

AMERICAN PHYSICIANS SERVICE GROUP INC  
Form 10-K/A  
May 02, 2007

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K/A**

**(Amendment No. 1)**

- Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2006**
- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**Commission File Number: 0-11453**

**AMERICAN PHYSICIANS SERVICE GROUP, INC.**

(Exact name of registrant as specified in its charter)

**Texas**

(State or other jurisdiction of incorporation or organization)

**1301 Capital of Texas Highway, Suite C-300, Austin Texas**

(Address of principal executive offices)

**Registrant's telephone number, including area code: (512) 328-0888**

**75-1458323**

(I.R.S. employer Identification No.)

**78746**

(Zip Code)

**Securities registered pursuant to Section 12(b) of the Act:**

Title of each class

Name of each exchange

None

on which registered

None

**Securities registered pursuant to Section 12(g) of the Act:**

**Common Stock, \$0.10 par value**

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated

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by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to

the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last

business day of the registrant's most recently completed second fiscal quarter.

Aggregate Market Value at June 30, 2006: \$31,614,017

Indicate the number of shares outstanding of each of the registrant's class of common stock, as of the latest practicable date.

**Number of Shares Outstanding At**

**Title of Each Class**

**March 1, 2007**

Common Stock, \$.10 par value

2,815,445

**Documents Incorporated By Reference**

Selected portions of the Registrant's definitive proxy material for the 2006 annual meeting of shareholders are incorporated by reference into Part III of the Form 10-K.

**EXPLANATORY NOTE**

American Physicians Service Group, Inc. is filing this Amendment No. 1 on Form 10-K/A (the Amendment No. 1) to its Annual Report on Form 10-K for the year ended December 31, 2006 (the 2006 Form 10-K), which was originally filed with the Securities and Exchange Commission on March 30, 2007, solely to correct a typographical error found in a table presenting selected financial data for our managed malpractice insurance exchange, American Physicians Insurance Exchange (APIE). This error, which is explained in further detail below, has no effect on any financial data presented in our consolidated financial statements included in the 2006 Form 10-K.

The typographical error is found on page 5 of the original 2006 Form 10-K filing within the selected financial data table for APIE. The line item entitled Members equity, along with all of the corresponding data within this line item for the years ended December 31, 2006, 2005, 2004 and 2003, was entered in error. This Amendment No. 1 corrects the error with a replacement line item entitled Statutory surplus along with the presentation of new, correct data within this line item for the years mentioned above.

Pursuant to Rule 12b-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act), this Amendment No. 1 amends Item 1 in its entirety and contains new certifications of our Chief Executive Officer and Chief Financial Officer.

This Amendment No. 1 contains only the item to the original filing that is being amended, and those unaffected parts or exhibits are not included herein. This Amendment No. 1 continues to reflect the financial position of the Company as of the date of the original filing and we have not updated the disclosure contained herein to reflect events that have occurred since the date of the original filing. Accordingly, this Amendment No. 1 should be read in conjunction with our other filings made with the Securities and Exchange Commission.

**AMERICAN PHYSICIANS SERVICE GROUP, INC.**

**ANNUAL REPORT ON FORM 10-K**

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006**

References in this report to we, us, our, and the Company mean American Physicians Service Group, Inc.

**PART I**

**ITEM 1. BUSINESS**  
**General**

We, through our subsidiaries, provide services that include brokerage and investment services to individuals and institutions, and management and agency services to malpractice insurance companies.

We were organized in October 1974 under the laws of the State of Texas. Our principal executive office is at 1301 Capital of Texas Highway, Suite C-300, Austin, Texas 78746, and our telephone number is (512) 328-0888. Our website is [www.amph.com](http://www.amph.com). We make available free of charge on our website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission, or the SEC.

Financial information about our industry segments is disclosed in Note 16 to our accompanying consolidated financial statements in Appendix A hereof.

