

Accident Fund Holdings, Inc. and Subsidiaries

Consolidated Financial Statements as of and for the
Years Ended December 31, 2010 and 2009, and
Independent Auditors' Report

ACCIDENT FUND HOLDINGS, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009:	
Balance Sheets	2
Statements of Operations	3
Statements of Shareholder's Equity	4
Statements of Cash Flows	5
Notes to Consolidated Financial Statements	6-39

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated balance sheets of Accident Fund Holdings, Inc. and subsidiaries (the "Company") as of December 31, 2010 and 2009, 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 the Company as of December 31, 2010 and 2009, 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 15, 2011

ACCIDENT FUND HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2010 AND 2009 (In thousands)

	2010	2009
ASSETS		
INVESTMENTS:		
Available-for-sale securities	\$ 1,612,586	\$ 1,577,660
Trading securities	<u>230,981</u>	<u>233,534</u>
Total investments	1,843,567	1,811,194
CASH AND CASH EQUIVALENTS	103,740	114,064
SECURITIES LENDING COLLATERAL	77,095	69,383
PREMIUMS RECEIVABLE — Net	268,117	282,171
REINSURANCE RECOVERABLE	198,840	206,752
PROPERTY AND EQUIPMENT — Net	187,684	115,730
DEFERRED INCOME TAXES	67,997	92,520
GOODWILL	78,882	114,660
INTANGIBLE ASSETS	24,020	25,293
OTHER ASSETS	<u>131,711</u>	<u>113,419</u>
TOTAL	<u>\$ 2,981,653</u>	<u>\$ 2,945,186</u>
LIABILITIES AND SHAREHOLDER'S EQUITY		
LIABILITIES:		
Losses and loss adjustment expenses	\$ 1,399,664	\$ 1,305,488
Unearned premiums and other	315,536	335,666
Assessments, taxes, and fees payable	21,819	30,773
Securities lending collateral payable	77,095	69,383
Payable for purchases of securities	458	287
Notes payable	138,992	126,377
Junior subordinated debt	20,619	20,619
Other liabilities	<u>165,912</u>	<u>171,757</u>
Total liabilities	<u>2,140,095</u>	<u>2,060,350</u>
SHAREHOLDER'S EQUITY:		
Common stock, \$0 par value — authorized, 60,000 shares; issued and outstanding, 1,000 shares		
Additional paid-in capital	399,088	399,088
Accumulated other comprehensive income	20,522	10,088
Retained earnings	<u>421,948</u>	<u>475,660</u>
Total shareholder's equity	<u>841,558</u>	<u>884,836</u>
TOTAL	<u>\$ 2,981,653</u>	<u>\$ 2,945,186</u>

See notes to consolidated financial statements.

ACCIDENT FUND HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (In thousands)

	2010	2009
REVENUES:		
Net premiums earned	\$ 750,054	\$ 781,425
Net investment and other income	68,567	73,155
Net gains on investments	<u>71,644</u>	<u>105,511</u>
Total revenues	<u>890,265</u>	<u>960,091</u>
LOSSES AND EXPENSES:		
Losses and loss adjustment expenses	705,009	613,325
Operating and other expenses	190,169	191,991
Policyholder dividends	25,306	28,776
Interest expense	1,690	4,226
Impairment of goodwill	<u>35,778</u>	<u> </u>
Total losses and expenses	<u>957,952</u>	<u>838,318</u>
(LOSS) INCOME BEFORE FEDERAL INCOME TAX (BENEFIT) EXPENSE	(67,687)	121,773
FEDERAL INCOME TAX (BENEFIT) EXPENSE	<u>(13,975)</u>	<u>42,710</u>
NET (LOSS) INCOME	(53,712)	79,063
OTHER COMPREHENSIVE INCOME — Net of tax	<u>10,434</u>	<u>22,568</u>
COMPREHENSIVE (LOSS) INCOME	<u>\$ (43,278)</u>	<u>\$ 101,631</u>

See notes to consolidated financial statements.

ACCIDENT FUND HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDER'S EQUITY FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (In thousands)

	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive (Loss) Income	Retained Earnings	Total Shareholder's Equity
BALANCE — January 1, 2009	\$ 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 gains on investments — net of tax			22,722		22,722
Other changes in other comprehensive income — net of tax			(154)		(154)
BALANCE — December 31, 2009	-	399,088	10,088	475,660	884,836
Net loss				(53,712)	(53,712)
Change in unrealized gains on investments — net of tax			17,148		17,148
Other changes in other comprehensive income — net of tax			(6,714)		(6,714)
BALANCE — December 31, 2010	<u>\$ -</u>	<u>\$399,088</u>	<u>\$ 20,522</u>	<u>\$421,948</u>	<u>\$841,558</u>

See notes to consolidated financial statements.

ACCIDENT FUND HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (In thousands)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from premiums collected — net of reinsurance	\$ 745,019	\$ 803,292
Cash paid for:		
Losses and loss adjustment expenses	(607,845)	(602,834)
Underwriting expenses	<u>(175,892)</u>	<u>(168,355)</u>
Total	(783,737)	(771,189)
Other expenses	(49,842)	(41,085)
Net purchases, sales, and maturities of trading securities	42,927	352,998
Interest, dividends, and rental income received	79,864	73,719
Federal income taxes paid (recovered)	<u>15,632</u>	<u>(4,321)</u>
Net cash provided by operating activities	<u>49,863</u>	<u>413,414</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(1,382,919)	(1,703,609)
Proceeds from sale and maturity of investments	1,391,253	1,202,408
Purchase of property, equipment, and other assets	(81,136)	(74,789)
Proceeds from sale of property and equipment	<u> </u>	<u>18,850</u>
Net cash used in investing activities	<u>(72,802)</u>	<u>(557,140)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Other cash applied		(286)
Borrowings on notes payable	33,615	92,878
Repayment of notes payable	<u>(21,000)</u>	<u>(16,259)</u>
Net cash provided by financing activities	<u>12,615</u>	<u>76,333</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(10,324)	(67,393)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>114,064</u>	<u>181,457</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 103,740</u>	<u>\$ 114,064</u>
RECONCILIATION OF NET (LOSS) INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net (loss) income	\$ (53,712)	\$ 79,063
Adjustment to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation	9,182	9,287
Gain on sale of investments and equipment	(71,644)	(105,194)
Amortization of bond premium and discounts	12,614	2,315
Amortization of intangible assets	1,274	1,274
Impairment of goodwill	35,778	
Net purchases, sales, and maturities of trading securities	42,927	352,998
Deferred income tax benefit	19,324	31,736
Changes in assets and liabilities:		
Receivables and other assets	5,202	67,373
Liability for losses and loss adjustment expenses	94,176	(678)
Unearned premiums	(20,130)	(27,336)
Assessments, taxes, and other liabilities	<u>(25,128)</u>	<u>2,576</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 49,863</u>	<u>\$ 413,414</u>

See notes to consolidated financial statements.

