

Accident Fund Holdings, Inc.

Consolidated Financial Statements as of and for the
Years Ended December 31, 2009 and 2008, and
Independent Auditors' Report

ACCIDENT FUND HOLDINGS, INC.

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008:	
Balance Sheets	2
Statements of Operations	3
Statements of Shareholder's Equity	4
Statements of Cash Flows	5
Notes to Consolidated Financial Statements	6-37

INDEPENDENT AUDITORS' REPORT

To the Shareholder and Board of Directors of
Accident Fund Holdings, Inc.
Lansing, Michigan

We have audited the accompanying consolidated balance sheets of Accident Fund Holdings, Inc. (the "Company") as of December 31, 2009 and 2008, and the related consolidated statements of operations, shareholder's equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of Accident Fund Holdings, Inc. as of December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

March 5, 2010

ACCIDENT FUND HOLDINGS, INC.

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2009 AND 2008 (In thousands)

	2009	2008
ASSETS		
INVESTMENTS:		
Available-for-sale securities	\$ 1,577,660	\$ 1,048,402
Trading securities	<u>233,534</u>	<u>511,040</u>
Total investments	1,811,194	1,559,442
CASH AND CASH EQUIVALENTS	114,064	181,457
SECURITIES LENDING COLLATERAL	69,383	109,856
PREMIUMS RECEIVABLE — Net	282,171	328,006
REINSURANCE RECOVERABLE	206,752	233,372
PROPERTY AND EQUIPMENT — Net	115,730	69,048
DEFERRED INCOME TAXES	92,520	136,408
GOODWILL AND INTANGIBLE ASSETS	139,953	141,227
OTHER ASSETS	<u>113,419</u>	<u>105,935</u>
TOTAL	<u>\$ 2,945,186</u>	<u>\$ 2,864,751</u>
LIABILITIES AND SHAREHOLDER'S EQUITY		
LIABILITIES:		
Losses and loss adjustment expenses	\$ 1,305,488	\$ 1,306,166
Unearned premiums and other	335,666	363,002
Assessments, taxes, and fees payable	30,773	30,047
Securities lending collateral payable	69,383	109,856
Payable for purchases of securities	287	32,141
Notes payable	126,377	49,758
Junior subordinated debt	20,619	20,619
Other liabilities	<u>171,757</u>	<u>169,957</u>
Total liabilities	<u>2,060,350</u>	<u>2,081,546</u>
SHAREHOLDER'S EQUITY:		
Common stock, \$0 par value — authorized, 60,000 shares; issued and outstanding, 1,000 shares in 2009. \$10 par value — authorized, 1,000,000 shares; issued and outstanding, 300,000 in 2008	-	3,000
Additional paid-in capital	399,088	396,088
Accumulated other comprehensive income (loss)	10,088	(12,480)
Retained earnings	<u>475,660</u>	<u>396,597</u>
Total shareholder's equity	<u>884,836</u>	<u>783,205</u>
TOTAL	<u>\$ 2,945,186</u>	<u>\$ 2,864,751</u>

See notes to consolidated financial statements.

ACCIDENT FUND HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 (In thousands)

	2009	2008
REVENUES:		
Net premiums earned	\$ 781,425	\$ 859,692
Net investment and other income	73,155	82,068
Net gains (losses) on investments	<u>105,511</u>	<u>(149,070)</u>
Total revenues	<u>960,091</u>	<u>792,690</u>
LOSSES AND EXPENSES:		
Losses and loss adjustment expenses	613,325	600,283
Operating and other expenses	191,991	205,115
Policyholder dividends	28,776	34,262
Interest expense	<u>4,226</u>	<u>1,826</u>
Total losses and expenses	<u>838,318</u>	<u>841,486</u>
INCOME (LOSS) BEFORE FEDERAL INCOME TAX EXPENSE (BENEFIT)	121,773	(48,796)
FEDERAL INCOME TAX EXPENSE (BENEFIT)	<u>42,710</u>	<u>(18,047)</u>
NET INCOME (LOSS)	79,063	(30,749)
OTHER COMPREHENSIVE INCOME (LOSS) — Net of tax	<u>22,568</u>	<u>(26,551)</u>
COMPREHENSIVE INCOME (LOSS)	<u>\$ 101,631</u>	<u>\$ (57,300)</u>

See notes to consolidated financial statements.

ACCIDENT FUND HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDER'S EQUITY FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 (In thousands)

	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Shareholder's Equity
BALANCE — January 1, 2008	\$ 3,000	\$396,088	\$ 14,071	\$428,166	\$841,325
Net loss				(30,749)	(30,749)
Change in unrealized losses on investments — net of tax			(21,505)		(21,505)
Other changes in other comprehensive income — net of tax			(5,046)		(5,046)
Cumulative effect from adoption of ASC 715 measurement date provision — net of tax				(820)	(820)
BALANCE — December 31, 2008	3,000	396,088	(12,480)	396,597	783,205
Net income				79,063	79,063
Reorganization (Note 1)	(3,000)	3,000			-
Change in unrealized losses on investments — net of tax			22,722		22,722
Other changes in other comprehensive income — net of tax			(154)		(154)
BALANCE — December 31, 2009	<u>\$ -</u>	<u>\$399,088</u>	<u>\$ 10,088</u>	<u>\$475,660</u>	<u>\$884,836</u>

See notes to consolidated financial statements.

ACCIDENT FUND HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008 (In thousands)

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from premiums collected — net of reinsurance	\$ 803,292	\$ 873,903
Cash paid for:		
Losses and loss adjustment expenses	(602,834)	(588,816)
Underwriting expenses	<u>(168,355)</u>	<u>(185,015)</u>
Total	(771,189)	(773,831)
Other expenses	(41,085)	(58,529)
Net purchases, sales, and maturities of trading securities	352,998	(6,323)
Interest, dividends, and rental income received	73,719	82,839
Federal income taxes paid	<u>(4,321)</u>	<u>(44,432)</u>
Net cash provided by operating activities	<u>413,414</u>	<u>73,627</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(1,703,609)	(1,112,539)
Proceeds from sale and maturity of investments	1,202,408	1,008,234
Payment for purchase of subsidiaries — net of cash acquired		(395)
Purchase of property, equipment, and other assets	(74,789)	(34,682)
Proceeds from sale of property and equipment	<u>18,850</u>	<u>1,739</u>
Net cash used in investing activities	<u>(557,140)</u>	<u>(137,643)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Other cash applied	(286)	
Borrowings on notes payable	92,878	50,000
Repayment of notes payable	<u>(16,259)</u>	<u>(242)</u>
Net cash provided by financing activities	<u>76,333</u>	<u>49,758</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(67,393)	(14,258)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>181,457</u>	<u>195,715</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 114,064</u>	<u>\$ 181,457</u>
RECONCILIATION OF NET INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net income (loss)	\$ 79,063	\$ (30,749)
Adjustment to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	9,287	9,186
(Gain) loss on investments and equipment	(105,194)	149,131
Amortization of bond premium and discounts	2,315	2
Amortization of intangible assets	1,274	5,453
Net purchases, sales, and maturities of trading securities	352,998	(6,323)
Deferred income tax benefit (expense)	31,736	(53,808)
Changes in assets and liabilities:		
Receivables and other assets	67,373	38,298
Liability for losses and loss adjustment expenses	(678)	(28,664)
Unearned premiums	(27,336)	13,948
Assessments, taxes, and other liabilities	<u>2,576</u>	<u>(22,847)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 413,414</u>	<u>\$ 73,627</u>

See notes to consolidated financial statements.

ACCIDENT FUND HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

1. ORGANIZATION

Our consolidated financial statements include the accounts of Accident Fund Holdings, Inc., an insurance holding company organized in 2009 (formerly Accident Fund Insurance Company of America and Subsidiaries) and its wholly owned direct and indirect subsidiaries (collectively the “Company”). The Company is a wholly owned subsidiary of Blue Cross Blue Shield of Michigan (“BCBSM”).

During October 2009, BCBSM entered into an agreement to exchange all its shares in Accident Fund Insurance Company of America (“Accident Fund”) for all shares in the newly formed holding company, Accident Fund Holdings, Inc. As a result, Accident Fund became a wholly-owned subsidiary of Accident Fund Holdings, Inc.

Subsidiaries of the Company include the following: Accident Fund Insurance Company of America (“Accident Fund”), Accident Fund National Insurance Company (“National”), Accident Fund General Insurance Company (“General”), United Wisconsin Insurance Company (“UWIC”), Third Coast Insurance Company (“TCIC”), and CWI Holdings, Inc. (“CWIH”), including its wholly owned subsidiary, CompWest Insurance Company (“CompWest”). In addition, CWIH owns 100% of the common securities of a Delaware statutory trust formed in June 2006, CWI Holdings 2006 Statutory Trust I (“Trust I”). In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 810 *Consolidation*, we have not consolidated Trust I into these consolidated financial statements.

