

STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF QUALIFYING FINANCIAL EXAMINATION

OF

**BLUEPAWS FAMILY PET INSURANCE COMPANY
PORTLAND, OREGON**

AS OF

October 24, 2000

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October 24, 2000

Honorable Mary C. Neidig, Director
Department of Consumer Business and Services
State of Oregon
350 Winter Street NE, Room 440
Salem, OR 97301-3883

Dear Director:

In accordance with your instructions and pursuant to ORS 731.300, I have examined the business affairs and financial condition of

**BLUEPAWS FAMILY PET INSURANCE COMPANY
11815 NE Glenn Widing Drive
Portland, Oregon 97220**

hereinafter referred to as "Company." The following report is respectfully submitted.

SCOPE OF EXAMINATION

This qualifying examination of the Company was conducted as of October 24, 2000, and included subsequent events that are considered material to the financial condition and compliance with the Oregon Insurance Code.

The examination was conducted pursuant to ORS 731.300 and in accordance with procedures and guidelines prescribed by the National Association of Insurance Commissioners (NAIC).

COMPANY HISTORY

The Company's Articles of Incorporation were approved on October 20, 2000. The Company's Articles of Incorporation authorize 2,000,000 shares of common stock. The Company has applied to become a licensed stock insurer offering property and casualty insurance covering veterinary expenses of pets.

CAPITALIZATION

On October 23, 2000, MMI Holdings, Inc., subscribed to 1,500,000 shares of the common stock of BluePaws Family Pet Insurance Company, an Oregon insurance corporation, with an authorized capital stock consisting of 2,000,000 shares of common stock at \$1.00 par value and agreed to pay for such shares the sum of \$1,500,000.

CORPORATE RECORDS

The examination included a review of the Company's corporate records, which include: Application for Certificate of Authority, Articles of Incorporation, Bylaws, and Certificate of Incorporation.

Board of Directors Meeting Minutes

On October 23, 2000, the directors of the Company waived notice and consented to actions in lieu of an organizational meeting. Among the actions approved were the adoption of the Bylaws, appointment of the present officers, issuance of the stock and its sale to MMI, negotiations of a provider agreement, approval of the funding agreement, signing a managing general agency agreement, authorizing bank accounts and investments, and authorizing officers to transact business necessary to obtain a Certificate of Authority in any jurisdiction. These actions were in compliance with ORS 733.730

Articles of Incorporation

On October 20, 2000, the Department of Consumer and Business Services – Insurance Division issued the Company a Certificate of Incorporation stating the Company’s Articles of Incorporation are in conformity with Oregon statutes.

Bylaws

The Bylaws are in conformity with Oregon statutes.

MANAGEMENT AND CONTROL

The Company’s Board of Directors and their respective affiliation are as follows:

Name and Address

Affiliation

Scott D. Campbell, DVM*
11815 NE Glen Widing Drive

Banfield Pet Hospital – CEO

Portland, OR 97220

Kathryn A Minx
11815 NE Glen Widing Drive
Portland, OR 97220

BluePaws Family Pet Insurance Company
President

Name and Address

Affiliation

Peter Arthur Cheney
3250 E. 44th Street
Vernon, CA 90058

Kal Kan Foods, Inc.
President
(a division of Mars Incorporated)

Richard Edward Rice
10206 No. 108th Place
Scottsdale, AZ 85259

Medical Management International (MMI)
Board of Directors

Phillip L. Francis
19601 North 27th Avenue
Paradise Valley, AZ 85027

PETsMART, Inc.
CEO Board of Directors

*Chairman of the Board

The Board of Directors meets all the provisions of ORS 732.305.

Officers

The officers of the Company, as of October 24, 2000, are as follows:

Name

Title

Scott D. Campbell
Kathryn A. Minx
Robert A. Bruce
Heloise M. Dolan
John D. May

Chairman/Chief Executive Officer
President/Chief Operating Officer
Secretary/Treasurer
Director, Operations
Chief Information Officer

Based on a review of directors and officers biographical affidavits, it appears the Board of Directors and officers possess the insurance experience necessary to manage the affairs of the Company as required for the Company to hold a certificate of authority under the provisions

of ORS 731.386.

