

JUN 19 2018

FILED

CERTIFICATION

June 19, 2018

I, Bruce R. Range, Director of Insurance of the State of Nebraska, do hereby certify
that the attached is a full and correct copy of the Financial Examination Report of

PHYSICIANS LIFE INSURANCE COMPANY

as of

December 31, 2016

The report is now on file and forming a part of the records of this Department.

I hereto subscribe my name under the seal of my office at Lincoln, Nebraska.



Bruce R. Range

DIRECTOR OF INSURANCE

CERTIFICATE OF ADOPTION

Notice of the proposed report for the financial examination of

PHYSICIANS LIFE INSURANCE COMPANY

dated as of December 31, 2016 verified under oath by the examiner-in-charge on
May 25, 2018 and received by the company on May 29, 2018, has been adopted
without modification as the final report pursuant to Neb. Rev. Stat. § 44-5906(3) (a).

Dated this 8th day of June 2018.

STATE OF NEBRASKA
DEPARTMENT OF INSURANCE

A handwritten signature in black ink, appearing to read 'Justin C. Schrader', is written over a horizontal line.

Justin C. Schrader, CFE
Chief Financial Examiner

STATE OF NEBRASKA

Department of Insurance

EXAMINATION REPORT

OF

PHYSICIANS LIFE INSURANCE COMPANY

as of

December 31, 2016



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Omaha, Nebraska
May 24, 2018

Honorable Bruce R. Ramage
Director of Insurance
Nebraska Department of Insurance
941 "O" Street, Suite 220
Lincoln, Nebraska 68508

Dear Sir:

Pursuant to your instruction and authorizations, and in accordance with statutory requirements, an examination has been conducted of the financial condition and business affairs of:

PHYSICIANS LIFE INSURANCE COMPANY
2600 Dodge Street
Omaha, Nebraska 68131

(hereinafter also referred to as the "Company") and the report of such examination is respectfully presented herein.

INTRODUCTION

The Company was last examined as of December 31, 2012 by the State of Nebraska. The current financial condition examination covers the intervening period to, and including, the close of business on December 31, 2016, and includes such subsequent events and transactions as were considered pertinent to this report. The State of Nebraska participated in this examination and assisted in the preparation of this report.

The same examination staff conducted a concurrent financial condition examination of the Company's parent, Physicians Mutual Insurance Company (PMIC).

SCOPE OF EXAMINATION

This examination was conducted pursuant to and in accordance with both the NAIC Financial Condition Examiners Handbook (Handbook) and Section §44-5904(1) of the Nebraska

Insurance Statutes. The Handbook requires that examiners plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including, but not limited to: corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. The examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and Annual Statement Instructions, when applicable to domestic state regulations.

A general review was made of the Company's operations and the manner in which its business has been conducted in order to determine compliance with statutory and charter provisions. The Company's history was traced and has been set out in this report under the caption "Description of Company". All items pertaining to management and control were reviewed, including provisions for disclosure of conflicts of interest to the Board of Directors and the departmental organization of the Company. The Articles of Incorporation and By-Laws were reviewed, including appropriate filings of any changes or amendments thereto. The minutes of the meetings of the Shareholder, Board of Directors and committees, held during the examination period, were read and noted. Attendance at meetings, proxy information, election of Directors and Officers, approval of investment transactions and authorizations of salaries were also noted.

The fidelity bond and other insurance coverages protecting the Company's property and interests were reviewed, as were plans for employee welfare and pension. Certificates of Authority to conduct the business of insurance in the various states were inspected and a survey was made of the Company's general plan of operation.

Data reflecting the Company's growth during the period under review, as developed from the Company's filed annual statements, is reflected in the financial section of this report under the caption "Body of Report".

The Company's reinsurance facilities were ascertained and noted, and have been commented upon in this report under the caption "Reinsurance". Accounting records and procedures were tested to the extent deemed necessary through the risk-focused examination process. The Company's method of claims handling and procedures pertaining to the adjustment and payment of incurred losses were also noted.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This included a review of workpapers prepared by Deloitte & Touche LLP, the Company's external auditors, during their audit of the Company's accounts for the years ended December 31, 2015 and 2016. Portions of the auditor's workpapers have been incorporated into the workpapers of the examiners and have been utilized in determining the scope and areas of emphasis in conducting the examination. This utilization was performed pursuant to Title 210 (Rules of the Nebraska Department of Insurance), Chapter 56, Section 013.