ACCIDENT FUND HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

1. ORGANIZATION

Our consolidated financial statements include the accounts of Accident Fund Holdings, Inc. and subsidiaries (the “Company”), an insurance holding company organized in 2009 (formerly Accident Fund Insurance Company of America and subsidiaries) and its wholly owned direct and indirect subsidiaries. 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. and subsidiaries. As a result, Accident Fund became a wholly owned subsidiary of the Company.

Subsidiaries of the Company include the following: 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) Topic 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 50 states and the District of Columbia as of December 31, 2010.

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 other comprehensive income 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 earnings. As of December 31, 2010 and 2009, 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 banks. 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 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, nonbinding 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.

Our financial assets and liabilities carried at fair value have been classified, for disclosure purposes, based on a hierarchy defined by FASB ASC Topic 820, *Fair Value Measurements and Disclosures*. It defines fair value as the price that would be received for an asset or paid to transfer a liability (exit price) in the principal most advantageous market for the asset or liability in an orderly transaction between market participants. ASC Topic 820 prioritizes the inputs used in measuring fair value into the following levels:

Level 1 — Unadjusted quoted prices for identical assets or liabilities in active markets

Level 2 — Inputs other than Level 1 that are based on observable market data, including quoted prices for similar assets in active markets, quoted prices for identical assets in inactive markets, and inputs derived principally from or corroborated by observable market data by correlation or other means

Level 3 — Unobservable inputs reflecting our own assumptions based on the best information available in the circumstances

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. We employ a systematic methodology that considers available evidence in evaluating potential impairment of investments. If the amortized cost of an investment exceeds its fair value, we evaluate, among other factors, the magnitude and duration of the decline in fair value, the financial health and business outlook of the issuer, and our 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 premium 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, 2010 and 2009, were \$92.3 million and \$96.8 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, 2010, is adequate to meet our future obligations. However, actual claim experience may differ significantly from the established reserves.

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 — In connection with acquiring the assets and liabilities of subsidiaries, the excess of the purchase price over fair value of identifiable net assets acquired is recorded as goodwill. Goodwill is not amortized, but is reviewed for impairment at least annually or more frequently should circumstances indicate. The impairment review incorporates both a market and income valuation approach. The income approach relies on a discounted cash flow model that requires significant management judgment with respect to the discount rate and estimates of future premiums, losses, and investment results. Changes in judgments, assumptions, and estimates could result in significantly different estimates of fair value, and such changes could materially affect the financial statements in any given year. We completed the annual impairment tests as of September 30, 2010, and as a result recorded an impairment for CWIH (see Note 6). No impairment was indicated for 2009.

Intangible Assets — We hold various intangible assets with definite and indefinite useful lives. 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 indefinite-lived 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 estimated 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 2 1/2 years to 40 years.

Consolidation of Variable Interest Entities — As discussed in Notes 10 and 18, we have entered into agreements with a developer to construct a new corporate headquarters building and parking structure in Lansing, Michigan. For one agreement, the Company has loaned approximately \$123 million to a development company created by the developer solely to provide for the construction of the new corporate headquarters. For the other agreement, \$31 million in taxable bonds were issued by the Economic Development Corporation of the City of Lansing to a different development company created by the developer solely to provide for the construction of the new parking structure. As defined in ASC Topic 810, an enterprise shall consolidate a variable interest entity (VIE) if it has the power to direct the activities of the VIE that most significantly affect the entity's economic performance and the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE. We have evaluated the Company's investment in the development companies and have determined that they are VIEs and that we are the primary beneficiary. As such, we have consolidated the VIEs into these consolidated financial statements.

New Accounting Standards — In June 2009, the FASB issued FASB ASC Topic 860, *Transfers and Servicing*. ASC Topic 860 is intended to improve the relevance, representational faithfulness, and comparability of the information that an entity provides in its consolidated financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. ASC Topic 860 was effective for the Company on January 1, 2010. The adoption of ASC 860 did not have a material impact on the Company's consolidated financial position or results of operations.

In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-06, *Improving Disclosures about Fair Value Measurement*. It requires that the reporting entity disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. This section of ASU No. 2010-06 was effective for the Company for the period ending December 31, 2010, and resulted in expanded disclosures in Note 4. Effective for periods after December 31, 2010, the Company, under ASU No. 2010-06, is required to disclose separately, at gross, purchases, sales, issuances, and settlements in the roll forward activity in the Level 3 fair value measurements.

In October 2010, the FASB issued ASU No. 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*. The ASU addresses diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. Costs, such as incremental direct costs of contract acquisition and certain costs related directly to acquisition activities performed by the insurer for the contract, including underwriting, policy issuance and processing, and sales force contracting selling costs, should be capitalized. Only costs associated with a successful contract acquisition should be capitalized. Most advertising and costs associated with soliciting potential customers and nondirect costs, including overhead related to sales are not capitalized. ASU No. 2010-26 is effective for the Company for fiscal years beginning after December 15, 2011, with early adoption being permitted. We have not yet commenced evaluating the potential impact, if any, of the adoption of ASU No. 2010-26 on the Company's consolidated financial statements.