Parent and Affiliated Companies

MMI Holdings, Inc., bought 1,500,000 shares of the Company's common stock for \$1,500,000 cash. This gave MMI Holdings, Inc., 100% ownership of the Company's issued and outstanding stock. MMI Holdings, Inc., also owns 100% of Blue Paws, LLC, and Medical Management International, Inc. Blue Paws, LLC, is the managing general agent for the Company, providing all personnel and equipment necessary for the Company's daily operations in return for management fees as outlined in the following section. Medical Management International, Inc. (MMI), owns or is under common management with the veterinarian practices and practice management systems in Oregon and Texas. In some states the veterinarian practices must be professional corporations, incorporated as "A Caring Doctor." Independent franchise owners also use the same business infrastructure as MMI.

MMI Holdings, Inc., through its funding agreement, undertaken to pay directly or through BluePaws, LLC, for the initial organizational and operational expenses of the Company prior to the issuance of a Certificate of Authority to the Company. The Company shall not be obligated to repay the amounts paid for these expenses. Therefore, no liabilities are recorded prior to the issuance of a Certificate of Authority.

Management Agreement

Effective October 23, 2000, the Company entered into a managing general agency agreement with BluePaws, LLC (Manager). Under this agreement the manager provides all the personnel and performs all the daily operations of the Company with only a few exceptions.

These exceptions are that the manager may not commit the Company to a reinsurance contract, collect payment from a reinsurer, appoint a submanager, appoint an agent without checking the agents license, or pay a claim for more than \$10,000 or 1% of the Company's policyholders surplus for the last completed calendar year. Management fees to be paid to the manager are equal to the sum of all annual policy fees paid to the Company for the month; plus a third party administration (TPA) fee equal to actual expenses incurred for policy issue and administration performed not to exceed 10% of the difference between earned premium for the month and the amount of annual policy fees; plus a marketing and general services fee equal to actual expenses incurred for marketing and general services performed, not to exceed 45% of the difference between earned premium for the month and the amount of annual policy fees. The Company retains the costs of losses incurred, income taxes, premium taxes, sales taxes and any other government taxes or assessments and reinsurance costs. At least monthly the manager shall report all transactions and remit all funds due under the agreement to the Company.

The managing general agency agreement complied with the requirements set forth in ORS 744.300 through 744.316.

Following is an explanation of the Company's high expense ratio:

The 55% expense ratio is comparable to expenses ratios of similar veterinarian insurance companies. Pet insurance products are new to the United States. Because of this lack of awareness, the Company must spend heavily on advertising to educate Americans on the value of the product.

Traditional property and casualty products are distributed through the agent/broker network at a normal fee of 20% of first year commissions. For pet insurance, this fee would total \$2 per month per policy (20% times \$10 per month). The normal property and casualty network is not interested in distributing the product for only \$2 per month. The Company is unable to use this channel and will rely on direct response advertising for most of their sales.

The Company will utilize direct response marketing, limited brand advertising, targeted marketing to network providers, marketing to Banfield's Wellness Care Plan subscribers and PETsMART customers, and other strategic relationships to cost-effectively penetrate the market.

In addition, the Company will be setting up a telemarketing team that is staffed by licensed property and casualty agents. These agents will take inbound phone calls and also respond to Web inquiries. The inbound telemarketing function will be expanded to include outbound calling to unfulfilled leads and cold calls. Setting up this licensed sales team is a very costly and labor intensive distribution channel.

Other factors causing a higher expense ratio are as follows:

Advertising

- Brochures in each Banfield and PETsMART
 - Direct mail postcards to all existing Banfield customers
 - Direct mail postcards to Pet owners within a five-mile radius of PETsMART
 - Introductory TV and radio advertisement to launch the product (continue if needed depending on response to direct mail)
-
- Outbound sales calls (hot leads) in response to responses from direct mail
 - Outbound sales calls (cold) to Pet owners
 - An overall goal of keeping the cost per lead under \$15, the cost per sale under \$100

Internet

The Company has developed an e-commerce capability.