Any failure of items to add to the totals shown in schedules and exhibits appearing throughout this report is due to rounding.

DESCRIPTION OF COMPANY

HISTORY

The Company was incorporated under the laws of the State of Nebraska as a capital stock life insurance company on January 15, 1970, and was licensed to commence business on January 28 of that same year. It was and has remained a wholly owned subsidiary of Physicians Mutual Insurance Company since the date of incorporation. The Amended and Restated Articles of

Incorporation provide that the Company shall have perpetual existence. Under provisions of its current charter, and in conformity with Nebraska Statutes, the Company is authorized to write the kinds of insurance prescribed in Section 44-201, Subsections (1) and (4), of the Nebraska Insurance Statutes (life and sickness and accident).

MANAGEMENT AND CONTROL

Holding Company

The Company is a member of an insurance holding company system as defined by Nebraska Statute. An organizational listing flowing from the ‘Ultimate Controlling Person’, as reported in the 2016 Annual Statement, is represented by the following (subsidiaries are denoted through the use of indentations, and unless otherwise indicated, all subsidiaries are 100% owned):

- Physicians Mutual Insurance Company
 - Physicians Life Insurance Company
 - MD45 Transport, LLC
 - Physicians Mutual Insurance Company Foundation
 - Physicians Mutual Employee Benefit Trust
 - Physicians Mutual Services Corporation
 - Seniors Information Network, LLC
 - National Association of Medicare Members, Inc.

Shareholder

Article IV of the Company’s Articles of Incorporation states, “the aggregate number of shares which the Company shall have authority to issue is One Million Five Hundred Thousand (1,500,000) shares of common stock, and the par value of each said share is One Dollar and 67/100 (\$1.67).” As of the examination date, Company records indicate that 1,500,000 shares are issued and outstanding for capital of \$2,505,000, and are all owned by Physicians Mutual Insurance Company (PMIC). As of the examination date the Company’s paid-in surplus is \$102,487,905, which is unchanged since the previous examination. There have been stock

dividends totaling \$200,000 and cash dividends totaling \$5,800,000 paid since inception of the Company. There were no dividends paid during this examination period.

The By-Laws state, “the annual meeting of the shareholders shall be held on the third Saturday in the month of February in each year...at the principal office of the Company, for the purposes of receiving the reports of the Officers, electing Directors and for the transaction of such other business as may properly come before the meeting.”

Board of Directors

Article III of the By-Laws states, “the Board of Directors shall consist of not less than five (5), divided into three (3) groups as nearly equal in number as is possible.”

The following persons were serving as Directors at December 31, 2016:

<u>Name and Residence</u>	<u>Principal Occupation</u>
Dale E. Brett, M.D. Omaha, Nebraska	Retired Physician and Treasurer of the Company
James T. Canedy, M.D. Omaha, Nebraska	Practicing Physician and Secretary of the Company
William A. Cuttler, III Omaha, Nebraska	Funeral Director
Timothy C. Fitzgibbons, M.D. Omaha, Nebraska	Practicing Physician
Martin M. Mancuso, M.D. Omaha, Nebraska	Practicing Physician
Robert A. Reed Omaha, Nebraska	Executive Chairman of the Board of Directors & Senior Finance and Strategic Counsel
Robert A. Reed Jr. Omaha, Nebraska	President and Chief Executive Officer of the Company
John D. Woodbury, M.D. Omaha, Nebraska	Retired Physician

Officers

Article VI of the Articles of Incorporation states, “the Officers of the Company shall consist of a President, a Secretary and a Treasurer who shall be elected by the Directors and who shall hold office until their successors are elected and qualified. The Directors may select one or more Vice Presidents and may designate one or more other offices, and assign their duties and responsibilities.”