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, 2010 and 2009, consist of the following (in thousands):

	2010	2009
Bank deposits	\$ 32,912	\$ 12,985
Money market funds	<u>70,828</u>	<u>101,079</u>
Total	<u>\$ 103,740</u>	<u>\$ 114,064</u>

4. INVESTMENTS

The components of net investment and other income for the years ended December 31, 2010 and 2009, are as follows (in thousands):

	2010	2009
Interest and dividend income:		
Debt securities	\$ 66,553	\$ 72,568
Short-term investments	888	1,971
Equity securities	<u>3,058</u>	<u>3,039</u>
Total interest and dividend income	70,499	77,578
Rental and other income	<u>487</u>	<u>610</u>
Gross investment income	70,986	78,188
Investment expenses	<u>(2,419)</u>	<u>(5,033)</u>
Net investment and other income	<u>\$ 68,567</u>	<u>\$ 73,155</u>

Net gains (losses) included in operations and net changes in unrealized gains (losses) included in other comprehensive income for the years ended December 31, 2010 and 2009, are summarized as follows (in thousands):

	2010	2009
Net investment gains (losses):		
Debt securities:		
Available for sale:		
Net realized gains on sale of available-for-sale debt securities	\$ 33,746	\$ 30,660
Impairment loss on available-for-sale debt securities		(323)
Trading securities:		
Net realized losses on sale of trading debt securities	(142)	(7,298)
Net recognized gains on holding of trading debt securities	8,383	48,303
Equity securities:		
Available for sale — net realized (losses) gains on sale of available-for-sale equity securities	(12)	46
Trading securities:		
Net realized gains (losses) on sale of trading equity securities	6,813	(14,988)
Net recognized gains on holding of trading equity securities	23,367	49,096
Other invested assets	<u>(511)</u>	<u>15</u>
Net investment gains	<u>71,644</u>	<u>105,511</u>
Net changes in unrealized gains (losses) on available-for-sale investments:		
Debt securities	21,601	28,395
Equity securities	4,372	6,477
Other	<u>(10)</u>	<u>85</u>
Net changes in unrealized gains	<u>25,963</u>	<u>34,957</u>
Net realized investment gains (losses) and changes in unrealized losses on investments	<u>\$ 97,607</u>	<u>\$ 140,468</u>

A summary of the disposition through sale or call of debt securities and sale of equity securities for the years ended December 31, 2010 and 2009, is as follows (in thousands):

	2010	2009
Proceeds from sales of investment securities	<u>\$ 1,462,848</u>	<u>\$ 2,347,927</u>
Gross gains on sales of investment securities	\$ 60,985	\$ 68,836
Gross losses on sales of investment securities	(20,580)	(60,416)
Impairments of investment securities		<u>(323)</u>
Net realized gains	<u>\$ 40,405</u>	<u>\$ 8,097</u>

The Company's investments measured at fair value as of December 31, 2010, are summarized as follows (in thousands):

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Cash and cash equivalents	\$ 103,740	\$ -	\$ -	\$ 103,740
Available-for-sale securities:				
Corporate debt	\$ -	\$ 754,455	\$ -	\$ 754,455
Residential mortgage backed		396,784		396,784
U.S. government and agency	300,227			300,227
Collateralized mortgage backed		118,536		118,536
Equity mutual funds	38,654			38,654
Collateralized debt obligation			3,380	3,380
Certificate of deposit	550			550
	<u>\$ 339,431</u>	<u>\$ 1,269,775</u>	<u>\$ 3,380</u>	<u>\$ 1,612,586</u>
Trading securities:				
Common stock	\$ 169,115	\$ -	\$ -	\$ 169,115
Corporate debt		44,567		44,567
Collateralized mortgage backed		223		223
Residential mortgage backed		1,237		1,237
Other asset backed		126		126
Preferred stock		1,464		1,464
Collateralized mortgage obligation		1,693		1,693
Foreign		12,556		12,556
	<u>\$ 169,115</u>	<u>\$ 61,866</u>	<u>\$ -</u>	<u>\$ 230,981</u>
Total investments	<u>\$ 508,546</u>	<u>\$ 1,331,641</u>	<u>\$ 3,380</u>	<u>\$ 1,843,567</u>
Securities lending collateral:				
Corporate debt	\$ -	\$ 36,103	\$ -	\$ 36,103
Common stock		40,992		40,992
	<u>\$ -</u>	<u>\$ 77,095</u>	<u>\$ -</u>	<u>\$ 77,095</u>

The Company's investments measured at fair value as of December 31, 2009, are summarized as follows (in thousands):

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Cash and cash equivalents	<u>\$ 114,064</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 114,064</u>
Available-for-sale securities:				
Corporate debt	\$ -	\$ 740,411	\$ -	\$ 740,411
Residential mortgage backed		410,145		410,145
U.S. government and agency	268,783			268,783
Collateralized mortgage backed		119,363		119,363
Equity mutual funds	34,198			34,198
Collateralized debt obligation			3,991	3,991
Certificate of deposit	<u>769</u>			<u>769</u>
	<u>\$ 303,750</u>	<u>\$ 1,269,919</u>	<u>\$ 3,991</u>	<u>\$ 1,577,660</u>
Trading securities:				
Common stock	\$ 152,767	\$ -	\$ -	\$ 152,767
Corporate debt	1	68,572		68,573
Collateralized mortgage backed		2,836		2,836
Residential mortgage backed		1,932		1,932
Other asset backed		167		167
Preferred stock		1,044		1,044
Collateralized mortgage obligation		1,463		1,463
Foreign Bonds		<u>4,752</u>		<u>4,752</u>
	<u>\$ 152,768</u>	<u>\$ 80,766</u>	<u>\$ -</u>	<u>\$ 233,534</u>
Total investments	<u>\$ 456,518</u>	<u>\$ 1,350,685</u>	<u>\$ 3,991</u>	<u>\$ 1,811,194</u>
Securities lending collateral:				
Corporate debt	\$ -	\$ 16,097	\$ -	\$ 16,097
Common stock		16,763		16,763
U.S. Treasury		<u>36,523</u>		<u>36,523</u>
	<u>\$ -</u>	<u>\$ 69,383</u>	<u>\$ -</u>	<u>\$ 69,383</u>

Subsequent to the issuance of the 2009 consolidated financial statements, we determined that certain securities presented in the Level 1 category should have been presented in the Level 2 category based on the observable inputs used to value the securities. We have corrected the 2009 presentation of such securities in the table above. The impact to the 2009 disclosure was to decrease Level 1 total investments and securities lending collateral from \$1,746.1 million to \$456.5 million and increase Level 2 total investments and securities lending collateral from \$130.4 million to \$1420.1 million. The correction had no impact on investment values reported in 2009 and had no effect on the 2009 consolidated balance sheet, consolidated statement of operations, consolidated statement of shareholder's equity, and consolidated statement of cash flows.