- The Company plans to launch an Internet marketing program with PETsMART (petsmart.com) in the early stages of the project.
- The Company will operate an Internet site that will allow for the purchase of policies on-line, including immediate underwriting.
- The Company's insurance site will allow consumers to obtain information on-line, including access to policy and claims payment information.
- The Company's system will allow participating veterinarians to submit claims on-line through the Internet, complete with an eligibility look-up capability.

As noted above, there are significant expenses involved in establishing the distribution system for pet insurance. Once the Company's distribution system is firmly in place the development and marketing expenses should decline as a percentage of premium revenue. In addition, once the member base is established the level of administrative ratio is projected to decline as

economies of scale are realized.

CONFLICT OF INTEREST

The Company requires officers and directors to read the corporate conflict of interest policy and then disclose any conflict of interest on a signed conflict of interest statement.

From a review of the conflict of interest statements, it appeared the affected personnel performed due diligence in disclosing all and any potential conflicts of interest.

FIDELITY BONDS AND OTHER INSURANCE

The Company has adequate insurance coverages in all exposed areas of risk. The examination of these coverages involved determining the methods by which the Company assesses risk, adequacy of limits and retentions, and solvency of the insurers providing the coverages.

Both the Company and BluePaws, LLC, (managing general agent) are named insureds under the policy. Professional liability is covered for aggregate losses up to \$2,000,000.

The crime/bond coverage of \$500,000 met the prescribed minimum coverage as specified by the NAIC. Other major coverages of the Company are general commercial liability, auto liability, and excess liability.

TERRITORY AND PLAN OF OPERATION

The Company plans to provide insurance coverage for veterinary care of pets, primarily cats

and dogs. This type of coverage is not included under ORS 731.162 “Health Insurance”, which applies only to humans. Since veterinary expenses are considered a casualty, casualty insurance as described in ORS 731.158(5) will apply. Marketing is to be through the Internet, at pet stores and veterinarian’s offices. Initially the Company plans to only write business in Oregon, and as growth permits will pursue applications to write in other states.

REINSURANCE

Currently the Company does not have reinsurance coverage. The Company’s maximum retention on any of its policies is \$10,000 per risk. As such, the Company does not retain risk on any one subject in excess of 10% of its surplus to policyholders as prohibited by ORS 731.504.

ACCOUNTS AND RECORDS

The records and source documentation supported the amounts presented in the Company’s October 24, 2000, financial statements and are maintained in a manner by which the financial condition can readily be verified as required by ORS 733.170.

Based on a review of the Company’s accounts, it appears the Company has made sufficient provisions for the recording of all assets, liabilities, surplus, income and expenses related to its proposed operations.

Market Conduct

The Company appears to have adequate procedures and policies in place to transact insurance with the following exceptions:

1. The Company intended to market the plan as both an individual and a group plan. P& C laws do not allow for group plans except in special circumstances. This is being addressed by Jan Vitus, Rates and Forms Analyst.

2. The Company planned to perform mid term cancellations if the pet's age or other factors were incorrect and reenroll them under the correct rate. This can only be done in the first 60 days. After the 60 period has expired, the Company would be unable to alter the policy until the next renewal period unless the insured agrees or unless there was material misrepresentation.

3. The Company's forms allow for preexisting conditions of named items. As in number two, the Company intended to cancel/rewrite the policy if additional preexisting conditions were found. However, if the policy is issued the Company must pay claims on any preexisting conditions not named until the next renewal unless they can prove that it is a material misrepresentation. They can only cancel the policy within the first 60 days if a material misrepresentation is not apparent.

The Company has been informed of these areas and intends to make appropriate changes. I do not believe they should impede the issuance of a Certificate of Authority.