**Our Insurance Services**

APS Insurance Services, Inc., or Insurance Services, is our wholly-owned subsidiary. Prior to October 1, 2003, we owned 80% of Insurance Services. On October 1, 2003, we acquired the remaining 20% minority interest in Insurance Services for approximately \$2.0 million in cash (see Note 14 to our consolidated financial statements included herein). Insurance Services, through its wholly-owned subsidiaries APS Facilities Management, Inc., dba APMC Insurance Services, Inc., or FMI, and American Physicians Insurance Agency, Inc., or Agency, provides management and agency services to American Physicians Insurance Exchange, or APIE, a reciprocal insurance exchange. Our revenues from this segment contributed 48%, 46% and 48% of our total revenues in 2006, 2005 and 2004, respectively.

Substantially all of our revenue from the insurance services segment was attributable to FMI providing management services to APIE. A reciprocal insurance exchange is an organization that sells insurance only to its subscribers, who may pay, in addition to their annual insurance premiums, a contribution to the exchange's surplus. These exchanges generally have the need for few, if any paid employees and, instead, enter into a contract with an attorney-in-fact that provides all management and administrative services for the exchange. As the attorney-in-fact for APIE, FMI receives a percentage of the earned premiums of APIE, as well as a portion of APIE's profits. The amount of these premiums can be adversely affected by competition. Substantial underwriting losses, which might result in a curtailment or cessation of operations by APIE, would also adversely affect FMI's revenue and, accordingly, our revenue. To limit possible underwriting losses, APIE currently reinsures its risk in excess of \$250,000 per medical incident. APIE offers medical professional liability insurance for physicians in Texas and Arkansas. FMI's assets are not subject to any insurance claims by policyholders of APIE. FMI has been APIE's exclusive manager since APIE's inception in 1975. The management agreement between FMI and APIE provides for full management by FMI of the affairs of APIE under the direction of APIE's physician board of directors. Subject to the direction of this board, FMI sells and issues policies, investigates, settles and defends claims, and otherwise

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manages APIE's day to day operations. As described below, in consideration for performing its services, FMI receives a management fee based on APIE's earned premiums (before payment of reinsurance premiums), as well as a portion of APIE's profits. FMI pays salaries and personnel related expenses, rent and office operations costs, information technology costs and many other operating expenses of APIE. APIE is responsible for the payment of all claims, claims expenses, peer review expenses, directors' fees and expenses, legal, actuarial and auditing expenses, its taxes, outside agent commissions and certain other specific expenses. Under the management agreement, FMI's authority to act as manager of APIE is automatically renewed each year unless a majority of the subscribers to APIE elect to terminate the management agreement by reason of an adjudication that FMI has been grossly negligent, has acted in bad faith or with fraudulent intent or has committed willful misfeasance in its management activities. Termination of FMI's management agreement with APIE would have a material adverse effect on us.

APIE is authorized to do business in the States of Texas and Arkansas, and specializes in writing medical professional liability insurance for physician groups, individual physicians and other healthcare providers. APIE currently insures approximately 4,700 physicians, dentists and other healthcare providers, the vast majority of which are in Texas. APIE writes insurance in Texas primarily through purchasing groups and is not subject to certain rate and policy form regulations issued by the Texas Department of Insurance. It reviews applicants for insurance coverage based on the nature of their practices, prior claims records and other underwriting criteria. APIE is one of the largest medical professional liability insurance companies in the State of Texas.

On June 5, 2006 we announced plans for a strategic merger with APIE. Both our and APIE's boards of directors voted to approve the transaction subject to approval by the Texas Department of Insurance, necessary filings with the SEC and the approval of our shareholders and subscriber-policyholders of APIE. The original purchase price was \$33 million, comprised of approximately 1.7 million shares of APS common stock to be issued to the policyholders of APIE and the conversion of approximately \$10.4 million of APIE obligations into mandatorily redeemable APS preferred stock. On August 24, 2006, we announced that we agreed to an increase in the purchase price of APIE, which was also approved by APIE. The revised purchase price is \$39 million; comprised of approximately 2.0 million shares of APS common stock issued to the policyholders of APIE and the conversion of approximately \$10.4 million of APIE obligations into mandatorily redeemable APS preferred stock. The preferred stock has a 3% annual dividend and must be redeemed at the rate of not less than \$1 million per year until December 31, 2016 at which time it must have been fully redeemed. At a special meeting of shareholders held March 22, 2007, the shareholders of APS approved the issuance of common and preferred shares of APS for the acquisition of APIE. APIE subscribers also approved the transaction on the same day. The acquisition is set to close effective April 1, 2007. As the acquirer, we will account for this transaction consistent with the Statement of Financial Standards No. 141, *Business Combinations*, whereby direct costs of the business combination are capitalized and become part of the total purchase price.