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 the 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 Topic 820 on January 1, 2008, these securities changed from Level 2 to Level 3 within the ASC Topic 820 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)	
	Collateralized Debt Obligations	Total
Balance — January 1, 2010	\$ 3,991	\$ 3,991
Total gains or losses (realized/unrealized):		
Included in earnings		
Included in other comprehensive income	(611)	(611)
Purchases, issuances, and settlements		
Transfers in and/or out of Level 3	_____	_____
Balance — December 31, 2010	<u>\$ 3,380</u>	<u>\$ 3,380</u>
The amount of total gains or losses for the period included in earnings (or other comprehensive income) attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2010	<u>\$ (611)</u>	<u>\$ (611)</u>

Our assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at December 31, 2009, are as follows (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	Collateralized Debt Obligations	Total
Balance — January 1, 2009	\$ -	\$ -
Total gains or losses (realized/unrealized):		
Included in earnings		
Included in other comprehensive income	(146)	(146)
Purchases, issuances, and settlements		
Transfers in and/or out of Level 3	<u>4,137</u>	<u>4,137</u>
Balance — December 31, 2009	<u>\$ 3,991</u>	<u>\$ 3,991</u>
The amount of total gains or losses for the period included in earnings (or other comprehensive income) attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2009	<u>\$ (146)</u>	<u>\$ (146)</u>

Investments in available-for-sale securities as of December 31, 2010 and 2009, consist of the following (in thousands):

	2010			
	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	\$ 289,220	\$ 11,063	\$ (54)	\$ 300,229
Asset-backed securities and collateralized mortgage obligations	505,396	10,472	(550)	515,318
Collateralized debt obligations	4,000		(620)	3,380
Corporate notes	<u>721,495</u>	<u>35,746</u>	<u>(2,236)</u>	<u>755,005</u>
Total debt securities, including short-term investments	1,520,111	57,281	(3,460)	1,573,932
Equity securities	<u>42,809</u>	<u>4</u>	<u>(4,159)</u>	<u>38,654</u>
Total marketable securities — available for sale	<u>\$ 1,562,920</u>	<u>\$ 57,285</u>	<u>\$ (7,619)</u>	<u>\$ 1,612,586</u>

	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>(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>

Gross unrealized gains and losses as of December 31, 2010 and 2009, less applicable deferred income taxes, on available-for-sale securities are as follows (in thousands):

	2010	2009
Unrealized gains	\$ 57,285	\$ 42,029
Unrealized losses	<u>(7,619)</u>	<u>(18,326)</u>
Net unrealized gains	49,666	23,703
Deferred income tax expense	<u>(17,111)</u>	<u>(8,296)</u>
Net unrealized gains on available-for-sale investments	<u>\$ 32,555</u>	<u>\$ 15,407</u>

The amortized cost and estimated fair value of bonds, notes, and other securities held as of December 31, 2010, 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	\$ 56,227	\$ 56,271
Due after one year through five years	246,543	255,965
Due after five years through ten years	702,946	737,729
Due after ten years	<u>4,999</u>	<u>5,269</u>
Total	1,010,715	1,055,234
Collateralized debt obligations	4,000	3,380
Asset-backed securities and collateralized mortgage obligations	<u>505,396</u>	<u>515,318</u>
Total available-for-sale debt securities	<u>\$1,520,111</u>	<u>\$1,573,932</u>

The aggregate fair values of available-for-sale investments, by asset category, in an unrealized loss position as of December 31, 2010 and 2009, are shown below (in thousands):

	2010			
	12 Months or Less		Greater than 12 Months	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
U.S. government and agency securities	\$ 54	\$ 3,011	\$ -	\$ -
Asset-backed securities and collateralized mortgage obligations	550	154,715		
Corporate notes	2,236	114,144		
Collateralized debt obligations			620	3,380
Equity securities			<u>4,159</u>	<u>35,637</u>
Total available-for-sale securities	<u>\$ 2,840</u>	<u>\$ 271,870</u>	<u>\$ 4,779</u>	<u>\$ 39,017</u>
	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	1,857	143,776		
Collateralized debt obligations			9	3,991
Equity securities			<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>

In accordance with our impairment policy, securities that have a fair market value that is below amortized cost are considered impaired and are analyzed and reviewed by management to determine if the impairment is other-than-temporary. Factors taken into account for each individual security include the length of time and extent to which the fair value has been less than the amortized cost, the underlying financial condition, and the specific circumstances that are impacting the issuer in the marketplace. For debt securities, an OTTI is present when a credit loss is determined to exist for the underlying security or we have the intent to sell the security before anticipated recovery. A credit loss for impairment purposes occurs when we do not anticipate the full recovery of amortized cost. For equity securities, we evaluate whether it has the intent and ability to hold the security for a sufficient period of time to allow for a full recovery in value. The Company has determined no other-than-temporary impairment existed as of December 31, 2010 and 2009.

The carrying value of securities and collateral involved in securities lending arrangements as of December 31, 2010 and 2009, are as follows (in thousands):

	2010	2009
Securities	\$ 80,418	\$ 67,280
Cash collateral balance	77,095	69,383
Noncash collateral balance	5,339	

United States government securities with carrying values as of December 31, 2010 and 2009, of \$175,086,602 and \$161,003,250, 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, 2010 and 2009, include the following (in thousands):

	2010	2009
Investments in limited partnerships	\$ 3,447	\$ 3,777
79,868 shares of BCS Insurance	4,526	4,526
65,522 shares of Federal Home Loan Bank of Indianapolis (FHLBI)	7,818	6,552
Investment in Trust I	<u>619</u>	<u>619</u>
Total	<u>\$ 16,410</u>	<u>\$ 15,474</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, 2010 and 2009, consist of the following (in thousands):

	2010	2009
Construction in progress — headquarters	\$ 139,227	\$ 87,996
Construction in progress — parking structure	24,188	
Land and improvements	500	500
Buildings and improvements	2,541	1,181
Furniture and equipment	15,339	23,856
Software	<u>52,251</u>	<u>40,126</u>
 Total	 234,046	 153,659
 Less accumulated depreciation	 <u>(46,362)</u>	 <u>(37,929)</u>
 Net property and equipment	 <u>\$ 187,684</u>	 <u>\$ 115,730</u>

Depreciation expense for the years ended December 31, 2010 and 2009, was \$9,182,043 and \$9,286,578, respectively. Construction in progress includes \$7,467,465 and \$2,734,966 of capitalized interest as of December 31, 2010 and 2009, respectively.