BLUEPAWS FAMILY PET INSURANCE COMPANY
STATEMENT OF ASSETS, LIABILITIES, RESERVES AND OTHER FUNDS
As of October 24, 2000

<u>ASSETS</u>	<u>Per Company</u>	<u>Examination</u>	<u>Per</u>
		<u>Adjustments</u>	<u>Examination</u>
Bonds (Note 1)	\$1,500,000		\$1,500,000
Cash & short term investments	<u>25,000</u>		<u>25,000</u>
Total Assets	<u>\$1,525,000</u>	<u>0</u>	<u>\$1,525,000</u>
 <u>LIABILITIES</u>			
Total Liabilities	<u>\$ 0</u>		<u>\$ 0</u>
 <u>SURPLUS AND OTHER FUNDS</u>			
Common stock	\$1,500,000		\$1,500,000
Gross paid in and contributed surplus	0		0
Unassigned funds	<u>25,000</u>		<u>25,000</u>
Surplus as regards policyholders	<u>\$1,525,000</u>	<u>-0-</u>	<u>\$1,525,000</u>
Total Liabilities and Other Funds	<u>\$1,525,000</u>	<u>-0-</u>	<u>\$1,525,000</u>

NOTES TO THE FINANCIAL STATEMENTS

Note 1 - Assets

Following are the government bonds held in trust at Wells Fargo Bank NA., October 19, 2000:

<u>CUSIP #</u>	<u>Issuer</u>	<u>Maturity Date</u>	<u>Par Value</u>	<u>Cost</u>	<u>NAIC Desig.</u>	<u>Yield</u>
313588R56	FNMA	11/30/00	\$620,000.00	\$625,565.97	1	6.250%
3133396S46	FHLMC	12/07/00	416,000.00	412,529.06	1	6.267%
313397BH3	FHLMC	02/01/01	480,000.00	471,460.00	1	6.267%
	Total		1,516,000.00	1,499,555.03		

Wells Fargo 100% Treasury Money Market Fund 444.97

Total Invested \$1,500,000.00

Pursuant to ORS 732.105(2), the following amount was on deposit with the Oregon Insurance Division at US National Bank as a corporate security bond to obtain a Certificate of Authority.

<u>Issuer</u>	<u>Maturity Date</u>	<u>Days</u>	<u>Par Value</u>	<u>Cost</u>	<u>NAIC Desig.</u>	<u>Yield</u>
US Treasury Bills	04/19/01	151	25,000.00	24,293.86	1	

Though the Company could withdraw the \$25,000 security after obtaining their Certificate of Authority, their intention is to leave it on deposit and increase it to \$50,000. This would help them meet the certificate of authorization requirements for Texas.

CONCLUSION

I recommend the Company be granted a Certificate of Authority. Under the current scenario the managing general agent agreement allocates enough of the net premium (55%) to Blue Paws, LLC, that if the incurred loss ratio rises above the projected 43% level, the Company could quickly lose money. Based on a conversation with their actuary, Peggy Onstott, losses are projected to reach an average 50% level. These projections assume lower losses in the first year with higher losses in subsequent years. I recommend the Company be closely monitored to ensure it remains solvent.

SUBSEQUENT EVENT

Subsequent to the date of this examination report, the company changed its name from BluePaws Family Pet Insurance Company to BluePaw Family Pet Insurance Company, effective November 13, 2000.

ACKNOWLEDGMENT

The examiner wishes to express his appreciation for the cooperation extended by the officers and employees of the Company during the course of the examination.

Respectfully submitted,

Michael P. Phillips, CFE, CPA, AES
Insurance Examiner
Insurance Division
Department of Consumer and Business Services
State of Oregon

AFFIDAVIT

STATE OF OREGON))
County of Marion) ss

Michael P. Phillips, being duly sworn, deposes and says that the foregoing qualifying financial report of examination as of October 24, 2000, BluePaws Family Pet Insurance Company, Portland, Oregon, subscribed by him is true to the best of his knowledge and belief.

Michael P. Phillips, CFE, CPA, AES
Insurance Examiner
Insurance Division
Department of Consumer and Business Services
State of Oregon

Subscribed and sworn before me this _____ day of _____, 2000.

Notary Public in and for the State of Oregon

My commission expires _____