Through the Company’s subsidiaries, we sell workers’ compensation insurance and services to companies located primarily in several Midwestern and Southern states and in California. One or more of our companies are licensed to write primary insurance in 49 states and the District of Columbia as of December 31, 2009.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation — We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP). These principles differ in some respects from statutory accounting principles, which we use in preparing reports to state insurance regulatory authorities (see Note 20).

Principles of Consolidation — We have consolidated all wholly-owned subsidiaries and have eliminated all intercompany balances and transactions.

Cash and Cash Equivalents — Cash and cash equivalents include readily marketable securities having initial maturities of 90 days or less. We carry cash and cash equivalents at cost, which approximates fair value.

Short-term Investments — Short-term investments include commercial paper, certificates of deposit, and other readily marketable investments with initial maturities over 90 days but less than one year.

Investments — We classify our investments in all debt securities and equity securities with readily determinable fair values as either available-for-sale securities or trading securities.

Trading Securities — We classify debt and equity securities as trading securities if (1) we have bought them for short-term resale or (2) they are part of a portfolio managed by external investment managers who have broad authority to buy and sell securities without our prior approval. These securities are reported at fair value with unrealized gains and losses included in earnings.

Available-for-Sale Securities — Short-term investments and debt and equity securities not considered trading securities are classified as available-for-sale and are reported at fair value. Unrealized gains and losses on these securities are excluded from net income but are recorded as a separate component of comprehensive income (loss) and shareholder's equity, net of deferred income taxes.

Realized gains and losses on disposition of investments are based on specific identification of the investments sold and are included in earnings.

Financial futures and forward contracts are commitments to purchase or sell designated financial instruments at a future date for a specified price or yield. They may be settled in cash or through delivery. Most of the securities we purchase settle within normal time requirements and therefore are not considered futures or forward contracts. We do periodically purchase "to-be-announced" securities that settle more than 30 days from the trade date. We consider such securities to be forwards and account for increases or decreases in the fair value as basis adjustments, with the change flowing through the consolidated statements of operations. As of December 31, 2009 and 2008, we had no commitments to purchase any security expected to settle outside normal time requirements.

Securities Lending — We participate in a securities lending program with our custodian bank. Under the terms of the securities lending agreement, we lend United States securities in exchange for collateral consisting of government-sponsored agency securities, approximating 102% of the value of the securities loaned. These agreements are primarily overnight in nature and settle the next business day. We recognize the cash collateral received and the corresponding liability to return the cash collateral in the balance sheet.

Fair Value Measurements — Fair values of debt and equity securities are obtained from a third party pricing service (pricing service) and are based on quoted market prices, where available. When market prices are not available, fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality (matrix pricing). In instances where there is little or no market activity for the same or similar instruments, the pricing service estimates fair value using methods, models and assumptions they believe market participants would use to determine a current transaction price. Inputs that are often used in the valuation methodologies include, but are not limited to, non-binding broker quotes, benchmark yields, credit spreads, default rates, and prepayment speeds. We perform monthly analyses on the prices received from the pricing service to determine whether the prices are reasonable estimates of fair value. Some of these estimates are subjective in nature and involve uncertainties and matters of considerable judgment. The use of different assumptions, judgments, and estimation methodologies may have a material effect on the estimated fair values. Accordingly, the fair values presented in these consolidated financial statements do not necessarily represent the amounts we could realize in a current market exchange.

Financial Instrument Impairment — For available-for-sale securities, investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary. The Company employs a systematic methodology that considers available evidence in evaluating potential impairment of its

investments. In the event that the amortized cost of an investment exceeds its fair value, the Company evaluates, among other factors, the magnitude and duration of the decline in fair value, the financial health and business outlook of the issuer and the Company's ability and intent to hold the investment. When a decline in fair value is determined to be other-than-temporary on a security held as available-for-sale, an impairment charge is recorded as a realized capital loss and a new cost basis in the investment is established.

Premiums, Unearned Premiums, and Premiums Receivable — We recognize premiums as earned over the policy terms using the daily pro rata method. Unearned premiums represent the portion of written premium that relates to the unexpired term of the policies in force. Premiums receivable represent (a) premiums we have billed but which our policyholders have not yet paid, (b) future premium installments we have not yet billed, and (c) estimates of additional earned but unbilled premiums which we project will result from policy audits. Premiums receivable are reported net of an allowance for doubtful accounts.

Deferred Policy Acquisition Costs — The costs directly related to writing or renewing insurance policies are referred to as policy acquisition costs and consist of commissions, premium-based taxes and assessments, and certain other direct underwriting expenses. Although these costs are typically paid when we issue a policy, we defer and amortize them over the same period as the corresponding premiums are earned. We continually review deferred policy acquisition costs for recoverability and consider anticipated investment income in this analysis as well as in determining whether deficiency reserves are necessary.

Liability for Losses and Loss Adjustment Expenses — Losses represent the amounts we expect to pay for reported and unreported claims, reduced for estimated recoveries from third parties. The costs of investigating, resolving, and processing these claims are known as loss adjustment expenses.

The liability for losses and loss adjustment expenses is an estimate based on actuarial and other assumptions related to the ultimate cost to settle such claims. Because losses depend upon factors such as duration of worker disability, medical cost trends, occupational disease, inflation, and life expectancy, the process we use to establish the liability for losses and loss adjustment expenses is necessarily based on judgments. We discount the indemnity portion of liabilities for unpaid losses for certain large claims on a tabular basis. The tabular discounting on these workers' compensation claims is based on the CDC National Center for Health Statistics Table, using a 3.5% rate. The held discounted reserves on these unpaid workers' compensation claims, net of reinsurance, at December 31, 2009 and 2008 were \$96.8 million and \$93.3 million, respectively. We continually review our reserves using a variety of statistical and actuarial techniques to analyze current claims costs, frequency and severity data, and economic and legal factors. As loss experience develops and new information becomes available, we adjust the liability established in prior years. Adjustments resulting from revisions of the estimates of the liability for losses and loss adjustment expenses are reflected in our results of operations in the period in which they are determined.

We believe the liability for losses and loss adjustment expenses at December 31, 2009 is adequate to meet our future obligations.

Reinsurance — We record reinsurance recoverables and ceded unearned premiums as assets. The balances of these items are calculated in a manner consistent with the underlying reinsured losses and insurance contracts.

Goodwill of Acquired Business — Goodwill on acquisitions accounted for under the purchase method represents the difference between purchase price and the fair value of net assets acquired. We review goodwill annually for impairment using a variety of methods. Impairments, if any, are charged to earnings.

Intangible Assets — We hold various intangible assets with useful lives ranging from one year to indefinite periods. Where the useful life can be estimated, we amortize the cost of the asset over its useful life and charge that amortization expense to operations in the period in which it occurs. We review intangible assets annually for impairment using a variety of methods. Impairments, if any, are charged to earnings.

Impairment of Long-Lived Assets — We routinely review long-lived assets, such as certain real estate holdings, to test for impairment of carrying values. We record a loss if the carrying amount of a long-lived asset is not recoverable from projected undiscounted cash flows. In such a situation, the amount of the loss is the difference between the carrying amount and fair value of the asset.

Policyholder Dividends — We record policyholder dividends as an expense over the effective period of the related policies.

Insurance-Related Assessments — We recognize liabilities for insurance-related assessments when an assessment has been imposed. We also recognize such liabilities when available information indicates an assessment is likely to be imposed, the event giving rise to the assessment has occurred, and we can reasonably estimate the assessment.

Health Care Benefits — We self-insure certain medical, dental, vision, and short-term disability benefits provided to some of our employees. Liabilities for such benefits are based on actual claim data and estimates of incurred-but-not-reported claims developed by use of historical claim trends. Actual settlements and claims could differ materially from these estimates.

Income Taxes — We account for income taxes using the asset and liability method. Under this method, we calculate the tax effect, using current tax rates, of temporary differences between carrying values of assets and liabilities for financial reporting purposes and the bases of such assets and liabilities as measured by tax laws and regulations. The effect on deferred taxes for a change in tax rates is recognized in income in the period that includes the enactment date.

Property and Equipment — We report property and equipment at cost, less accumulated depreciation. We depreciate these assets in equal annual amounts over their estimated useful lives, which range from two-and-half years to 40 years.

Consolidation of Variable Interest Entities — As discussed in Notes 10 and 18, the Company has entered an agreement with a developer to construct a new corporate headquarters building for the Company in Lansing, Michigan. The Company has loaned approximately \$84 million to a development company created by the developer solely to provide for the construction of the new corporate headquarters. As defined in ASC 810, an enterprise shall consolidate a variable interest entity if that enterprise has a variable interest that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. We have evaluated the Company's investment in the development company and have determined that it is a variable interest entity. As such, we have consolidated the variable interest entity into these consolidated financial statements.