The Officers are nominated by the Compensation Committee on an annual basis, with the exception of Robert Reed, Sr. and Robert Reed, Jr., who are under contract with the Company.

The following is a listing of Senior Officers elected and serving the Company at December 31, 2016:

<u>Name</u>	<u>Office</u>
Robert A. Reed	Executive Chairman of the Board of Directors and Senior Finance and Strategic Counsel
Robert A. Reed Jr.	President and Chief Executive Officer
James T. Canedy, M.D.	Secretary
Dale E. Brett, M.D.	Treasurer
Melissa J. Crawford	Senior Vice President - Markets, Products and Technology
Howard G. Daubert	Senior Vice President – Corporate Services Group
Robert L. Gunia	Senior Vice President – Public Affairs Group and Assistant Secretary
Edward J. Kaspar	Senior Vice President – Customer Group
Michael J. Wade	Senior Vice President – Chief Financial Officer and Assistant Treasurer

Committees

Article III of the Company’s By-Laws states, “the Board of Directors, may designate from its members an Executive Committee, which shall consist of at least three Directors, together with the Chairman of the Board, the President and the Secretary, which shall have and may exercise all the authority of the Board of Directors when the entire Board of Directors are

not in session; the Board of Directors may also designate one or more other committees consisting of at least two Directors.”

The following persons were serving on the Investment Committee at December 31, 2016:

Dale E. Brett, M.D.	James T. Canedy, M.D.
Robert A. Reed	Robert A. Reed, Jr.
Steven A. Scanlan	Michael J. Wade
John D. Woodbury, M.D.	

The following persons were serving on the Underwriting Committee at December 31, 2016:

Dale E. Brett, M.D.	James T. Canedy, M.D.
William A. Cutler, III	Timothy C. Fitzgibbons, M.D.
Edward J. Kaspar	Martin M. Mancuso, M.D.
Robert A. Reed	Robert A. Reed, Jr.
John D. Woodbury, M.D.	

The following persons were serving on the Claim Committee at December 31, 2016:

Dale E. Brett, M.D.	James T. Canedy, M.D.
William A. Cutler, III	Timothy C. Fitzgibbons, M.D.
Edward J. Kaspar	Therese M. McDermott
Martin M. Mancuso, M.D.	Robert A. Reed
Robert A. Reed, Jr.	John D. Woodbury, M.D.

The following persons were serving on the Audit Committee at December 31, 2016:

Dale E. Brett, M.D.	James T. Canedy, M.D.
Robert A. Reed	Robert A. Reed, Jr.
Michael J. Wade	John D. Woodbury, M.D.

The following persons were serving on the Compensation Committee at December 31, 2016:

Dale E. Brett, M.D.	James T. Canedy, M.D.
Martin M. Mancuso, M.D.	John D. Woodbury, M.D.

TRANSACTIONS WITH AFFILIATES

Service Agreement

PMIC provides equipment, space and personnel necessary for the operations of its subsidiaries. By agreement dated June 24, 1997 and amended January 1, 2004, PMIC agrees to perform all reasonable services necessary in connection with the solicitation, issuance, and servicing of policies and claims in connection with policies previously issued and hereafter issued by the Company. Compensation for these services is the actual salary represented by the time spent in the performance of such services, and costs and expenses associated with respect to equipment, office space and other overhead expenses represented by the time and use devoted to such services. PMIC is also to receive payment for any direct expenses paid on behalf of the Company. Upon 60 day's prior written notice to the other party, either party may terminate the Agreement. The total expenses allocated under this agreement to the Company during 2016 and 2015 were \$34,952,361 and \$35,076,361, respectively.

Net Worth Agreement

The Company entered into a Net Worth Agreement with PMIC effective January 1, 1993, whereby PMIC agrees to take any actions necessary to maintain the Company's financial position with a surplus level in excess of Risk Based Capital requirements.

This agreement can be canceled by either party with a written 90 day notice provided such termination does not eliminate the obligation of PMIC to infuse cash into the Company with respect to the obligation to support, supplement, or permit the timely payment of contractual claims received by the Company from policyholders of insurance contracts or annuity contracts during the term of the agreement.

