth. New direct written premium growth of \$13.5 million exceeded our goal by \$10 million, bringing our total written premium to \$65 million in 2001.

When we began our five-year plan in 1998, MMIC insured 5,924 physicians, 14 hospitals and 543 clinics. We retained 99.6 percent of our policyholders last year and by year end, we insured 10,009 physicians, 139 hospitals and 774 clinics. This is a remarkable accomplishment.

Last year was our ninth consecutive year of returning unanticipated profits to policyholders. We returned \$8 million to physicians and \$95,464 to hospitals in 2001; and the board declared dividends of \$4 million for distribution to physicians in 2002. MMIC is one of a few medical malpractice carriers still returning dividends to policyholders.

Two thousand and one was an extraordinary year for MMIC, a year of opportunities and challenges.

In 2001, underwriting, claim and risk management became even more focused on those factors underlying our gradually increasing claim severity. Jury verdicts and settlements in the upper Midwest reached their highest level ever last year. So far, we have been able to keep our claim severity at a reasonable level when compared to other parts of the country. Fortunately, at the same time, frequency remained at historic low levels of 5 per 100 physicians.

The overall impact of the events of 2001 required MMIC to increase physician and hospital rates in all our states for 2002. Even with these increases, the current cost of our coverage is near a historic

low level, almost the lowest in the United States. We sustained a modest loss from operations, primarily because we increased loss reserves for 2001 to more closely reflect the current, more challenging environment. MMIC still remains financially strong at every level as shown by its rating of A (Excellent) by A. M. Best.

In 2001, MMIC™ Technology Solutions exceeded goals, with decreased costs and increased revenue. While there is the ongoing challenge of the healthcare sector's relatively slow adaptation of technology, we benefited from our MMIC branding and the trust we have built with policyholders. We are gratified by the acceptance of our newer products and services and are confident that Technology Solutions will be profitable by the end of its third year.

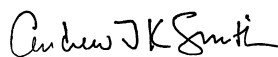
MMIC Benefits, our affiliated insurance agency, exceeded gross revenue goals in 2001 by 3.5 percent. We benefited from greater cross selling by the MMIC sales staff. To supplement our benefits services, we acquired 20 percent ownership of Langan & Flynn, LLC, a human resources consulting firm offering a variety of consulting services to both healthcare and non-healthcare clients.

MMIC continued its leadership role by developing resources to assist physicians with the challenges of dealing with HIPAA (the Health Insurance Portability and Accountability Act of 1996) regulations. MMIC has been directly involved in shaping HIPAA at the national level through our effort with the Physician Insurers Association of America and the Department of Health and Human Services.

Finally, we thank Drs. Anton Nesse, Richard Schmidt and Tom Evans, who left the board in 2001. We are appreciative of their leadership and support during an exciting time in MMIC's history.

Joining the MMIC board last year were Drs. Mark Barnhill, Peter J. Daly, T. Michael Tedford and William L. Youmans. Dr. Barnhill is a Des Moines, Iowa, pediatrician; Dr. Daly a St. Paul, Minn., orthopedic surgeon; Dr. Tedford a Minneapolis, Minn., otolaryngologist; and Dr. Youmans a Minneapolis family practitioner.

Last year was a pivotal year in our history, a year in which we had to adapt to the challenges of a chaotic insurance environment. We succeeded while maintaining our core principles. As the medical malpractice market continues to change, we strongly believe that our business strategy will allow us to capitalize on many future opportunities to grow, prosper and serve the needs of our shareholders and policyholders.



ANDREW J.K. SMITH, MD  
Board Chair  
Midwest Medical Insurance  
Holding Company



DAVID P. BOUNK,  
President and CEO  
Midwest Medical Insurance  
Holding Company



JACK L. KLEVEN,  
President and COO  
Midwest Medical Insurance  
Company

## 2001 HIGHLIGHTS

**Our Success** in implementing and refining MMIC's business strategy has allowed us to create opportunities, during these turbulent times for medical malpractice insurers. We work hard to understand the industry and the needs of our clients. We don't stop at just being an insurer. We have created a variety of other products and services to help our clients succeed in the healthcare environment.