New Accounting Standards — In June 2009, the FASB issued FASB ASC 105 *Generally Accepted Accounting Principles* (FASB Statement No. 168), which establishes the FASB ASC as the sole source of authoritative GAAP. Its primary purpose is to improve clarity and use of existing standards by grouping authoritative literature under common topics. The adoption of ASC 105 changed the Company's references to GAAP accounting standards, but did not have a material impact on the Company's financial position or results of operations.

In February 2007, the FASB issued new guidance for measuring financial assets and liabilities. The new guidance is now part of ASC 825 *Financial Instruments* (FASB Statement No. 159). The objective of

ASC 825 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported net income caused by measuring related assets and liabilities differently. This statement permits entities to choose, at specified election dates, to measure eligible items at fair value (i.e., the fair value option). ASC 825 was effective in 2008; however, the Company chose not to apply.

In December 2007, the FASB issued new guidance for reporting of business combinations. The new guidance is now part of ASC 805 *Business Combinations* (FASB Statement No. 141(R)). This statement retains a substantial portion of the requirements contained in the original FASB Statement No. 141, but requires acquired assets and liabilities to be valued at fair market value instead of using a purchase price allocation process. ASC 805 also requires that acquisition related costs be expensed as incurred and restructuring costs contemplated at the time of acquisition be accounted for separately from the business combination. The adoption of ASC 805 did not have a material impact on the Company's financial position or results of operations.

In December 2007, the FASB issued new guidance for the accounting and reporting of noncontrolling interests in consolidated financial statements. The new guidance, which is now part of ASC 810 (FASB Statement No. 160), establishes accounting and reporting standards that require (i) the ownership interest in subsidiaries held by parties other than the parent to be clearly identified and presented in the consolidated balance sheet within shareholder's equity, but separate from the parent's equity, (ii) the amount of consolidated net income attributable to the parent and the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of operations, and (iii) changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary to be accounted for consistently. ASC 810 is effective for the Company on January 1, 2009. The Company did not have material non-controlling interests; therefore, the adoption of ASC 810 did not have a material impact on the Company's financial position or results of operations.

In April 2008, the FASB issued new guidance for the determination of useful lives for intangible assets. The new guidance is now part of ASC 350 *Intangibles — Goodwill and Other*. The guidance amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142. ASC 350 also requires expanded disclosure related to the determination of intangible asset useful lives. ASC 350 is effective for the Company on January 1, 2009. The adoption of ASC 350 did not have a material impact on the Company's financial position or results of operations.

In December 2008, the FASB issued new guidance for the disclosure of postretirement benefit plan assets. The new guidance, which is now part of ASC 715 *Compensation — Retirement Benefits* (FASB Statement No. 132 (R)-1), requires entities to provide enhanced disclosures about how investment allocation decisions are made, the major categories of plan assets, the inputs and valuation techniques used to measure fair value of plan assets, the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period, and significant concentrations of risk within plan assets. ASC 715-20 is effective for the Company beginning with its year ended December 31, 2009. The adoption of ASC 715-20 resulted in additional disclosures in the Employee Benefits footnote (see Note 14).

In April 2009, the FASB issued new guidance for the accounting for other-than-temporary impairments (OTTI). The new guidance, which is now part of ASC 320 *Investments — Debt and Equity Securities* (FASB Statement of Position No. 115-2 and 124-2), modifies the existing OTTI methodology and reporting requirements for investments in debt securities. Under ASC 320, the primary threshold for impairment is no longer "intent and ability to hold" but instead, "intent to sell." Specifically, an OTTI is triggered if fair market value is less than amortized cost and (1) the Company has the intent to sell the security, (2) is more likely than not that it will be required to sell the security before recovery, or (3) a

credit loss is anticipated as the Company does not expect to recover the entire amortized cost basis of the security. If the Company has the ‘intent to sell’ impairment losses are recognized in earnings. If a credit loss is anticipated, but the Company does not have the intent to sell the debt security, the impairment is separated into its credit loss component and losses from other factors such as market movements in interest rate. The credit loss component is recognized in earnings, and losses from other factors are recognized as a component of other comprehensive income (loss). ASC 320 is effective for interim and annual periods ending after June 15, 2009 and was applied to existing and new investments held by the Company as of January 1, 2009. The adoption of ASC 320 did not have a material impact on the Company’s financial position or results of operations.

In May 2009, the FASB issued new guidance to establish principles and requirements for subsequent events. The new guidance, which is now ASC 855 *Subsequent Events* (FASB Statement No. 165), sets forth the period after the balance sheet date during which management of a reporting entity shall evaluate events or transactions that may occur for potential recognition or disclosure in the consolidated financial statements, the circumstances under which an entity shall recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity shall make about events or transactions that occurred after the balance sheet date. ASC 855 is effective for interim or annual financial periods ending after June 15, 2009. The adoption of ASC 855 did not have a material impact on the Company’s financial position or results of operations.

Estimates — The preparation of the consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

3. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2009 and 2008, consist of the following (in thousands):

	2009	2008
Bank deposits	\$ 12,985	\$ 14,524
Corporate notes and commercial paper		30,704
Money market funds	<u>101,079</u>	<u>136,229</u>
Total	<u>\$ 114,064</u>	<u>\$ 181,457</u>

4. INVESTMENTS

The components of net investment and other income for the years ended December 31, 2009 and 2008, are as follows (in thousands):

	2009	2008
Interest and dividend income:		
Debt securities	\$72,568	\$75,565
Short-term investments	1,971	4,313
Equity securities	<u>3,039</u>	<u>2,849</u>
Total interest and dividend income	77,578	82,727
Rental and other income	<u>610</u>	<u>2,437</u>
Gross investment income	78,188	85,164
Investment expenses	<u>(5,033)</u>	<u>(3,096)</u>
Net investment and other income	<u>\$73,155</u>	<u>\$82,068</u>

Net gains (losses) included in operations and net changes in unrealized gains (losses) included in other comprehensive income (loss) for the years ended December 31, 2009 and 2008, are summarized as follows (in thousands):

	2009	2008
Net investment gains (losses):		
Debt securities:		
Available for sale:		
Net realized gains on sale of available-for-sale debt securities	\$ 30,660	\$ 7,392
Impairment loss on available-for-sale debt securities	(323)	(13,838)
Trading securities:		
Net realized losses on sale of trading debt securities	(7,298)	(4,695)
Net recognized gains (losses) on holding of trading debt securities	48,303	(47,441)
Equity securities:		
Available for sale — net realized gains on sale of available-for-sale equity securities	46	
Trading securities:		
Net realized losses on sale of trading equity securities	(14,988)	(23,028)
Net recognized gains (losses) on holding of trading equity securities	49,096	(66,492)
Other invested assets	<u>15</u>	<u>(968)</u>
Net investment gains (losses)	<u>105,511</u>	<u>(149,070)</u>
Net changes in unrealized gains (losses) on available-for-sale investments:		
Debt securities	28,395	(17,130)
Equity securities	6,477	(15,954)
Other	<u>85</u>	<u></u>
	<u>34,957</u>	<u>(33,084)</u>
Net realized investment gains (losses) and changes in unrealized losses on investments	<u>\$ 140,468</u>	<u>\$ (182,154)</u>

A summary of the disposition through sale or call of debt securities and equity securities for the years ended December 31, 2009 and 2008, is as follows (in thousands):

	2009	2008
Proceeds from sales of investment securities	<u>\$2,347,927</u>	<u>\$2,867,239</u>
Gross gains on sales of investment securities	\$ 68,836	\$ 45,085
Gross losses on sales of investment securities	(60,416)	(65,416)
Impairments of investment securities	<u>(323)</u>	<u>(13,838)</u>
Net realized gains (losses)	<u>\$ 8,097</u>	<u>\$ (34,169)</u>

The following table summarizes the Company's investments measured at fair value as of December 31, 2009 (in thousands):

	Fair Value Measurements Using			Total Fair Value
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash and cash equivalents	\$ 114,064	\$ -	\$ -	\$ 114,064
Trading securities	221,367	12,167		233,534
Available-for-sale securities	1,455,368	118,301	3,991	1,577,660
Security lending collateral	69,383			69,383
Total	<u>\$1,860,182</u>	<u>\$130,468</u>	<u>\$3,991</u>	<u>\$1,994,641</u>

The following table summarizes the Company's investments measured at fair value as of December 31, 2008 (in thousands):