6. GOODWILL AND INTANGIBLE ASSETS

We annually evaluate recorded goodwill and indefinite lived intangible assets for impairment. We completed our annual impairment test as of September 30, 2010. Because of current workers compensation market conditions in California and uncertainty about the duration of such conditions, we determined that the carrying value of the goodwill related to the acquisition of CWIH exceeded its fair value. As a result, we performed an impairment analysis using an income based approach and recognized an impairment loss of \$35.8 million in 2010. No impairment was deemed necessary in 2009.

The composition of goodwill and intangible assets at December 31, 2010, consists of the following (in thousands):

	Gross Balance	Accumulated Amortization	Net Value	Useful Life
Goodwill	\$ 126,258	\$ 47,376	\$ 78,882	
Broker network	19,700	3,200	16,500	20 years
Trade name	7,400		7,400	Indefinite Life
Covenant not to compete	900	900		3 years
State licenses	120	-	120	Indefinite Life
	<u>\$ 154,378</u>	<u>\$ 51,476</u>	<u>\$ 102,902</u>	

The composition of goodwill and intangible assets at December 31, 2009, consists of the following (in thousands):

	Gross Balance	Accumulated Amortization	Net Value	Useful Life
Goodwill	\$ 162,036	\$ 47,376	\$ 114,660	
Brokernetwork	19,700	2,199	17,501	20 years
Trade name	7,400		7,400	Indefinite Life
Covenant not to compete	900	628	272	3 years
State licenses	120	-	120	Indefinite Life
	<u>\$ 190,156</u>	<u>\$ 50,203</u>	<u>\$ 139,953</u>	

Amortization expense for the years ended December 31, 2010 and 2009, was \$1,273,684 and \$1,273,684, respectively.

Future expected amortization expense as of December 31, 2010, is as follows in (thousands):

Years Ending December 31	
2011	\$ 977
2012	977
2013	977
2014	977
2015	977
Thereafter	<u>11,615</u>
Total	<u>\$ 16,500</u>

7. LOSSES AND LOSS ADJUSTMENT EXPENSES

Activity in the reserves for losses and loss adjustment expenses for the years ended December 31, 2010 and 2009, is summarized as follows (in thousands):

	2010	2009
Balance — January 1	\$ 1,305,488	\$ 1,306,166
Less reinsurance recoverable	<u>193,236</u>	<u>204,405</u>
Net balance — January 1	<u>1,112,252</u>	<u>1,101,761</u>
Incurred related to:		
Current	618,014	561,866
Prior years	<u>86,995</u>	<u>51,459</u>
Total	<u>705,009</u>	<u>613,325</u>
Paid related to:		
Current	188,778	170,733
Prior years	<u>419,087</u>	<u>432,101</u>
Total	<u>607,865</u>	<u>602,834</u>
Net balance — December 31	1,209,396	1,112,252
Plus reinsurance recoverables	<u>190,268</u>	<u>193,236</u>
Balance — December 31	<u>\$ 1,399,664</u>	<u>\$ 1,305,488</u>

The provision for prior years' losses and loss adjustment expenses, net of reinsurance recoveries, increased by approximately \$87 million and \$51.5 million in 2010 and 2009, respectively. The increase in 2010 and 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. For 2010, the increase was also attributable to certain judicial decisions in California, which affected medical utilization, indemnity settlement values, and defense costs.

8. OTHER ASSETS

Other assets as of December 31, 2010 and 2009, consist of the following (in thousands):

	2010	2009
Other invested assets	\$ 16,410	\$ 15,474
Accrued investment income	17,332	15,922
Deferred policy acquisition costs	39,210	39,666
Prepaid reinsurance premiums	7,618	12,534
Other prepaid expenses	3,390	3,132
Funds held by others	540	308
Federal income tax recoverable	31,300	14,793
Other	<u>15,911</u>	<u>11,590</u>
Total	<u>\$ 131,711</u>	<u>\$ 113,419</u>

9. PREMIUMS RECEIVABLE

Premiums receivable as of December 31, 2010 and 2009, consist of the following (in thousands):

	2010	2009
Premiums in course of collection	\$ 58,800	\$ 58,636
Future installments not yet billed	206,749	224,259
Accrued retrospective premiums	4,338	2,941
Earned but unbilled premiums	<u>3,264</u>	<u>2,000</u>
Total	273,151	287,836
Allowance for uncollectible premiums	<u>(5,034)</u>	<u>(5,665)</u>
Premiums receivable — net	<u>\$ 268,117</u>	<u>\$ 282,171</u>

10. DEBT

The debt outstanding as of December 31, 2010 and 2009, is as follows (in thousands):

	2010	2009
FHLBI	\$ 91,711	\$ 109,574
Notes payable to Fifth Third Bank	16,281	16,803
Notes payable, issued by Economic Development Corporation of the City of Lansing	<u>31,000</u>	<u> </u>
Total	138,992	126,377
Junior subordinated debt	<u>20,619</u>	<u>20,619</u>
Total	<u>\$ 159,611</u>	<u>\$ 146,996</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	2010 Balance	2009 Balance
2008	20 year	4.81 %	FHLBI — loan no. 1	\$ 22,143	\$ 23,793
2008	20 year	5.53	FHLBI — loan no. 2	22,143	23,793
2009	5 year	2.67	FHLBI — loan no. 3	<u>47,425</u>	<u>61,988</u>
Total outstanding loans				<u>\$91,711</u>	<u>\$109,574</u>

The FHLBI loans are collateralized by \$172,994,275 of available-for-sale bonds held in a segregated trust account. Total interest expense for years ended December 31, 2010 and 2009, was \$3,895,820 and \$4,322,089, respectively.