TERRITORY AND PLAN OF OPERATION

As evidenced by current or continuous Certificates of Authority, the Company is licensed to transact business in all states, with the exception of New York, and the District of Columbia.

The Company currently writes life, pre-need, accident and health insurance, and fixed annuities. During the period covered by this examination, business was produced by direct mail, television, radio, newspaper, email and internet advertisement through the Company's direct marketing channels and by personal solicitation through the Agency and Pre-need Divisions. The Brokerage Division was terminated in July, 2006. The Company continues to receive renewal premiums on policies sold by brokers. The direct marketing channels produced approximately 71% of the Company's net written premium during 2016. The Agency Division produced approximately 4% of the Company's net written premium during 2016. The Pre-need Division produced approximately 25% of the Company's net written premium during 2016.

The direct marketing channels include the Direct Marketing Group, the Telesales Department and the eCommerce Department. These departments are each under the direction of an Officer of the Company and focus on both the acquisition of new customers and gaining additional sales from existing customers.

The Agency Division is under the direction of the Agency Vice President who is assisted by two Vice Presidents of Agency Administration. In addition, the Company utilizes the services of two salaried full-time field employees as Regional Managers. Each such manager has a proportionate number of Division Managers under his or her supervision. The Division Managers are full-time employees and act exclusively for the Company. They are authorized to recruit, appoint and train agents within their territories, subject to Home Office approval. They receive

remuneration in the form of overwrite commissions on business produced by agents under their supervision.

At December 31, 2016, the Company's agency force was comprised of the following:

Division Managers	19
Contracted Agents	911

The contracted agents are independent contractors who act as career agents for the Company. All contacted agents receive commissions and can also earn cash bonuses and lead or advertising credits by meeting production and persistency requirements.

REINSURANCE

Assumed

The Company entered into an automatic 50% Coinsurance life agreement with AAA Life Insurance Company (AAA), effective January 1, 1999 and amended September 27, 2001 and July 31, 2002. The recent amendment added PMIC as a party to the agreement.

Effective February 1, 2003, the Company entered into a retrocession agreement whereby Transamerica International Re, retroceded 20% of the yearly renewable term business to the Company under a quota share agreement.

Ceded

Effective January 1, 2004, the Company entered into a reinsurance agreement with PMIC that replaced the previous reinsurance agreement effective January 1, 2003. Per the January 1, 2004 agreement, the Company cedes 100% of the liabilities associated with Medicare Supplement insurance. The Company is paid a "front fee allowance" of 3% of premiums. The Company terminated sales of its Medicare Supplement business in 2009. Medicare Supplement business is currently sold through PMIC. This agreement is still in effect, with premiums of \$68,617,017, and reserves ceded of \$14,040,305 in 2016.

Effective February 1, 2003 the Company reinsured its new 10 and 20-year term plans with Transamerica Reinsurance Company (Transamerica) under a series of three treaties. The first treaty was a 100% first dollar quota share arrangement. Treaty two was a retrocession agreement whereby Transamerica's Bermuda affiliate, Transamerica International Re, retroceded 20% of the business back to the Company under a quota share arrangement. Under treaty three, the Company reinsured any excess above face amounts of \$100,000 to Transamerica. Because Transamerica was also the underwriter, a facultative agreement was not needed.

General

All contracts reviewed contained standard insolvency, arbitration, errors and omissions, and termination clauses where applicable. All contracts contained the clauses necessary to assure reinsurance credits could be taken.

BODY OF REPORT

GROWTH

The following comparative data reflects the growth of the Company during the period covered by this examination:

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
Bonds	\$1,252,308,570	1,309,195,130	1,356,938,433	1,435,718,433
Admitted assets	1,378,696,838	1,430,485,171	1,490,669,926	1,596,430,967
Aggregate reserves for life contracts	1,109,506,614	1,167,618,855	1,223,130,562	1,295,174,267
Total liabilities	1,256,042,660	1,300,423,290	1,352,772,812	1,445,651,585
Capital and surplus	122,654,178	130,061,881	137,897,114	150,779,382
Premium income	248,611,776	262,427,101	275,047,276	296,521,342
Net investment income	62,703,957	65,281,754	65,401,518	67,055,016
Death benefits	124,790,470	131,195,395	139,196,159	136,358,103
Net income	8,348,361	7,044,437	6,415,653	13,187,803

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the State of Nebraska Department of Insurance and present the financial condition of the Company for the period ending December 31, 2016. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statements and should be considered an integral part of the financial statements. A reconciliation of the capital and surplus account for the period under review is also included.