	Fair Value Measurements Using			Total Fair Value
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash and cash equivalents	\$ 181,457	\$ -	\$ -	\$ 181,457
Trading securities	455,309	55,731		511,040
Available-for-sale securities	995,686	52,716		1,048,402
Security lending collateral	109,856			109,856
Total	<u>\$1,742,308</u>	<u>\$108,447</u>	<u>\$ -</u>	<u>\$1,850,755</u>

With the advice of investment managers we determine fair values by applying the following guidelines. If available, we use market prices in active markets for identical assets and classify these assets as Level 1. When market prices for identical financial instruments in an active market are not available, we estimate fair value based on quoted prices for similar assets in active markets, quoted prices for identical assets in inactive markets and/or other inputs derived directly from observable market data and classify these assets as Level 2. In situations where there is little or no market activity for same or similar financial instruments, we estimate fair value using our own assumptions about future cash flows and appropriate risk-adjusted discount rates and classify these assets as Level 3. Based on market conditions that resulted in the absence of quoted prices in active markets for our auction rated securities and collateralized debt obligations, we changed our valuation methodology for the securities to a discounted cash flow analysis during the fourth quarter 2009. Accordingly, since our initial adoption of ASC 820 on January 1, 2008, these securities changed from Level 2 to Level 3 within ASC 820 hierarchy. The following table presents our assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

	Level 3
Balance — December 31, 2008	\$ -
Transfer to level 3	4,137
Total gains (unrealized):	
Included in earnings	(146)
Included in other comprehensive income	<u> </u>
Balance — December 31, 2009	<u>\$ 3,991</u>

Investments in available-for-sale securities as of December 31, 2009 and 2008, consist of the following (in thousands):

	2009			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Marketable securities — available-for-sale:				
Debt securities, including short-term investments:				
U.S. government and agency securities	\$ 275,059	\$ 962	\$ (7,238)	\$ 268,783
Asset-backed securities and collateralized mortgage obligations	508,881	21,291	(663)	529,509
Collateralized debt obligations	4,000		(9)	3,991
Corporate notes	<u>723,260</u>	<u>19,776</u>	<u>(1,857)</u>	<u>741,179</u>
Total debt securities, including short-term investments	1,511,200	42,029	(9,767)	1,543,462
Equity securities	<u>42,757</u>	<u> </u>	<u>(8,559)</u>	<u>34,198</u>
Total marketable securities — available for sale	<u>\$ 1,553,957</u>	<u>\$ 42,029</u>	<u>\$ (18,326)</u>	<u>\$ 1,577,660</u>

	2008			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Marketable securities — available-for-sale:				
Debt securities, including short-term investments:				
U.S. government and agency securities	\$ 252,612	\$ 28,301	\$ -	\$ 280,913
Asset-backed securities and collateralized mortgage obligations	343,146	11,434	(10,983)	343,597
Corporate notes and commercial paper	<u>421,063</u>	<u>1,992</u>	<u>(26,887)</u>	<u>396,168</u>
Total debt securities, including short-term investments	1,016,821	41,727	(37,870)	1,020,678
Equity securities	<u>42,835</u>	<u>_____</u>	<u>(15,111)</u>	<u>27,724</u>
Total marketable securities — available for sale	<u>\$ 1,059,656</u>	<u>\$ 41,727</u>	<u>\$ (52,981)</u>	<u>\$ 1,048,402</u>

Gross unrealized gains and losses as of December 31, 2009 and 2008, less applicable deferred income taxes, on available-for-sale securities are as follows (in thousands):

	2009	2008
Unrealized gains	\$ 42,029	\$ 41,727
Unrealized losses	<u>(18,326)</u>	<u>(52,981)</u>
Net unrealized gains (losses)	23,703	(11,254)
Deferred income tax (expense) benefit	<u>(8,296)</u>	<u>3,939</u>
Net unrealized gains (losses) on available-for-sale investments	<u>\$ 15,407</u>	<u>\$ (7,315)</u>

The amortized cost and estimated fair value of bonds, notes, and other securities held as of December 31, 2009, by contractual maturity are shown below (in thousands). Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due in one year or less	\$ 130,363	\$ 131,343
Due after one year through five years	296,439	301,419
Due after five years through ten years	547,805	553,625
Due after ten years	<u>23,712</u>	<u>23,575</u>
Total	998,319	1,009,962
Collateralized debt obligations	4,000	3,991
Asset-backed securities and collateralized mortgage obligations	<u>508,881</u>	<u>529,509</u>
Total available-for-sale securities	<u>\$1,511,200</u>	<u>\$1,543,462</u>

The aggregate fair values of available-for-sale investments, by asset category, in an unrealized loss position as of December 31, 2009 and 2008, are shown below (in thousands):

	2009			
	12 Months or Less		Greater Than 12 Months	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
U.S. government and agency securities	\$ 4,558	\$ 224,627	\$ 2,680	\$ 24,998
Asset-backed securities and collateralized mortgage obligations	663	55,749		
Corporate notes and commercial paper	1,857	143,776	9	3,991
Equity securities	<u> </u>	<u> </u>	<u>8,559</u>	<u>34,198</u>
Total available-for-sale securities	<u>\$7,078</u>	<u>\$424,152</u>	<u>\$11,248</u>	<u>\$63,187</u>
	2008			
	12 Months or Less		Greater Than 12 Months	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
U.S. government and agency securities	\$ -	\$ -	\$ -	\$ -
Asset-backed securities and collateralized mortgage obligations	10,948	30,003	35	49
Corporate notes and commercial paper	22,894	343,008	3,993	16,664
Equity securities	<u>15,111</u>	<u>27,574</u>	<u> </u>	<u> </u>
Total available-for-sale securities	<u>\$48,953</u>	<u>\$400,585</u>	<u>\$4,028</u>	<u>\$16,713</u>

Because we have determined the investments have not been subject to credit losses and we do not have the intent to sell the securities and have the ability to hold such securities, we do not consider these investments to be other-than-temporarily impaired.

The carrying value of securities and collateral involved in securities lending arrangements as of December 31, 2009 and 2008, are as follows (in thousands):

	2009	2008
Securities	\$ 67,280	\$ 106,929
Collateral balance	69,383	109,856

United States government securities with carrying values as of December 31, 2009 and 2008, of \$161,003,250 and \$146,947,356, respectively, were on deposit with regulatory authorities.

Other invested assets, which are included in “Other assets” on the consolidated balance sheets as of December 31, 2009, include the following (in thousands):

	Carrying Value
Investments in limited partnerships	\$ 3,777
79,868 shares of BCS Insurance	4,526
65,522 shares of Federal Home Loan Bank of Indianapolis	6,552
Investment in Trust I	<u>619</u>
 Total	 <u><u>\$ 15,474</u></u>

The investments shown in the table above are not readily marketable. As a result, we periodically review available financial and other information to determine whether they have suffered any impairment in value. We report adjustments to the carrying value as a component of operations during the year.

5. PROPERTY AND EQUIPMENT

Property and equipment as of December 31, 2009 and 2008, consist of the following (in thousands):

	2009	2008
Construction in progress — headquarters	\$ 87,997	\$ 24,659
Land and improvements	499	4,988
Buildings and improvements	1,181	23,212
Furniture and equipment	23,856	20,252
Software	<u>40,126</u>	<u>38,196</u>
 Total	 153,659	 111,307
 Less accumulated depreciation	 <u>(37,929)</u>	 <u>(42,259)</u>
 Net property and equipment	 <u><u>\$ 115,730</u></u>	 <u><u>\$ 69,048</u></u>

Depreciation expense for the years ended December 31, 2009 and 2008, was \$9,286,578 and \$9,185,977, respectively.

During 2009 and 2008, we reviewed our real estate holdings for possible impairment in value and no impairment was deemed necessary.

6. GOODWILL AND INTANGIBLE ASSETS

We annually evaluate recorded goodwill and indefinite lived intangible assets for impairment. We completed our annual impairment tests as of September 30, 2009 and 2008, and no impairment was deemed necessary. Goodwill and intangible assets as of December 31, 2009, consist of the following (in thousands):

	Useful Life	Initial Value	Accumulated Amortization	Carrying Value
Goodwill:				
Assets acquired — net of liabilities assumed — in 1994	Indef.	\$ 101,520	\$ 47,376	\$ 54,144
Acquisition of CWIH in 2007	Indef.	35,778		35,778
Acquisition of UWIC in 2005	Indef.	<u>24,738</u>	<u> </u>	<u>24,738</u>
Total		<u>162,036</u>	<u>47,376</u>	<u>114,660</u>
Intangible assets:				
Broker network	20 yrs	19,700	2,199	17,501
Trade names	Indef.	7,400		7,400
Customer base	1 yr	3,900	3,900	-
Covenant not to compete	3 yrs	900	628	272
State licenses	Indef.	<u>120</u>	<u> </u>	<u>120</u>
Total		<u>32,020</u>	<u>6,727</u>	<u>25,293</u>
Net goodwill and intangible assets		<u>\$ 194,056</u>	<u>\$ 54,103</u>	<u>\$ 139,953</u>

Amortization expense for the years ended December 31, 2009 and 2008, was \$1,273,684 and \$5,452,712, respectively.