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 Topic 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, 2010, 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, 2010. Interest payable is included in accrued expenses on the accompanying consolidated balance sheets.

The notes payable issued by the Economic Development Corporation of the City of Lansing relate to bonds issued to fund construction of a new parking structure. The proceeds of the bonds were loaned to a development company pursuant to a loan agreement dated March 1, 2010. As noted in Note 2, the development company is a VIE that we have consolidated into these consolidated financial statements. The loan is amortized over 30 years with a variable interest rate determined weekly by a Remarketing Agent, subject to a maximum rate of 12%.

The notes payable to Fifth Third Bank relate to the sale and leaseback of certain capitalized software. Outstanding borrowings with Fifth Third Bank as of December 31, 2010, 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 %	\$ 7,393	\$448	\$ 7,083	\$ 3,069
Fifth Third Bank — sale-leaseback	December 2009	5 years	5.87 %	6,273	373	10,101	1,684
Fifth Third Bank — sale-leaseback	December 2010	5 years	2.97 %	<u>2,615</u>	—	—	—
Total				<u>\$ 16,281</u>	<u>\$821</u>	<u>\$ 17,184</u>	<u>\$ 4,753</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, 2010, are as follows in (thousands):

Years Ending December 31	
2011	\$ 27,847
2012	28,216
2013	27,843
2014	11,444
2015	7,214
Thereafter	<u>93,455</u>
Total minimum payments	196,019
Less amount representing interest	<u>(36,408)</u>
Total debt	<u>\$ 159,611</u>

At December 31, 2010 and 2009, the carrying value of debt approximates fair value.

11. OTHER LIABILITIES

Other liabilities as of December 31, 2010 and 2009, consist of the following (in thousands):

	2010	2009
Accrued commissions	\$ 13,176	\$ 13,730
Accrued expenses	9,743	8,120
Accrued employee expenses	8,582	11,100
Accrued pensions	26,394	15,724
Accrued postretirement benefits	18,423	13,144
Policyholder dividends	33,230	39,294
Overdraft checks	18,215	24,522
Reinsurance premium payable — residual market retrocession	9,389	9,456
Assumed paid losses — residual markets	9,964	8,801
Other liabilities	<u>18,796</u>	<u>27,866</u>
Total	<u>\$ 165,912</u>	<u>\$ 171,757</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. 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, 2010 and 2009, are as follows (in thousands):

	2010	2009
Written premiums:		
Direct	\$ 745,502	\$ 798,311
Reinsurance assumed	20,750	23,626
Reinsurance ceded	<u>(39,724)</u>	<u>(42,849)</u>
Net premiums written	<u>\$ 726,528</u>	<u>\$ 779,088</u>
Earned premiums:		
Direct	\$ 768,457	\$ 800,370
Reinsurance assumed	21,503	25,021
Reinsurance ceded	<u>(39,906)</u>	<u>(43,966)</u>
Net premiums earned	<u>\$ 750,054</u>	<u>\$ 781,425</u>
Losses and loss adjustment expenses incurred:		
Direct	\$ 714,047	\$ 623,088
Reinsurance assumed	21,832	20,055
Reinsurance ceded	<u>(30,870)</u>	<u>(29,818)</u>
Net losses and loss adjustment expenses incurred	<u>\$ 705,009</u>	<u>\$ 613,325</u>

Reinsurance recoverables and prepaid reinsurance as of December 31, 2010 and 2009, consist of the following (in thousands):

	2010	2009
Reinsurance recoverables:		
Unpaid losses recoverable on workers' compensation policies	\$ 174,490	\$ 175,446
Unpaid losses recoverable on disability policies	15,778	17,790
Accrued reinsurance premiums recoverable and other	405	1,038
Paid losses recoverable	<u>8,167</u>	<u>12,478</u>
Total	<u>\$ 198,840</u>	<u>\$ 206,752</u>
Total prepaid reinsurance	<u>\$ 7,618</u>	<u>\$ 12,534</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 \$31,300,186 and \$14,792,659 were recoverable from BCBSM as of December 31, 2010 and 2009, respectively.

The significant components of federal income tax expense (benefit) for the years ended December 31, 2010 and 2009, are as follows (in thousands):

	2010	2009
Current	\$ (33,299)	\$ 10,974
Deferred	<u>19,324</u>	<u>31,736</u>
Total	<u>\$ (13,975)</u>	<u>\$ 42,710</u>

The tax effects of the temporary differences giving rise to the deferred tax assets and liabilities as of December 31, 2010 and 2009, are as follows (in thousands):

	2010	2009
Deferred income tax assets:		
Discount of liability for losses and loss adjustment expenses	\$ 65,049	\$ 59,379
Unearned premiums	26,206	27,559
Pension and postretirement benefits	15,786	10,593
Policyholder dividends	7,968	9,216
Goodwill	4,299	4,732
Guaranty fund assessments		1,470
Net operating loss carryovers of TCIC	7,349	7,563
Accrued expenses	1,550	1,972
Premium receivable	3,701	4,539
Other	2,412	5,643
Allowance	<u>(5,390)</u>	<u>(7,563)</u>
Total deferred income tax assets — net of allowance	<u>128,930</u>	<u>125,103</u>
Deferred income tax liabilities:		
Net unrealized gains on investment securities	27,984	8,418
Property and equipment	6,635	1,930
Deferred policy acquisition costs	12,652	13,124
Intangible assets	8,407	8,853
Other	<u>5,255</u>	<u>258</u>
Total deferred income tax liabilities	<u>60,933</u>	<u>32,583</u>
Net deferred income tax assets	<u>\$ 67,997</u>	<u>\$ 92,520</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, 2010 and 2009, for the following reasons (in thousands):

	2010	2009
Tax provision at statutory rate	\$ (23,706)	\$ 42,621
Tax effect of:		
Goodwill impairment	12,522	
Dividends received exclusion	(673)	(603)
Realized value of net operating loss carryover of TCIC	(2,170)	(186)
Other	<u>52</u>	<u>878</u>
Provision for income tax (benefit) expense	<u>\$ (13,975)</u>	<u>\$ 42,710</u>
Effective tax rate	<u>18 %</u>	<u>35 %</u>

As of December 31, 2010, approximately \$20,998,640 of tax loss carryforwards, which will begin to expire in 2012, were available to offset future taxable income in TCIC. Future tax benefits associated with the tax loss carryforwards are recognized to the extent that realization of these benefits is considered more likely than not. This determination is based on the expectation that related operations will be sufficiently profitable or various tax, business, and other planning strategies will enable us to utilize the tax loss carryforwards. In making this determination we consider all available positive and negative evidence, and as a result, have recorded a valuation allowance in the amount of \$5,390,842.