FINANCIAL STATEMENT **December 31, 2016**

<u>Assets</u>		<u>Assets Not</u>	<u>Net</u>
	<u>Assets</u>	<u>Admitted</u>	<u>Admitted</u>
			<u>Assets</u>
Bonds	\$1,435,718,433		\$1,435,718,433
Preferred stocks	31,035,016		31,035,016
Common stocks	3,470,300		3,470,300
Cash and short-term investments	55,390,288		55,390,288
Contract loans	27,210,582	\$ 17,009	27,193,573
Derivatives	8,256,413		8,256,413
Other invested assets	3,515,749		3,515,749
Receivables for securities	<u>205,512</u>	<u> </u>	<u>205,512</u>
Subtotal, cash and invested assets	\$1,564,802,294	\$ 17,009	\$1,564,785,285
Investment income due and accrued	14,693,597		14,693,597
Amounts recoverable from reinsurers	75,000		75,000
Other amounts receivable under reinsurance contracts	286,123		286,123
Current federal income tax recoverable	74,410		74,410
Net deferred tax asset	38,218,987	22,219,168	15,999,819
Guaranty funds receivable	204,628		204,628
Receivables from parent, subsidiary and affiliates	312,105		312,105
Other amounts receivable	774,476	774,476	
Debit suspense items	<u>819,179</u>	<u>819,179</u>	<u> </u>
Totals	<u>\$1,620,260,798</u>	<u>\$23,829,832</u>	<u>\$1,596,430,967</u>

Liabilities, Surplus, and Other Funds

Aggregate reserves for life contracts	\$1,295,174,267
Liability for deposit-type contracts	22,817,303
Contract claims for life	16,889,248
Premiums and annuity considerations	2,005,435
Other amounts payable on reinsurance	173,427
Interest maintenance reserve	7,399,649
Commissions to agents due or accrued	251,851
General expenses due or accrued	879,765
Taxes, licenses and fees	1,053,561
Current federal income taxes	2,470,913
Unearned investment income	875,899
Amounts withheld or retained by company as agent or trustee	849,996
Remittances and items not allocated	933,624
Borrowed money	75,043,633
Asset valuation reserve	10,377,432
Drafts outstanding	8,319,822
Payable for securities	91,402
Miscellaneous interest	<u>44,359</u>
Total liabilities	<u>\$1,445,651,585</u>
Common capital stock	\$ 2,505,000
Gross paid in and contributed surplus	102,487,905
Unassigned funds	<u>45,786,477</u>
Total capital and surplus	<u>\$ 150,779,382</u>
Totals	<u>\$1,596,430,967</u>

SUMMARY OF OPERATIONS – 2016

Premiums and annuity considerations	\$296,521,342
Considerations for supplementary contracts with life contingencies	2,989,299
Net investment income	67,055,016
Amortization of interest maintenance reserve	1,118,011
Commissions and expense allowances on reinsurance ceded	1,668,813
Income on derivatives	2,337,629
Change in market value on derivatives	5,134,955
Miscellaneous income	<u>2,411,366</u>
Totals	\$379,236,431
Death benefits	136,358,103
Matured endowments	341,426
Annuity benefits	20,356,593
Surrender benefits and withdrawal for life contracts	37,684,194
Interest and adjustments on contract or deposit-type contract funds	540,230
Payments on supplementary contracts with life contingencies	2,553,860
Increase in aggregate reserves for life and accident and health contracts	<u>72,043,705</u>
Totals	\$269,878,112
Commissions on premiums, annuity considerations, and deposit type contract funds	14,360,706
Commissions and expense allowances on reinsurance assumed	507,100
General insurance expenses	62,489,947
Insurance taxes, licenses and fees	6,725,004
Cost of derivatives	<u>5,233,821</u>
Totals	\$359,194,690
Net gain from operations	20,041,741
Federal income taxes incurred before federal income taxes and net realized gains	6,435,801
Net realized capital losses	<u>(418,137)</u>
Net income	<u>\$ 13,187,803</u>