Generally, medical professional liability insurance is offered on either a claims made basis or an occurrence basis. Claims made policies insure physicians only against claims that occur and that are reported during the period covered by the policy. Occurrence policies insure physicians against claims based on occurrences during the policy period regardless of when they are reported. APIE offers only a claims made policy in Texas and Arkansas, but provides for an extended reporting option upon termination of the policy. APIE reinsures 100% of all Texas and Arkansas coverage risk between \$250,000 and \$1,000,000 per medical incident, primarily through certain domestic and international insurance companies.

The management agreement with FMI obligates APIE to pay management fees to FMI based on APIE's earned premiums before payment of reinsurance premiums. The management fee percentage is 13.5% of earned premiums. In addition, any pretax profits of APIE will be shared equally with FMI (profit sharing) so long as the total amount does not exceed 3% of earned premiums. Only after prior year net losses are completely offset can FMI then share equally the profits at APIE. The management agreement with FMI will be terminated upon closing of the merger.

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The following table presents selected financial and other data for APIE:

	<u>Years Ended December 31,</u>			
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Total revenue	\$ 77,331	\$ 64,866	\$ 69,313	\$ 56,148
Earned premiums subject to management fees	65,180	64,135	64,416	51,816
Total assets	176,586	145,128	131,152	102,728
Statutory surplus	45,551	29,789	21,238	15,783
Management fees (including commissions) (1)	8,971	9,031	8,675	7,067
Profit sharing	1,994	2,007	1,929	722
Number of insureds	4,712	3,919	3,623	3,073

(1) This amount includes management fees and commissions paid to FMI and Agency in addition to commissions of \$0, \$0, \$0 and \$513 in 2006, 2005, 2004 and 2003, respectively, paid to other carriers directly related to APIE's controlled

### **Our Financial Services**

Through our subsidiaries, APS Financial Corporation, or APS Financial, APS Capital Corporation, or APS Capital, and APS Asset Management, Inc., or Asset Management, we provide investment and investment advisory services to institutions and individuals throughout the United States. Our revenues from this segment were 52%, 54% and 52% of our total revenues in 2006, 2005 and 2004, respectively.

APS Financial is a fully licensed broker/dealer that provides brokerage and investment services primarily to institutional and high net worth individual clients. APS Financial also provides portfolio accounting, analysis, and other services, to insurance companies and banks. Although these other services account for only a small portion of the revenues of APS Financial, they can be instrumental in maintaining the business of some clients. APS Financial has its main office in Austin, Texas.

APS Financial charges commissions on both exchange and over-the-counter, or OTC, transactions in accordance with industry practice. When APS Financial executes OTC transactions as a dealer, it receives, in lieu of commissions, markups or markdowns.

APS Financial is a member of the National Association of Securities Dealers, Inc., or NASD, and the Securities Investor Protection Corporation, or SIPC, and, in addition, is licensed in 44 states and the District of Columbia.

Every registered broker/dealer doing business with the public is subject to stringent rules with respect to net capital requirements promulgated by the SEC. These rules, which are designed to measure the financial soundness and liquidity of broker/dealers, specify minimum net capital requirements. As a registered broker/dealer, APS Financial is subject to these rules. Compliance with applicable net capital requirements could limit APS Financial's operations, such as limiting or prohibiting trading activities that require the use of significant amounts of capital. A significant operating loss or an extraordinary charge against net capital could adversely affect the ability of APS Financial to expand or even maintain our present levels of business. At December 31, 2006, APS Financial was in compliance with all applicable net capital requirements.