The Company has received notice from the IRS of their intent to review tax years 2006-2008. We do not anticipate any adverse findings and, accordingly, have recorded no provision for any additional federal tax liability or any related interest liability.

Effective January 1, 2009, we adopted ASC 740, *Income Taxes*. As of December 31, 2010 and 2009, the Company had no material unrecognized tax benefits or accrued interest and penalties. Our 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 2010 were open for examination as of December 31, 2010.

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.

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, 2010 and 2009, were \$1,767,112 and \$1,651,887, 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, 2010 and 2009, totaled \$452,670 and \$4,045,121, 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 2010 and 2009.

Other Postretirement Benefits — We provide postretirement health care and other benefits to some of our employees who meet service and age requirements. 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, 2010 and 2009, 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, 2010 or 2009.

	Pensions		Postretirement	
	2010	2009	2010	2009
Change in projected benefit obligation:				
Benefit obligation at beginning of year	\$ 39,666	\$ 33,120	\$ 13,144	\$ 12,040
Service cost	4,001	3,618	1,152	1,130
Interest cost	2,614	2,351	805	812
Amendments	3		(384)	
Actuarial loss (gain)	8,245	2,299	4,009	(726)
Benefits and administrative costs paid	(2,900)	(1,722)	(303)	(112)
Projected benefit obligation at end of year	\$ 51,629	\$ 39,666	\$ 18,423	\$ 13,144
Change in plan assets:				
Fair value at beginning of year	23,993	15,706		
Employer contribution	453	4,045		
Actual return on plan assets	3,689	5,964		
Benefits and administrative costs paid	(2,900)	(1,722)		
Plan assets at end of year	\$ 25,235	\$ 23,993		
Funded status — underfunded	\$ (26,394)	\$ (15,673)		
Accumulated benefit obligation — end of year	\$ 43,254	\$ 33,882		

The amount recognized in the consolidated balance sheets as of December 31, 2010 and 2009, 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	
	2010	2009	2010	2009
Balance sheets:				
Other assets	\$ -	\$ 51	\$ -	\$ -
Other liabilities	<u>(26,394)</u>	<u>(15,724)</u>	<u>(18,423)</u>	<u>(13,144)</u>
Net balance sheet liabilities	<u>\$ (26,394)</u>	<u>\$ (15,673)</u>	<u>\$ (18,423)</u>	<u>\$ (13,144)</u>
Accumulated other comprehensive loss (income):				
Net actuarial loss	\$ 15,008	\$ 8,496	\$ 4,330	\$ 321
Net prior service cost (credit)	121	67	(946)	(701)
Deferred income tax (benefit) expense	<u>(5,295)</u>	<u>(2,997)</u>	<u>(1,185)</u>	<u>133</u>
Total accumulated other comprehensive loss (income)	<u>\$ 9,834</u>	<u>\$ 5,566</u>	<u>\$ 2,199</u>	<u>\$ (247)</u>

Changes in the net actuarial loss and the accumulated other comprehensive loss as of December 31, 2010 and 2009, are as follows (in thousands):

	Pensions		Postretirement	
	2010	2009	2010	2009
Change in net actuarial loss (gain):				
Net actuarial loss at the beginning of the year	\$ 8,496	\$ 10,194	\$ 321	\$ 1,083
Amortization cost for the year	(383)	(159)		(36)
Liability loss (gain)	8,245	2,299	4,009	(726)
Asset gain	(1,350)	(3,760)		
Other		<u>(78)</u>		
Net actuarial loss at the end of the year	<u>\$ 15,008</u>	<u>\$ 8,496</u>	<u>\$ 4,330</u>	<u>\$ 321</u>
Change in accumulated other comprehensive loss (income):				
Accumulated other comprehensive loss (income) in prior year	\$ 5,566	\$ 4,977	\$ (247)	\$ 188
Amortized during the year:				
Net prior service cost	51	40	139	91
Net actuarial gain	(383)	(159)		(36)
Occurring during the year:				
Net prior service cost (credit)	3		(384)	
Net actuarial loss (gain) during the year	6,894	(1,461)	4,009	(726)
Other adjustments		2,487		
Deferred tax (benefit) expense	<u>(2,297)</u>	<u>(318)</u>	<u>(1,318)</u>	<u>236</u>
Total accumulated other comprehensive loss (income) at the end of the year	<u>\$ 9,834</u>	<u>\$ 5,566</u>	<u>\$ 2,199</u>	<u>\$ (247)</u>

We expect to recognize the following amounts as components of net periodic benefit cost in 2011 (in thousands):

	2010	
	Pensions	Postretirement
Amortization of prior service credit	\$ (20)	\$ (140)
Amortization of net loss	<u>710</u>	<u>180</u>
Total amortization expected to be recognized	<u>\$ 690</u>	<u>\$ 40</u>

Information regarding the pension and postretirement benefit plans' components of net period cost for the years ended December 31, 2010 and 2009, are as follows (in thousands):

	Pensions		Postretirement	
	2010	2009	2010	2009
Service cost	\$ 4,001	\$ 3,618	\$ 1,152	\$ 1,130
Interest cost on projected benefit obligation	2,614	2,351	805	812
Expected return on assets	(2,338)	(2,204)		
Net amortization and deferral	332	119	(139)	(54)
Internal asset transfers		<u>(790)</u>		
Net periodic pension cost before special events	4,609	3,094	1,818	1,888
Special events		<u>76</u>		
Net periodic pension cost	<u>\$ 4,609</u>	<u>\$ 3,170</u>	<u>\$ 1,818</u>	<u>\$ 1,888</u>

We expect to pay the following retirement plan benefits and postretirement 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 December 31	Pension	Postretirement	Subsidies
2011	\$ 2,020	\$ 420	\$ (10)
2012	1,830	450	(10)
2013	3,280	580	(20)
2014	3,470	720	(30)
2015	3,830	840	(30)
2016 through 2020	<u>26,140</u>	<u>6,500</u>	<u>(390)</u>
Total	<u>\$ 40,570</u>	<u>\$ 9,510</u>	<u>\$ (490)</u>

Under the Medicare Modernization Act of 2003, the government provides tax-exempt federal subsidies to employers that provide prescription drug coverage to retirees that are actuarially equivalent to the benefits available under the Medicare Part D program. As a component of the Patient Protection and Affordable Care Act, this subsidy will no longer be tax exempt effective for tax years beginning after December 31, 2010. Employers receiving the subsidies will no longer be able to deduct the full amount paid for coverage provided to retirees while receiving the subsidy; but instead, only the net cost will be deducted.