CAPITAL AND SURPLUS ACCOUNT

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
Capital and surplus, beginning	\$115,837,916	\$122,654,180	\$130,061,881	\$137,897,114
Net income	\$ 8,348,361	\$ 7,044,437	\$ 6,415,653	\$ 13,187,803
Change in net unrealized capital gains	642,061	31,886	(186,679)	(153,136)
Change in net deferred income tax	(897,697)	(493,824)	(180,017)	(70,399)
Change in nonadmitted assets	1,665,574	1,135,288	(476,138)	216,921
Cumulative effect of changes in accounting principles	(462,388)			
Change in asset valuation	(2,479,648)	(310,085)	2,262,414	(298,921)
Net change for the year	<u>\$ 6,816,263</u>	<u>\$ 7,407,701</u>	<u>\$ 7,835,233</u>	<u>\$ 12,882,268</u>
Capital and surplus, ending	<u>\$122,654,180</u>	<u>\$130,061,881</u>	<u>\$137,897,114</u>	<u>\$150,779,382</u>

EXAMINATION CHANGES IN FINANCIAL STATEMENTS

Unassigned funds (surplus) in the amount of \$45,786,477, as reported in the Company's 2016 Annual Statement, has been accepted for examination purposes. Examination findings, in the aggregate, were considered to have no material effect on the Company's financial condition.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

The recommendations appearing in the previous report of examination are reflected below together with the remedial actions taken by the Company to comply therewith:

Custodial Agreement – It is recommended that the Company revise its custodial agreement with FHLB of Topeka to include all provisions related to safeguards and controls of securities pursuant to Title 210 (Nebraska Department of Insurance Rules and Regulations), Chapter 81.

Action: The Company has complied with this recommendation.

Schedule Y – It is recommended the Company disclose the Physicians Mutual Insurance Company Foundation and the Company's trusts for the benefit of employees in its Schedule Y in each of the individual annual statements in accordance with NAIC Annual Statement Instructions and SSAP No. 25.

Action: The Company has complied with this recommendation.

COMMENTARY ON CURRENT EXAMINATION FINDINGS

There are no comments or recommendations that have been made as a result of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

There are no comments or recommendations that have been made as a result of this examination.

ACKNOWLEDGMENT

The courteous cooperation extended by the Officers and employees of the Company during this examination is hereby acknowledged.

In addition to the undersigned, Kim Hurst, CFE, Derek Petersen, CFE, Linda Scholl, CISA, CFE, APIR, Santosh Ghimire, Kolby Shanks, and Joel Tapsoba Financial Examiners; Gary Evans, CISA, AES, Information Systems Specialist; and Rhonda Ahrens, FSA, and Derek Wallman; Actuarial Examiners; all with the Nebraska Department of Insurance, participated in this examination and assisted in the preparation of this report.

Respectfully submitted,



Tadd K. Wegner
Supervisory Examiner
Department of Insurance
State of Nebraska

State of Nebraska,

County of Lancaster,

Tadd K. Wegner, being duly sworn, states as follows:

1. I have authority to represent the Department of Insurance of the State of Nebraska in the examinations of Physicians Mutual Insurance Company and Physicians Life Insurance Company. The Department of Insurance of the State of Nebraska is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
2. I have reviewed the examination work papers and examination report, and the examinations of Physicians Mutual Insurance Company and Physicians Life Insurance Company was performed in a manner consistent with the standards and procedures required by the Department of Insurance of the State of Nebraska.

The affiant says nothing further.

Tadd K. Wegner
Examiner-in-Charge's Signature

Subscribed and sworn before me by Tadd K. Wegner on this 25th day of May, 2018.

(SEAL)



Lori L. Bruss
Notary Public

My commission expires July 21, 2020 [date].