APS Financial clears its transactions through Southwest Securities, Inc., or Southwest, on a fully disclosed basis. Southwest also processes orders and floor reports, matches trades, transmits execution reports to APS Financial and records all data pertinent to trades. APS Financial pays Southwest a fee based on the number and type of transactions that Southwest conducts for APS Financial.

APS Capital was established in 2005 and is dedicated to the clearing and settlement of trades involving syndicated bank loans, trade claims and distressed private loan portfolios. This company seeks to develop business with clients who trade in the high-yield bond market. In addition to marketing to professional hedge funds and institutional clientele, we also may receive referral leads from our affiliate companies.

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Asset Management, a registered investment adviser under the Investment Advisers Act of 1940, was formed and registered with the SEC in 1998. We formed Asset Management to manage fixed income and equity assets for institutional and individual clients on a fee basis. Asset Management's mission is to provide clients with investment results within specific client-determined risk parameters.

### Competition

**Insurance Services.** Substantially all of our revenue from this segment was attributable to FMI providing management services to APIE. Because FMI's management fee is based on the combined earned premiums and profit of APIE, our revenue can be adversely affected by APIE's competition. While there is no direct competition with respect to providing management services to APIE, APIE does compete with several insurance carriers, including Medical Protective Insurance Company, Texas Medical Liability Trust, ProAssurance, The Doctors Company and the Texas Medical Liability Insurance Underwriting Association (JUA). These companies are considered APIE's competitors because they are the companies to whom policyholders who cancel their policies with APIE typically move. APIE competes with these companies on a variety of factors including price, customer service, expertise in claims handling, policy coverage, risk management services and financial strength. In premiums written and asset size, Medical Protective Insurance Company, Texas Medical Liability Trust, ProAssurance and The Doctors Company are significantly larger than APIE. With the successful passing of tort reform legislation in late 2003, additional companies have re-entered the Texas market, resulting in increased competition.

**Financial Services.** APS Financial, APS Capital and Asset Management are engaged in a highly competitive business. Their competitors include, with respect to one or more aspects of their business, all of the member organizations of the New York Stock Exchange and other registered securities exchanges, all members of the NASD, registered investment advisors, members of the various commodity exchanges and commercial banks and thrift institutions. Many of these organizations are national rather than regional firms and have substantially greater personnel and financial resources than us. In many instances APS Financial, APS Capital and Asset Management compete directly with these organizations. In addition, there is competition for investment funds from the real estate, insurance, banking and thrift industries.

### Regulation

**Insurance Services.** FMI has received certificates of authority from the Texas and Arkansas insurance departments, licensing it on behalf of the subscribers of APIE. APIE, as a reciprocal insurance exchange, is subject to regulation by the insurance departments of the States of Texas and Arkansas. These regulations strictly limit all financial dealings of a reciprocal insurance exchange with our officers, directors, affiliates and subsidiaries. In the case of APIE, these regulations apply to FMI, the attorney-in-fact. Premium rates, advertising, solicitation of insurance, types of insurance issued and general corporate activity are also subject to regulation by the insurance departments of the States of Texas and Arkansas.

**Financial Services.** APS Financial and Asset Management are subject to extensive regulation under both federal and state laws. The SEC is the federal agency charged with administration of the federal securities and investment advisor laws. Much of the regulation of broker/dealers, however, has been delegated to self-regulatory organizations, principally the NASD and the national securities exchanges. These self-regulatory organizations adopt rules (subject to approval by the SEC) which govern the industry and conduct periodic examinations of member broker/dealers. APS Financial is also subject to regulation by state and District of Columbia securities commissions.

The regulations to which APS Financial is subject cover all aspects of the securities business, including sales methods, trade practices among broker/dealers, uses and safekeeping of customers' funds and securities, capital structure of securities firms, record keeping and the conduct of directors, officers and employees. Additional legislation, changes in rules promulgated by the SEC and by self-regulatory organizations, or changes in the interpretation or enforcement of existing laws and rules, may directly affect the method of operation and profitability of APS Financial and, accordingly, us. The SEC, self-regulatory organizations and state securities commissions may conduct administrative proceedings that can result in censure, fine, suspension or expulsion of APS Financial and/or our officers or employees. The principal purpose of regulation and discipline of broker/dealers is the protection of customers and the securities markets, rather than protection of creditors and shareholders of broker/dealers.