### A (EXCELLENT)

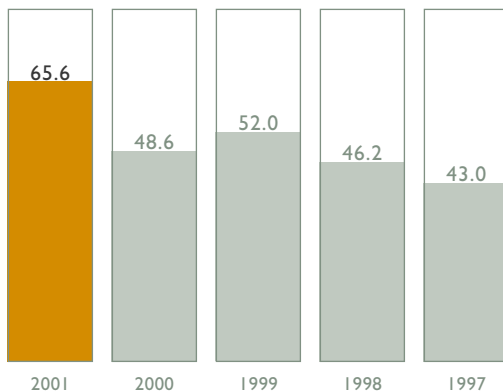
MMIC is rated A (Excellent) by A. M. Best, Inc., a premier independent insurance rating organization. The rating reflects MMIC's financial strength and leadership position in its operating territories. We have maintained an "A" rating, the highest available to medical malpractice specialty companies, since 1992.

### PREMIUM GROWTH

Chaos in the medical malpractice marketplace brought us many opportunities for growth. When others were leaving the market, we had the management and processes in place that enabled us to choose the best of the available accounts and price appropriately.

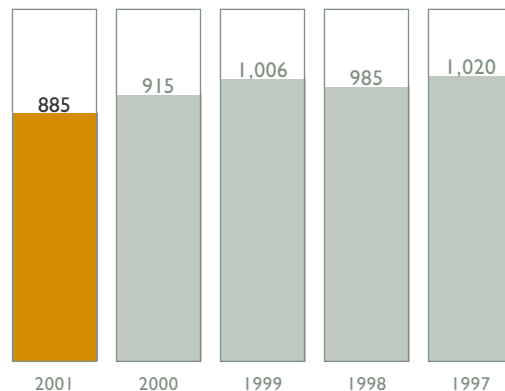
#### PREMIUM GROWTH

*In Millions*



#### AVERAGE UNDERWRITING EXPENSE PER PHYSICIAN

*In Dollars*

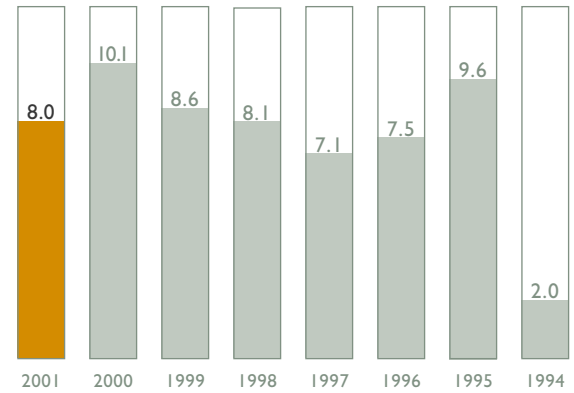


## POLICYHOLDER DIVIDENDS

MMIC continues to return excess profits to qualifying policyholders. Last year we returned \$8 million to policyholders in Minnesota, Iowa, North and South Dakota, and Nebraska. MMIC has returned \$70 million to policyholders over the past eight years, including \$10 million from the stock restructure.