Future expected amortization expense is as follows in (thousands):

Years Ending December 31	
2010	\$ 1,249
2011	977
2012	977
2013	977
2014	977
Thereafter	<u>12,616</u>
Total	<u>\$ 17,773</u>

7. LOSSES AND LOSS ADJUSTMENT EXPENSES

Activity in the reserves for losses and loss adjustment expenses for the years ended December 31, 2009 and 2008, is summarized as follows (in thousands):

	2009	2008
Balance — January 1	\$ 1,306,166	\$ 1,337,459
Less reinsurance recoverable	<u>204,405</u>	<u>247,165</u>
Net balance — January 1	<u>1,101,761</u>	<u>1,090,294</u>
Incurred related to:		
Current	561,866	597,573
Prior years	<u>51,459</u>	<u>2,710</u>
Total	<u>613,325</u>	<u>600,283</u>
Paid related to:		
Current	170,733	189,487
Prior years	<u>432,101</u>	<u>399,329</u>
Total	<u>602,834</u>	<u>588,816</u>
Net balance — December 31	1,112,252	1,101,761
Plus reinsurance recoverables	<u>193,236</u>	<u>204,405</u>
Balance — December 31	<u>\$ 1,305,488</u>	<u>\$ 1,306,166</u>

The provision for prior years' losses and loss adjustment expenses, net of reinsurance recoveries, increased by approximately \$51.5 million and \$2.7 million in 2009 and 2008, respectively. The increase in 2009 was attributable to the effect of current economic conditions on indemnity costs nationwide, increasing medical and legal costs in certain states, and amortization of tabular discount on a number of catastrophic claims. The 2008 increase was mainly due to several large losses and rising medical loss trends. We did not have to accrue additional premiums or return premiums as a result of the prior year effects.

8. OTHER ASSETS

Other assets as of December 31, 2009 and 2008, consist of the following (in thousands):

	2009	2008
Other invested assets	\$ 15,474	\$ 12,949
Accrued investment income	15,922	15,339
Deferred policy acquisition costs	39,666	40,197
Prepaid reinsurance premiums	12,534	8,537
Other prepaid expenses	3,132	3,912
Funds held by others	308	205
Federal income tax recoverable	14,793	17,868
Other	<u>11,590</u>	<u>6,928</u>
Total	<u>\$ 113,419</u>	<u>\$ 105,935</u>

9. PREMIUMS RECEIVABLE

Premiums receivable as of December 31, 2009 and 2008, consist of the following (in thousands):

	2009	2008
Premiums in course of collection	\$ 58,636	\$ 63,633
Future installments not yet billed	224,259	250,407
Accrued retrospective premiums	2,941	2,793
Earned but unbilled premiums	<u>2,000</u>	<u>16,108</u>
Total	287,836	332,941
Allowance for uncollectible premiums	<u>(5,665)</u>	<u>(4,935)</u>
Premiums receivable — net	<u>\$ 282,171</u>	<u>\$ 328,006</u>

10. DEBT

The following debt was outstanding as of December 31, 2009 and 2008 (in thousands):

	2009	2008
Notes payable to Federal Home Loan Bank of Indianapolis (FHLBI)	\$ 109,574	\$ 49,758
Junior subordinated debt	20,619	20,619
Notes payable to Fifth Third Bank	<u>16,803</u>	<u>-</u>
Total	<u>\$ 146,996</u>	<u>\$ 70,377</u>

The Company, as a member of the FHLBI, has long-term and line of credit borrowing privileges. Outstanding borrowings with the FHLBI are as follows (in thousands):

Year Originated	Term	Interest Rate	Description	December 31,	
				2009 Balance	2008 Balance
2008	20 year	4.81 %	FHLBI — loan no. 1	\$ 23,793	\$ 24,879
2008	20 year	5.53	FHLBI — loan no. 2	23,793	24,879
2009	5 year	2.67	FHLBI — loan no. 3	61,988	
Total outstanding loans				<u>\$ 109,574</u>	<u>\$ 49,758</u>

The FHLBI loans are collateralized by \$143,859,318 of available-for-sale bonds held in a segregated trust account. Total interest as of December 31, 2009 and 2008 was \$4,322,089 and \$581,779, respectively.

At December 31, 2009 and 2008, the carrying value of FHLBI loans approximates fair value.

In 2006, before its acquisition by the Company, CWIH arranged for the sale of \$20 million of trust preferred securities through Trust I. Trust I was created solely for the purpose of issuing the trust preferred securities. In accordance with ASC 810, we have not consolidated Trust I into these consolidated financial statements.

CWIH purchased all of the outstanding stock of Trust I for \$619,000, and that investment in Trust I is included in other assets in the consolidated balance sheets. Trust I used the \$20,619,000 proceeds from the sale of the trust preferred securities and common stock to purchase the floating rate junior subordinated debentures (the “junior subordinated debt”) issued to Trust I under an indenture. The junior subordinated debt is the sole asset of Trust I, and the trust preferred securities are the sole liabilities of Trust I.

The following table summarizes the nature and terms of the junior subordinated debt and trust preferred securities:

Issue date	June 15, 2006
Principal amount of trust preferred securities	\$20,000,000
Principal amount of junior subordinated debt	\$20,619,000
Maturity date of junior subordinated debt — unless accelerated earlier	June 15, 2036
Trust common stock	\$ 619,000
Interest rate — per annum ending on (but excluding) the interest payment date in June 2011	9.045 %
Interest rate — per annum for each subsequent period	Three-month LIBOR plus 3.6%
Redeemable at 100% of principal amount at option of CWIH on or after	June 15, 2011

Interest on the trust preferred securities and interest paid by CWIH to Trust I on the junior subordinated debt is payable quarterly in arrears. Through December 31, 2009, interest accrued at a rate of 9.045% and totaled \$1,864,989. We have the right, which we have not exercised, to defer interest payment on the junior subordinated debt for up to five years without triggering an event of default.

The trust preferred securities are subject to mandatory redemption in a like amount (a) upon repayment of all the junior subordinated debt on the stated maturity date, (b) contemporaneously with optional prepayment of all the junior subordinated debt by CWIH in conjunction with a special event (as defined), and (c) five years or more after the issue date, contemporaneously with the optional prepayment, in whole or in part, of the junior subordinated debt.

CWIH has provided a full, irrevocable, and unconditional guarantee of payments of amounts due on the trust preferred securities. The indenture contains certain covenants with which CWIH is in compliance as of December 31, 2009. Interest payable is included in accrued expenses on the accompanying consolidated balance sheets.

As of December 31, 2009 and 2008, the carrying value of the subordinated debt approximates fair value.

The notes payable to Fifth Third Bank relate to the sale and leaseback of certain capitalized software. As of December 31, 2009, outstanding borrowings with Fifth Third Bank are as follows (in thousands):

Description	Year Originated	Term	Interest Rate	Outstanding Borrowing	Interest Paid	Capitalized Software	Accumulated Depreciation
Fifth Third Bank — sale-leaseback	May 2009	5 years	5.30 %	\$ 9,316	\$307	\$ 10,681	\$ 3,446
Fifth Third Bank — sale-leaseback	December 2009	5 years	5.87	<u>7,487</u>	<u>-</u>	<u>7,487</u>	<u>-</u>
Total				<u>\$ 16,803</u>	<u>\$307</u>	<u>\$ 18,168</u>	<u>\$ 3,446</u>

For all sale-leaseback agreements, we are required to maintain letters of credit to collateralize the debt.

Future minimum payments required on outstanding debt as of December 31, 2009, is as follows in (thousands):

Years Ending

2010	\$ 25,617
2011	26,224
2012	25,827
2013	25,409
2014	8,963
Thereafter	<u>38,876</u>
Total minimum payments	150,916
Less amount representing interest	<u>(24,539)</u>
Total debt	<u>\$ 126,377</u>

11. OTHER LIABILITIES

Other liabilities as of December 31, 2009 and 2008, consist of the following (in thousands):

	2009	2008
Accrued commissions	\$ 13,730	\$ 18,127
Accrued expenses	8,120	7,618
Accrued employee expenses	11,100	15,889
Accrued pensions	15,724	17,414
Accrued postretirement benefits	13,144	12,040
Policyholder dividends	39,294	44,695
Overdraft checks	24,522	22,005
Reinsurance premium payable — residual market retrocession	9,456	7,750
Assumed paid losses — residual markets	8,801	7,258
Other liabilities	<u>27,866</u>	<u>17,161</u>
Total	<u>\$ 171,757</u>	<u>\$ 169,957</u>

12. REINSURANCE

In the ordinary course of business, we enter into reinsurance contracts, also known as treaties, whereby the Company and its subsidiaries assume and cede premiums and losses with other insurance companies. These arrangements serve to limit the maximum net loss on catastrophes. We also participate as a reinsurer in various residual market workers' compensation pools. Participation in these pools is mandatory in many states in which we conduct business, and thus the pools are frequently referred to as involuntary pools. Involuntary pool underwriting results generally are distributed to companies writing workers' compensation insurance in each state based upon each company's market share of the total voluntary workers' compensation market.