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APS Financial, as a registered broker/dealer and NASD member organization, is required by federal law to belong to the SIPC. When the SIPC fund falls below a certain minimum amount, members are required to pay annual assessments in varying amounts not to exceed 0.5% of their adjusted gross revenues to restore the fund. The SIPC fund provides protection for customer accounts up to \$500,000 per customer, with a limitation of \$100,000 on claims for cash balances.

### **Revenues and Industry Segments**

The information required by Regulation S-K Items 101(b) and 101(d) related to financial information about segments and financial information about sales is contained in Note 16 of our accompanying audited consolidated financial statements included in Appendix A of this Form 10-K.

### **Employees**

As of December 31, 2006, we employed, on a full time basis, approximately 107 persons, including 61 by Insurance Services, 38 by APS Financial and APS Capital, and 8 directly by us. We consider our employee relations to be good. None of our employees are represented by a labor union and we have experienced no work stoppages.

### **Executive Officers**

As of March 1, 2007, our executive officers were as follows:

Our officers serve until the next annual meeting of our directors and until their successors are elected and qualified (or until their earlier death, resignation or removal).

Mr. Shifrin has been our Chairman of the Board since March 1990. He has been our President and Chief Executive Officer since March 1989 and he was President and Chief Operating Officer from June 1987 to February 1989. He has been a director since February 1987. From February 1985 until June 1987, Mr. Shifrin served as our Senior Vice President - Finance and Treasurer. Mr. Shifrin also has been a director of Financial Industries Corporation since June 2003 and was Chairman of the Board of Prime Medical Services, Inc. from October 1989 until November 2004. With the merger of Prime Medical and HealthTronics, Inc., or Healthtronics, Mr. Shifrin became Vice-chairman of the Board of HealthTronics in November 2004. In 2006, Mr. Shifrin resigned his vice-chairmanship but remains a member of the Board of Directors of HealthTronics. Mr. Shifrin is a member of the World Presidents Organization.

Mr. Hayes has been our Senior Vice President - Finance since June 1995. Mr. Hayes was our Vice President from June 1988 to June 1995 and was our Controller from June 1985 to June 1987. He has been our Secretary since February 1987 and our Chief Financial Officer since June 1987. Mr. Hayes is a Certified Public Accountant.

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Mr. Magids has been our Senior Vice President Insurance Services since June 2001 and has been President and Chief Operating Officer of FMI since November 1998. Mr. Magids joined us in October 1996. Mr. Magids is a Certified Public Accountant and was with Arthur Andersen LLP from August 1986 until September 1996, most recently as Director of Business Development.

Mr. Solimine has been our Controller since June 1994. He has served as Secretary for APS Financial since February 1995. From July 1989 to June 1994, Mr. Solimine served as our Manager of Accounting.

There are no family relationships, as defined, among any of our executive officers, and there is no arrangement or understanding between any of our executive officers and any other person pursuant to which he or she was selected as an officer. Each of our executive officers was elected by our board of directors to hold office until the next annual election of officers and until his or her successor is elected and qualified or until his or her earlier death, resignation or removal. Our board of directors elects our officers in conjunction with each annual meeting of our shareholders.

### **Available Information**

We file annual, quarterly and current reports, proxy statements, and other documents with the SEC under the Exchange Act. You may read and copy any materials that we file with the SEC at the SEC's public reference room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the public reference room by calling the SEC at 1-800-SEC-0330. Also, the SEC maintains a website that contains these SEC filings. You can obtain these filings at the SEC's website at <http://www.sec.gov>.

We also make available free of charge on or through our website (<http://www.amph.com>) our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and, if applicable, amendments to those reports filed or furnished pursuant to Section 13(a) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.