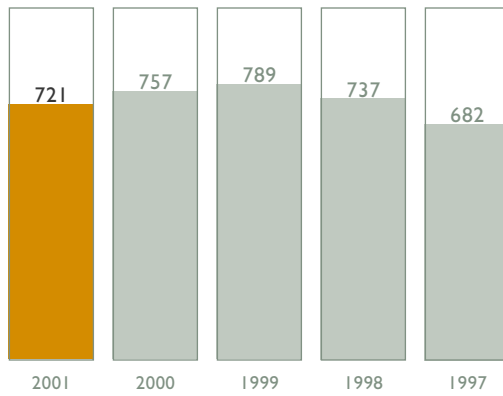
## ANNUAL RETURNS TO POLICYHOLDERS

*In Millions*

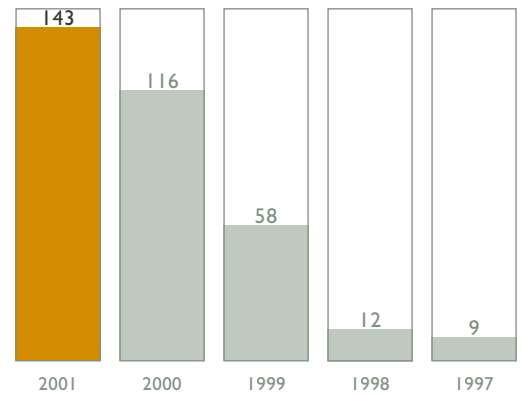


## YEAR-END OPEN CLAIMS

Physicians



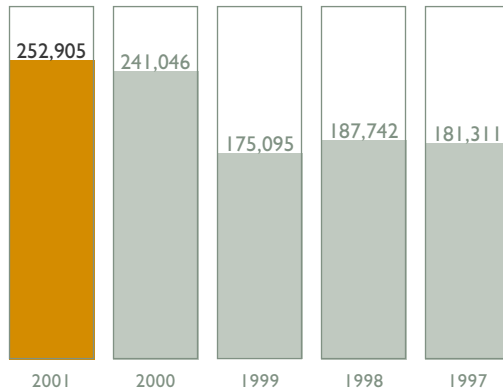
Hospitals



## AVERAGE INDEMNITY PAID

Physician and Clinic Professional Liability Cases

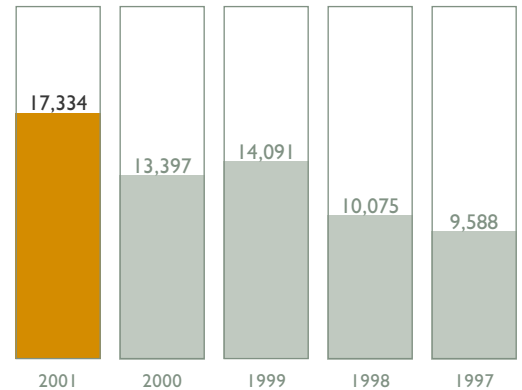
*In Dollars*



## AVERAGE ALLOCATED LOSS ADJUSTMENT EXPENSE

Physician and Clinic Professional Liability Cases

*In Dollars*

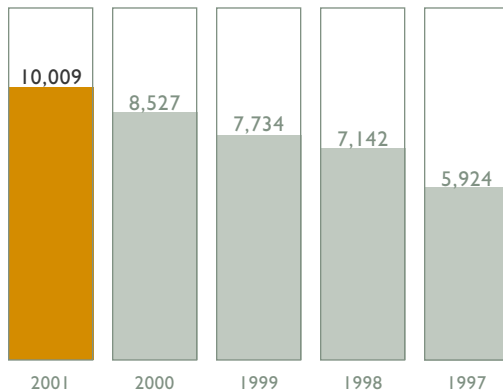


## MARKET SHARE

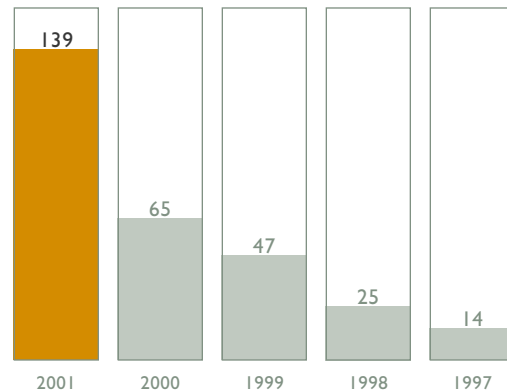
According to A.M. Best's 2000 report, MMIC was second to The St. Paul in market share in our core territory. The report included premiums for all healthcare providers and nursing homes. MMIC writes only physicians, clinics, health systems and hospitals. We are confident that MMIC will be number one in market share in 2002 in each of the states in which we principally write business.

### POLICYHOLDER GROWTH

#### Physicians



#### Hospitals



## TORT REFORM

Historically, we have had tort reform success in Minnesota and North Dakota. In recent years, there has been very little tort legislation at the local level. In 2001, we were active in Minnesota to protect the expert witness rule and the statute of limitations. As we look ahead, we believe MMIC will join forces with other organizations to aggressively push reforms if the availability and affordability of medical malpractice insurance, and concurrently, access to healthcare are significantly compromised. MMIC is also active at the national level through the Physician Insurers Association of America and as a member of the Health Care Liability Alliance in Washington, D.C.

## HIPAA EDUCATION AND AWARENESS

MMIC is a leader in helping policyholders tackle the challenges of the transaction, privacy and security regulations under HIPAA (the Health Insurance Portability and Accountability Act of 1996). We recognized the significance of HIPAA long before there was widespread awareness of the regulations.

Last year working with our affiliate Partners Healthcare Consulting, LLC, we capitalized on an opportunity to develop a range of HIPAA seminars and resources that can be found in the HIPAA Resource Center on the MMIC™medportal Web site ([www.mmicmedportal.com](http://www.mmicmedportal.com)). We believe we are the most complete and authoritative source of HIPAA information and education in the Midwest and perhaps anywhere.