Reinsurance does not relieve us of our primary obligations under our contracts of insurance. To the extent our reinsurers are unable or unwilling to honor their obligations under the reinsurance treaties, we remain primarily liable to our policyholders. To manage this risk, we periodically evaluate the financial condition of our reinsurers. When needed, we establish allowances for uncollectible reinsurance recoverables.

The effects of reinsurance activities on premiums and losses for the years ended December 31, 2009 and 2008, are as follows (in thousands):

	2009	2008
Written premiums:		
Direct	\$ 798,311	\$ 873,515
Reinsurance assumed	23,626	31,744
Reinsurance ceded	<u>(42,849)</u>	<u>(28,001)</u>
Net premiums written	<u>\$ 779,088</u>	<u>\$ 877,258</u>
Earned premiums:		
Direct	\$ 800,370	\$ 855,889
Reinsurance assumed	25,021	32,631
Reinsurance ceded	<u>(43,966)</u>	<u>(28,828)</u>
Net premiums earned	<u>\$ 781,425</u>	<u>\$ 859,692</u>
Losses and loss adjustment expenses incurred:		
Direct	\$ 623,088	\$ 585,818
Reinsurance assumed	20,055	18,205
Reinsurance ceded	<u>(29,818)</u>	<u>(3,740)</u>
Net losses and loss adjustment expenses incurred	<u>\$ 613,325</u>	<u>\$ 600,283</u>

Reinsurance recoverables and prepaid reinsurance as of December 31, 2009 and 2008, consist of the following (in thousands):

	2009	2008
Reinsurance recoverables:		
Unpaid losses recoverable on workers' compensation policies	\$ 175,446	\$ 181,569
Unpaid losses recoverable on disability policies	17,790	22,836
Accrued reinsurance premiums recoverable and other	1,038	6,999
Paid losses recoverable	<u>12,478</u>	<u>21,968</u>
Total	<u>\$ 206,752</u>	<u>\$ 233,372</u>
Total prepaid reinsurance	<u>\$ 12,534</u>	<u>\$ 8,537</u>

13. FEDERAL INCOME TAXES

The Company and all its subsidiaries are included in the consolidated federal income tax return of BCBSM. Current taxes are allocated between the Company and BCBSM and between the Company and its subsidiaries according to written tax-sharing agreements. Under these agreements, income taxes allocated to each company are equivalent to the liability it would have incurred had it filed a separate return. Federal income taxes of \$14,792,659 and \$17,867,729 were recoverable from BCBSM as of December 31, 2009 and December 31, 2008, respectively.

The significant components of federal income tax expense (benefit) for the years ended December 31, 2009 and 2008, are as follows (in thousands):

	2009	2008
Current	\$ 10,974	\$ 35,761
Deferred	<u>31,736</u>	<u>(53,808)</u>
Total	<u>\$42,710</u>	<u>\$ (18,047)</u>

The tax effects of the temporary differences giving rise to the deferred tax assets and liabilities as of December 31, 2009 and 2008, are as follows (in thousands):

	2009	2008
Deferred income tax assets:		
Discount of liability for losses and loss adjustment expenses	\$ 59,379	\$ 60,714
Unearned premiums	27,559	28,728
Net realized and unrealized losses on investment securities		37,949
Pension and postretirement benefits	10,593	10,255
Policyholder dividends	9,216	11,440
Goodwill	4,732	5,166
Guaranty fund assessments	1,470	1,470
Net operating loss carryovers of TCIC	7,563	7,927
Other	12,154	8,386
Allowance	<u>(7,563)</u>	<u>(7,927)</u>
Total deferred income tax assets — net of allowance	<u>125,103</u>	<u>164,108</u>
Deferred income tax liabilities:		
Net unrealized gains on investment securities	8,418	
Property and equipment	1,930	3,606
Deferred policy acquisition costs	13,124	14,069
Intangible assets	8,853	9,299
Other	<u>258</u>	<u>726</u>
Total deferred income tax liabilities	<u>32,583</u>	<u>27,700</u>
Net deferred income tax assets	<u>\$ 92,520</u>	<u>\$ 136,408</u>

The provision for income taxes differs from the amount computed by applying the United States statutory income tax rate of 35% to income before taxes as of December 31, 2009 and 2008, for the following reasons (in thousands):

	2009	2008
Tax provision at statutory rate	\$ 42,621	\$ (17,079)
Tax effect of:		
Dividends received exclusion	(603)	(557)
Realized value of net operating loss carryover of TCIC	(186)	(171)
Other	<u>878</u>	<u>(240)</u>
Provision for income taxes	<u>\$ 42,710</u>	<u>\$ (18,047)</u>
Effective tax rate	<u>35 %</u>	<u>37 %</u>

As of December 31, 2009, approximately \$21,609,978 of tax loss carryforwards, which will begin to expire in 2016, were available to offset future taxable income in TCIC. The realization of this benefit is in doubt, and, as a result, we have recorded a valuation allowance for the full amount of the benefit.

Effective January 1, 2009, the Company adopted ASC 740 *Income Taxes* (FASB Fin No. 48). As of December 31, 2009 and 2008, the Company had no material unrecognized tax benefits or accrued interest and penalties. The Company's policy is to account for interest as a component of interest expense and penalties as a component of other expense. Federal tax years 2006 through 2009 were open for examination as of December 31, 2009.

14. EMPLOYEE BENEFITS

Our employees participate in several employee benefit plans, several of which are sponsored by BCBSM. We maintain separate records for the liabilities of the BCBSM-sponsored plans that pertain to our employees; plan assets are commingled for all plan participants but for purposes of financial reporting are allocated to the Company on the basis of a pre-defined formula. In 2008, we changed the measurement date from September 30 to December 31, as required by ASC 715 (FASB 158), for each of our pension and postretirement benefit plans using the Remeasurement Method. The effect of changing the measurement date resulted in a one-time adjustment that decreased beginning retained earnings by \$820,000, net of tax.

Defined Contribution Plan — Substantially all employees who meet age and service requirements may participate in a 401(k) plan. Except for employees of CompWest, we match 50% of employee contributions up to 10% of bi-weekly adjusted wages. Employees of CompWest may receive a profit sharing contribution from CompWest to their 401(k) accounts. Total 401(k) expenses for the years ended December 31, 2009 and 2008, were \$1,651,887 and \$1,590,982, respectively.

Defined Benefit Pension Plan — The Company's defined benefit pension plan consists of two parts, a retirement account plan and a traditional defined benefit plan, described as follows:

Retirement Account Plan — Certain employees who meet age and service requirements and who are not members of a labor union participate in a defined benefit plan that provides participants an account balance to which interest credits and earnings credits are added. Employees can elect to receive the lump-sum value of their account balance when they retire or leave employment, or they can receive monthly payments at retirement. The Company contributions during the years ended December 31, 2009 and 2008, totaled \$4,045,121 and \$2,483,817, respectively.

Defined Benefit Plan — Employees who meet age and service requirements and who are members of a labor union participate in a defined benefit plan in which benefits are based on final compensation and credited service at the date of retirement or termination. We make annual contributions sufficient to meet the minimum funding standards of the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1986. No contributions to the plan were required during 2009 and 2008.

Other Postretirement Benefits — We provide postretirement health care and other benefits to some of our employees who meet service and age requirements. The benefits for qualified employees not represented by a labor union are subject to revision at the discretion of the Board of Directors. Postretirement benefits for employees who are represented by a labor union are subject to collective bargaining agreements.

Information regarding the change in benefit obligation, plan assets, and funded status as of December 31, 2009 and 2008, for the retirement account plan, the defined benefit plan, and the postretirement benefit plan are shown in the following table. The postretirement health care plan is unfunded and, as such, held no assets and had no asset allocations as of December 31, 2009 or 2008.