### HIPAA RESOURCE CENTER

As the deadlines for compliance approach, you can find the latest news and updates on HIPAA regulations and compliance and the following materials in the HIPAA Resource Center:

- Plain-English summaries of the HIPAA requirements
- Tools for implementing HIPAA readiness activities
- Links to key HIPAA resources
- Answers to frequently asked questions
- Seminar and workshop dates
- A glossary of terms
- A calendar of significant HIPAA dates

## TECHNOLOGY RESOURCES



When we created Technology Solutions three years ago, we knew it would be a challenge to make it a successful venture for MMIC and its policyholders. But you told us there was a need for these types of services and we saw it as another opportunity to follow our mission to serve independent physicians in a demanding health-care environment. After three very deliberate years of strategic planning and execution, Technology Solutions has exceeded our goals once again in 2001.

### MMIC™ PRACTICE SOLUTIONS

Practice Solutions sold its first two practice management systems in 2001. We offer this product to clinics of all sizes. We were especially proud when two of our policyholders became our first practice management clients.

### MMIC™ TECHNOLOGY CONSULTING

Technology Consulting has a solid and growing client base and continues to serve healthcare organizations across the state of Minnesota offering a variety of network, application and Web site services. Technology Consulting will continue to explore geographical expansion into MMIC's other states when it's practicable.

- Network (LAN, WAN) planning
- Network installation
- Web development
- Network management
- Technology planning
- Application system development/implementation

## MMIC™ MEDPORTAL

At the end of last year, more than 6,500 policyholders were registered members of the MMICmedportal. Users of the [www.mmicmedportal.com](http://www.mmicmedportal.com) Web site continue to grow. The MMICmedportal offers a number of exciting business applications including medical supply purchasing, on-line insurance forms, clinical information and electronic printing. We expect its value to increase as we enhance its content with transcription service and a greater ability to conduct your business with MMIC on-line.

### MMIC™ MEDPORTAL RESOURCES

- MD Consult on-line medical content
- Electronic document printing
- Medical supply purchasing
- Risk management materials
- On-line insurance forms
- HIPAA resource center
- Human resources services

### RISK MANAGEMENT MEDPORTAL RESOURCES

- On-line Publications
  - Risklutions Manual
  - Minimizing Obstetrical Risk Manual
  - Medical Office Staff Handbook
  - Perspective on Prevention newsletters
  - Litigation booklet
  - Malpractice handbook
- Register for seminars
- Request videos

## MMIC'S STRATEGIC ALLIANCES

### PARTNERS HEALTHCARE CONSULTING

Partners specializes in medical practice performance improvement, hospital-physician integration strategies and ambulatory strategic planning on a national basis. They work with medical groups as well as hospitals/health systems that own, operate, or joint venture ambulatory care delivery systems.

- Medical practice business planning and operations improvement
- Physician compensation design
- Coding, reimbursement and compliance
- Network/MSO development and performance improvement
- Health plan contracting
- Hospital/physician integration
- Strategic and market position planning
- Health Insurance Portability and Accountability Act (HIPAA)

### LANGAN AND FLYNN, LLC

Langan and Flynn, LLC, a human resources firm, offers a variety of human resource tools to policyholders. Many of the services are designed especially for healthcare organizations. We offer these services through our Human Resources E-Store on the MMICmedportal Web site, [www.mmicmedportal.com](http://www.mmicmedportal.com). The human resource materials are available 24 hours a day.

- Human Resource policies and forms that can be downloaded and customized
- A hotline where you have access to healthcare human resource professionals
- Employment background screening services
- On-line recruitment service
- Professional license and background checks
- Employment verifications

## MULTIPLE RELATIONSHIPS

We made progress in our multiple relationship cross-selling efforts. At the close of last year, 141 additional policyholders or customers were using more than one of our products or services. Now more than 2,000 physicians purchase more than one of our products and services. Our goal is to help more of our policyholders see the advantage of purchasing many of their healthcare business products from MMIC... a partner they can trust.



## CONDENSED CONSOLIDATED FINANCIAL INFORMATION

UNAUDITED, IN THOUSANDS

## BALANCE SHEETS

	December 31	
	2001	2000
<b>Assets</b>		
Invested assets	\$247,293	\$263,436
Other assets	40,112	38,305
<b>Total assets</b>	<b>\$287,405</b>	<b>\$301,741</b>
<b>Liabilities and shareholders' equity</b>		
Liabilities		
Unpaid losses and loss adjustment expenses	\$118,574	\$118,478
Other liabilities	41,944	42,665
Total liabilities	160,518	161,143
Shareholders' equity	126,887	140,598
<b>Total liabilities and shareholders' equity</b>	<b>\$287,405</b>	<b>\$301,741</b>