	Pensions		Postretirement	
	2009	2008	2009	2008
Change in projected benefit obligation:				
Benefit obligation at beginning of year	\$ 33,120	\$ 28,914	\$ 12,040	\$ 10,778
FASB Statement No. 158 measurement date transition	-	(351)	-	(322)
Service cost	3,618	2,870	1,130	922
Interest cost	2,351	1,907	812	701
Actuarial loss (gain)	2,299	951	(726)	183
Benefits and administrative costs paid	(1,722)	(1,171)	(112)	(222)
Projected benefit obligation at end of year	39,666	33,120	\$ 13,144	\$ 12,040
Change in plan assets:				
Fair value at beginning of year	15,706	21,174		
FASB Statement No. 158 measurement date transition	-	(745)		
Employer contribution	4,045	2,484		
Actual return on plan assets	5,964	(8,450)		
Benefits and administrative costs paid	(1,722)	(1,170)		
Asset reallocation	-	2,413		
Plan assets at end of year	23,993	15,706		
Funded status — underfunded	\$ (15,673)	\$ (17,414)		
Accumulated benefit obligation — end of year	\$ 33,882	\$ 27,979		

The amount recognized in the consolidated balance sheets as of December 31, 2009 and 2008, and the amounts in accumulated other comprehensive losses that have not yet been recognized as components of net periodic cost are as follows (in thousands):

	Pensions		Postretirement	
	2009	2008	2009	2008
Balance sheets:				
Other assets	\$ 51	\$ -	\$ -	\$ -
Other liabilities	<u>(15,724)</u>	<u>(17,414)</u>	<u>(13,144)</u>	<u>(12,040)</u>
Net balance sheet liabilities	<u><u>\$ (15,673)</u></u>	<u><u>\$ (17,414)</u></u>	<u><u>\$ (13,144)</u></u>	<u><u>\$ (12,040)</u></u>
Accumulated other comprehensive income (loss):				
Net actuarial gain	\$ 8,496	\$ 10,194	\$ 321	\$ 1,083
Net prior service cost (credit)	67	26	(701)	(792)
Other	-	(2,564)	-	-
Deferred income tax (expense) benefit	<u>(2,997)</u>	<u>(2,679)</u>	<u>133</u>	<u>(103)</u>
Total accumulated other comprehensive income (loss)	<u><u>\$ 5,566</u></u>	<u><u>\$ 4,977</u></u>	<u><u>\$ (247)</u></u>	<u><u>\$ 188</u></u>

Changes in the net actuarial loss and the accumulated other comprehensive loss as of December 31, are as follows (in thousands):

	Pensions		Postretirement	
	2009	2008	2009	2008
Change in net actuarial (gain) loss:				
Net actuarial gain (loss) at the beginning of the year	\$ 10,194	\$ (396)	\$ 1,083	\$ 1,644
Amortization cost for the year	(159)	(93)	(37)	(5)
Liability gain (loss)	2,298	(367)	(725)	(556)
Asset (loss) gain	(3,759)	11,050		
Other	(78)	-	-	-
	<u>\$ 8,496</u>	<u>\$ 10,194</u>	<u>\$ 321</u>	<u>\$ 1,083</u>
Change in accumulated other comprehensive income (loss):				
Accumulated other comprehensive income (loss) in prior year	\$ 4,977	\$ (272)	\$ 188	\$ 480
Amortized during the year:				
Net prior service credit	40	49	91	114
Net actuarial loss	(159)	(93)	(37)	(5)
Occurring during the year:				
Net prior service credit	-	-	-	-
Net actuarial gain	(1,461)	10,682	(726)	(556)
Balance of actuarial items arising in prior years recognized per ASC 715				
Other adjustments	2,487	(2,563)	-	-
Deferred tax	(318)	(2,826)	237	155
	<u>\$ 5,566</u>	<u>\$ 4,977</u>	<u>\$ (247)</u>	<u>\$ 188</u>
Total accumulated other comprehensive income (loss) at the end of the year				

We expect to recognize the following amounts as components of net periodic benefit cost in 2010 (in thousands):

	Pensions 2009	Postretirement 2009
Amortization of prior service credit	\$ (50)	\$ (90)
Amortization of net gain	<u>270</u>	<u>-</u>
Total amortization expected to be recognized	<u>\$ 220</u>	<u>\$ (90)</u>

The following table provides information regarding the pension and postretirement benefit plans' components of net period cost for the years ended December 31 (in thousands):

	Pensions		Postretirement	
	2009	2008	2009	2008
Service cost	\$ 3,618	\$ 2,870	\$ 1,130	\$ 922
Interest cost on projected benefit obligation	2,351	1,907	812	701
Expected return on assets	(2,204)	(1,736)		
Net amortization and deferral	119	31	(54)	(91)
Internal asset transfers	(790)			
Net periodic pension cost before special events	3,094	3,072	1,888	1,532
Special events	76			
Net periodic pension cost	<u>\$ 3,170</u>	<u>\$ 3,072</u>	<u>\$ 1,888</u>	<u>\$ 1,532</u>

We expect to pay the following retirement plan benefits and post-retirement health plan benefits and to receive anticipated subsidies under the Medicare Prescription Drug Improvement and Modernization Act of 2003 in each of the next five years and in the aggregate for the five years thereafter (in thousands):

Years Ending	Pension	Postretirement	Subsidies
2010	\$ 1,710	\$ 320	\$ (10)
2011	1,390	380	(10)
2012	1,680	460	(10)
2013	2,480	590	(20)
2014	3,120	740	(30)
2015 through 2019	<u>21,010</u>	<u>5,640</u>	<u>(330)</u>
Total	<u>\$ 31,390</u>	<u>\$ 8,130</u>	<u>\$ (410)</u>

We do not expect to contribute to the Retirement Plans during 2010.

The effect of the subsidy provided under the Medicare Prescription Drug Improvement and Modernization Act of 2003 was to reduce net periodic cost of the postretirement health plan by \$216,000 in 2009.

The assumptions used to determine the Company's benefit obligations and net periodic costs of its pension and postretirement benefits plans as of December 31, are as follows (in thousands):

	Pension		Postretirement	
	2009	2008	2009	2008
Discount rate	6.35%–6.9%	6.75%–6.9%	6.6%–6.65%	6.0 %
Expected return on plan assets	9.0%	9.0%	N/A	N/A
Rate of increase in compensation	3.0%–6.5%	3.0%–6.5%	N/A	N/A
	depending on age of participants	depending on age of participants		
Assumed health care cost trend rate:				
Cost trend rate for the next year	N/A	N/A	7.36 %	7.75 %
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	N/A	N/A	5.0 %	5.0 %
Year in which the rate reaches the ultimate trend rate	N/A	N/A	2015	2015

Increasing the assumed health care cost trend by 1% for all future years results in increases of approximately \$373,000 in annual service and interest costs and increases of approximately \$2,282,000 in the accumulated postretirement benefit obligations.

When selecting long-term rates of return, we consider various criteria, including historical returns and the asset allocation policy of the pension plan. The Retirement Plans have an asset allocation policy based on retirement plan characteristics, capital market expectations, and asset-liability projections. The Retirement Plans use a mix of core and satellite managers to implement the asset allocation policy. The asset mix is reviewed on a periodic basis, and the portfolio is reallocated any time there is a material deviation in the asset class as described in the allocation policy.

Weighted-average target asset allocation and actual asset allocations as of December 31, 2009 and 2008, by asset category are as follows:

	Target	2009	2008
Asset category:			
Equity securities	70.0 %	66.0 %	64.0 %
Debt securities	25.0	26.0	32.0
Other — cash	<u>5.0</u>	<u>8.0</u>	<u>4.0</u>
Total	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>

Health care benefit payments are estimates using the current actuarially assumed growth rates. These estimates are dependent upon various factors, including demographics and inflation. The above estimates are based upon the assumption that participant demographics remain unchanged.

The fair values of the Company's pension plan assets by asset category as of December 31, 2009 are as follows (in thousands):

	Fair Value Measurements Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash equivalents	\$ 1,593	\$ -	\$ -	\$ 1,593
Commingled Pension Trust (A)		6,971		6,971
Insurance Annuity Contract Limited Partnership	25		594	25 594
Equity securities —				
U.S. Companies	8,746	19		8,765
U.S. Treasury securities		389		389
Corporate bonds (B)	25	4,082	209	4,316
Mortgage-backed securities	<u>-</u>	<u>1,340</u>	<u>-</u>	<u>1,340</u>
Total	<u>\$ 10,389</u>	<u>\$ 12,801</u>	<u>\$ 803</u>	<u>\$ 23,993</u>

(A) Includes pension master trust's interest in PIMCO Stock Plus Limited Partnership, a commingled fund representing the pension core equity allocation and bench marked against the S&P 500 (\$151.4) and master trust's holding in Capital Guardian Non US Equity Fund, a commingled trust representing the pension's international equity allocation (\$69.2).

(B) Corporate bonds include fixed income securities in separately managed portfolios. The diversified fixed income mandated is targeted at 12.5% of pension assets and is managed by Western. Loomis Sayles manages a high yield fixed income portfolio targeted at 12.5% of pension assets.