## STATEMENTS OF INCOME

	Year Ended December 31	
	2001	2000
<b>Revenues</b>		
Net premiums earned	\$50,097	\$41,344
Net investment income	12,341	12,240
Realized capital gains	6,571	10,502
Other	2,637	4,023
	<b>71,646</b>	<b>68,109</b>
<b>Losses and expenses</b>		
Losses and loss adjustment expenses	58,299	39,587
Underwriting, acquisition and insurance expenses	8,844	7,570
Other operating expenses	6,901	6,822
	<b>74,044</b>	<b>53,979</b>
<b>Operating margin</b>	<b>(2,398)</b>	<b>14,130</b>
Policyholder dividends	4,050	8,108
(Loss) income from continuing operations before tax	(6,448)	6,022
Income tax (benefit) expense	(2,222)	437
(Loss) income from continuing operations after tax	(4,226)	5,585
Discontinued operations, net of tax	(375)	(299)
Net (loss) income	<b>\$ (4,601)</b>	<b>\$ 5,286</b>

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.

## BOARD OF DIRECTORS

ANDREW J.K. SMITH, M.D.  
Neurosurgeon  
Wayzata, Minnesota  
(CHAIR)

MICHAEL D. ABRAMS  
Executive Director  
Iowa Medical Society  
West Des Moines, Iowa

JOHN R. BALFANZ, M.D.  
Pediatrics  
St. Paul, Minnesota

GAIL P. BENDER, M.D.  
Oncology  
St. Louis Park, Minnesota

JAMES R. BISHOP, M.D.  
Director of Medical Affairs  
Edina, Minnesota

DAVID P. BOUNK  
President & CEO, MMIHC  
Minneapolis, Minnesota

TERENCE P. CAHILL, M.D.  
Family Practice  
Blue Earth, Minnesota

PETER J. DALY, M.D.  
Orthopedic  
St. Paul, Minnesota

G. RICHARD GEIER JR., M.D.  
General Surgery  
Rochester, Minnesota

ANTHONY C. JASPERS, M.D.  
Family Practice  
Lake Crystal, Minnesota

JACK L. KLEVEN  
President, MMIC  
Minneapolis, Minnesota

RUSSEL J. KUZEL, M.D.  
Family Practice  
Fargo, North Dakota

WAYNE F. LEEBAW, M.D.  
Endocrinology  
Edina, Minnesota

MARK O. LIABOE, M.D.  
Internal Medicine  
Dubuque, Iowa

PATRICIA J. LINDHOLM, M.D.  
Family Practice  
Fergus Falls, Minnesota

STEPHEN A. McCUE, M.D.  
Obstetrics-Gynecology  
Sunfish Lake, Minnesota

ROGER H. MEYER, M.D.  
Family Practice  
Seward, Nebraska

HAROLD W. MILLER, M.D.  
Family Practice  
Davenport, Iowa

MARK D. ODLAND, M.D.  
General Surgery  
Minneapolis, Minnesota

PAUL S. SANDERS, M.D.  
CEO Minnesota Medical Association  
Family Practice  
Minneapolis, Minnesota

T. MICHAEL TEDFORD, M.D.  
Otolaryngology  
Minneapolis, Minnesota

R. BRUCE TRIMBLE, M.D.  
Rheumatologist  
Mason City, Iowa

TOM D. THROCKMORTON, M.D.  
General Surgery  
Spencer, Iowa

WILLIAM L. YOUMANS, M.D.  
Family Practice  
Minneapolis, Minnesota

## SENIOR MANAGEMENT

DAVID P. BOUNK  
President and  
Chief Executive Officer  
MMIHC

JACK L. KLEVEN  
President and  
Chief Operating Officer  
MMIC

NILES A. COLE  
Chief Financial Officer/  
Vice President of Finance  
MMIHC

THOMAS H. LEE  
Chief Information Officer/  
Vice President Information Systems  
MMIHC

ELIZABETH S. LINCOLN  
Vice President  
Law and Health Policy  
MMIHC

DEBRA L. McBRIDE  
Vice President  
Risk Management  
MMIC

GERALD M. O'CONNELL  
Vice President  
Sales and Marketing  
MMIHC

JULIE J. STAFFORD  
Assistant Vice President  
Underwriting  
MMIC

JERRY A. ZEITLIN  
Vice President of Claim  
MMIC

STEVE N. GERBERDING  
Vice President Operations  
MMIC™ Technology Solutions

STEPHANIE A. KROEGER  
Assistant Vice President  
Human Resources  
MMIHC

ROSALIND M. MILLER  
Director of Communications  
MMIHC

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