Based on market conditions that resulted in the absence of quoted prices in active markets for our auction rated securities and collateralized debt obligations, we changed our valuation methodology for the securities to a discounted cash flow analysis during the fourth quarter 2009. The discounted cash flow analysis consisted of using the market yield for a similar rate security to discount the expected cash flow of the bond. The fair value of the bond is the net present value of the discounted cash flow. Accordingly, during 2009 these securities changed from Level 2 to Level 3 within the fair value hierarchy. The following table presents our assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)			
	Equities	Limited Partnership	Bonds	Total
Beginning balance at January 1, 2009	\$ 9	\$ 534	\$ 294	\$ 837
Actual return on plan assets:				
Relating to assets still held at the reporting date	28	(63)	234	199
Relating to assets sold during the period	(25)		(82)	(107)
Purchases, sales, and settlements	(3)	123	(47)	73
Transfers out of Level 3	(9)	-	(190)	(199)
Ending balance at December 31, 2009	<u>\$ -</u>	<u>\$ 594</u>	<u>\$ 209</u>	<u>\$ 803</u>

15. LEASES

We lease office space, office equipment, software, parking spaces, and storage under several operating leases expiring on various dates through the year 2024. Rental expense for 2009 and 2008 was \$2,733,793 and \$2,377,691, respectively. Future minimum lease payments as of December 31, 2009, are as follows (in thousands):

Years Ending	
2010	\$ 2,075
2011	2,312
2012	2,084
2013	1,587
2014	1,008
Thereafter	<u>9,942</u>
Total	<u>\$ 19,008</u>

The Company was the lessor of parking facilities with rental income for the years ended December 31, 2009 and 2008, totaling \$428,577 and \$389,581, respectively.

16. SERVICE AGREEMENTS

We have entered into certain noncancelable agreements with service providers. Future noncancelable commitments under these service agreements as of December 31, 2009, are as follows in (thousands):

Years Ending	
2010	\$ 2,456
2011	2,108
2012	1,709
2013	864
2014	403
Thereafter	_____
Total	<u>\$ 7,540</u>

17. RELATED-PARTY TRANSACTIONS

We have entered into an agreement whereby the Company and BCBSM may provide services to one another. The agreement provides for monthly payments and a year-end settlement based on actual cost of services performed. During 2009 and 2008, BCBSM supplied executive, legal, financial, and other services to the Company at a cost of \$1,244,871 and \$1,429,517, respectively.

We also purchase health care insurance benefits, some of which we self insure, for some of our employees from BCBSM and its subsidiary Blue Care Network (BCN). Total expenses paid for administration of self-insured benefits were \$397,782 and \$321,236 in 2009 and 2008; and total self-insured health care benefits reimbursed to BCBSM were \$9,921,106 and \$8,222,576 in 2009 and 2008, respectively. Total premiums paid were \$2,385,162 and \$2,366,223 in 2009 and 2008, respectively.

We sell workers' compensation insurance and services and short-term disability administration services to BCBSM and BCN. The administrative fees and insurance premiums paid by BCBSM and BCN during 2009 and 2008 were \$1,694,914 and \$1,321,107, respectively.

In 2009 we sold the current home office building and adjacent surface parking lot and parking structure to BCBSM at the asset's appraised value of \$18,850,000. We also entered into an agreement with BCBSM for the leaseback of the home office building while construction is being completed on our new corporate headquarters. The lease term ends on April 30, 2011. Total rent paid to BCBSM during 2009 was \$125,903.

18. COMMITMENTS AND CONTINGENCIES

We are involved in numerous lawsuits arising in the normal course of administering our workers' compensation business. In our opinion, we have made adequate provisions for the costs of resolving those matters in the loss and loss adjustment expense reserves or, based on the advice of legal counsel, we believe the matters will be resolved without material adverse effect on the Company's financial position or results of operations.

We have entered into an agreement with a developer to construct a new corporate headquarters building for the Company in Lansing, Michigan. As of December 31, 2009, the Company has advanced \$84 million for the construction of the new corporate headquarters and has committed to provide funds to complete the construction project. We estimate the remaining amount to fund the project to completion is approximately \$45 million. As noted in Note 2, we have recognized the amounts advanced as construction in progress in the consolidated financial statements under property and equipment.

19. INSURANCE-RELATED ASSESSMENTS

The liabilities and anticipated payment schedules for the guaranty fund and other insurance-related assessments recorded as of December 31, 2009 and 2008, are as follows (in thousands):

	2009	2008
Payable in one year or less	\$ 19,825	\$ 19,018
Payable after one year through five years	5,539	4,134
Payable after five years through ten years	1,566	1,511
Payable after ten years	<u>2,159</u>	<u>2,084</u>
 Total insurance-related assessments	 29,089	 26,747
 Other taxes and fees	 <u>1,684</u>	 <u>3,300</u>
 Total assessments, taxes, and fees payable	 <u>\$ 30,773</u>	 <u>\$ 30,047</u>

No anticipated premium tax offsets were available to reduce liabilities recorded as of December 31, 2009 and 2008.

Adjustments to accruals for guaranty fund assessments of \$(458,830) and \$(2,971,199) were credited to operations during 2009 and 2008, respectively. We expect to pay guaranty fund assessments in the future and have recorded liabilities totaling \$7,538,339 as of December 31, 2009.

20. STATUTORY ACCOUNTING AND DIVIDEND RESTRICTIONS

State insurance regulatory authorities require us to file statutory financial statements for each of the Company's insurance company subsidiaries. GAAP differs from statutory accounting practices prescribed or permitted by regulatory authorities. Differences between financial statement net income and statutory net income and between financial statement shareholder's equity and statutory capital and surplus are principally due to the following: investment in debt securities, which are carried at fair value under GAAP but generally at amortized cost for statutory purposes; unrealized gains and losses on certain equity securities, which are reported in net income under GAAP but not for statutory purposes; policy acquisition costs which are deferred under GAAP but expensed for statutory purposes; certain deferred income taxes which are recorded under GAAP but not for statutory purposes; the timing of the recognition of certain items such as policyholder dividends and pension expenses; and the treatment of certain assets that are charged against statutory capital and surplus under statutory accounting (non-admitted assets).

Under statutory accounting, the Company's insurance company subsidiaries capital and surplus was \$692,085,510 as of December 31, 2009, and \$577,272,594 as of December 31, 2008. Statutory net income (loss) for the years ended December 31, 2009 and 2008, was \$48,854,180 and \$(35,870,634), respectively.

The Company's insurance subsidiaries are subject to state regulations that establish minimum statutory capital and surplus thresholds and place restrictions on annual dividend and other distributions.

The Company's insurance subsidiaries are also subject to certain Risk-Based-Capital (RBC) requirements as specified by the National Association of Insurance Commissioners (NAIC). RBC determines minimum capital and surplus requirements through an analysis of various risk factors related to each company's operations. As of December 31, 2009 and 2008, the Company's insurance company subsidiaries had sufficient capital and surplus to exceed all minimum requirements.

State regulatory restrictions limit the maximum amount of annual dividends or other distributions, including loans or cash advances an insurance company may pay its shareholders without prior approval. As of December 31, 2009, the maximum amount of dividends the Company may receive from the insurance company subsidiaries during 2010, without prior approval is \$69,208,000. Accordingly, the remaining amount of the insurance companies capital and surplus is considered restricted.

21. OTHER COMPREHENSIVE INCOME (LOSS)

Other comprehensive income (loss) for the years ended December 31, 2009 and 2008, consists of the following (in thousands):

	2009	2008
Unrealized holding gains (losses) arising during the year	\$ 65,340	\$ (39,530)
Reclassification adjustment for investment (gains) losses included in net income	<u>(30,383)</u>	<u>6,446</u>
Net unrealized gains (losses) on investments	34,957	(33,084)
Increase in additional minimum pension liability	(236)	(7,763)
Income tax (expense) benefit related to items of other comprehensive income	<u>(12,153)</u>	<u>14,296</u>
Other comprehensive income (loss) — net of tax	<u>\$ 22,568</u>	<u>\$ (26,551)</u>

22. CATASTROPHE EXPOSURE

We are exposed to risk of catastrophe as a result of writing of business within certain geographic areas and as a result of writing only one line of business.

Specifically, we insure a small number of employers whose size and concentration of employees in several urban areas expose us to severe financial consequences should a catastrophic event occur at a work location of these employers. We are also exposed on a broad basis to earthquake losses, principally in California. We believe we have mitigated these risks through the purchase of reinsurance.

23. SUBSEQUENT EVENTS

We have evaluated subsequent events through March 5, 2010, the date the consolidated financial statements were available to be issued. No subsequent events were noted.

* * * * *