We expect to contribute \$5,280,000 to the Retirement Plans during 2011.

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, 2010 and 2009, are as follows (in thousands):

	Pension		Postretirement	
	2010	2009	2010	2009
Discount rate	6.25%-7.0%	6.35%–6.9%	6.70%	6.6%–6.65%
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	6.96 %	7.36%
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 \$367,000 in annual service and interest costs and increases of approximately \$5,676,000 in the accumulated postretirement benefit obligations.

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.

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 asset allocation policy, which was revised in 2010, will ultimately move to an asset allocation of 60% long-duration fixed-income securities and 40% return-seeking assets. Return-seeking assets under the policy are defined as any asset class other than long-duration fixed-income securities and will primarily include publicly traded equities, publicly traded high-yield fixed-income securities, and alternative assets and cash. Under the new policy, at least 95% of pension assets will be invested in publicly traded equities and fixed-income securities and cash. This pension asset allocation will occur over the next 5-7 years as the funded status of the pension improves and as market conditions change.

Under the previous pension asset allocation policy, we used a mix of core and satellite managers to actively manage pension assets consistent with the investment manager guidelines, and target asset allocations described in the policy. The former pension asset policy included a target allocation summarized in the table below and a range of plus or minus 3% of the target established. Under the former policy, at least 95% of pension assets were normally invested in publicly traded stocks and fixed-income securities. The only other permitted asset classifications under the previous policy were cash and private equity funds, which combined were targeted at 5% of plan assets.

Weighted-average target asset allocation and actual asset allocations as of December 31, 2010 and 2009, by asset category are as follows:

	Target	2010	2009
Asset category:			
Equity securities	70.0 %	71.0 %	66.0 %
Debt securities	25.0	24.0	26.0
Other — cash	<u>5.0</u>	<u>5.0</u>	<u>8.0</u>
Total	<u>100.0 %</u>	<u>100 %</u>	<u>100.0 %</u>

The fair values of the Company's pension plan assets by asset category as of December 31, 2010 and 2009, are as follows (in thousands):

Fair Value Measurements at December 31, 2010				
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash equivalents	\$ 838	\$ 60	\$ -	\$ 898
Commingled Pension Trust Limited Partnership		7,646	876	7,646 876
Equity securities —				
U.S. Companies	10,138	212		10,350
U.S. Treasury securities		1,082		1,082
Corporate bonds	19	4,117	79	4,215
Mortgage-backed securities		<u>168</u>		<u>168</u>
Total	<u>\$ 10,995</u>	<u>\$ 13,285</u>	<u>\$ 955</u>	<u>\$ 25,235</u>

Fair Value Measurements at December 31, 2009				
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash equivalents	\$ 1,593	\$ -	\$ -	\$ 1,593
Commingled Pension Trust Insurance Annuity Contract Limited Partnership	25	6,971		25 6,971 594
Equity securities —				
U.S. Companies	8,746	19		8,765
U.S. Treasury securities		389		389
Corporate bonds	25	4,082	209	4,316
Mortgage-backed securities		<u>1,340</u>		<u>1,340</u>
Total	<u>\$ 10,389</u>	<u>\$ 12,801</u>	<u>\$ 803</u>	<u>\$ 23,993</u>

The pension assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for 2010 and 2009, are as follows (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) at December 31, 2010			
	Equities	Limited Partnership	Bonds	Total
Beginning balance at January 1, 2010	\$ -	\$ 594	\$ 209	\$ 803
Actual return on plan assets:				
Relating to assets still held at the reporting date		60	19	79
Relating to assets sold during the period			19	19
Purchases, sales, and settlements		222	(96)	126
Transfers out of Level 3			(72)	(72)
Ending balance at December 31, 2010	<u>\$ -</u>	<u>\$ 876</u>	<u>\$ 79</u>	<u>\$ 955</u>

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) at December 31, 2009			
	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 2010 and 2009 was \$4,167,579 and \$2,733,793, respectively. Future minimum lease payments as of December 31, 2010, are as follows (in thousands):

Years Ending December 31	
2011	\$ 5,033
2012	4,379
2013	3,957
2014	3,491
2015	3,129
Thereafter	<u>8,995</u>
Total	<u>\$ 28,984</u>

The Company was the lessor of parking facilities with rental income for the years ended December 31, 2010 and 2009, totaling \$351,250 and \$428,577, 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, 2010, are as follows in (thousands):

Years Ending December 31	
2011	\$ 3,118
2012	2,679
2013	1,214
2014	403
2015	
Thereafter	<u> </u>
Total	<u>\$ 7,414</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 2010 and 2009, BCBSM supplied executive, legal, financial, and other services to the Company at a cost of \$1,516,073 and \$1,244,871, 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 administrative expenses and benefit reimbursements paid were \$9,338,018 and \$10,318,888 in 2010 and 2009, respectively. Total premiums paid were \$3,030,568 and \$2,385,162 in 2010 and 2009, 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 2010 and 2009 were \$1,207,847 and \$1,694,914, respectively.

In 2009, we sold the current home office building and adjacent surface parking lot and parking structure to BCBSM at the assets' 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 was \$1,122,916 and \$125,903 in 2010 and 2009, respectively.

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, 2010, the Company has advanced approximately \$123 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 \$5 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, 2010 and 2009, are as follows (in thousands):

	2010	2009
Payable in one year or less	\$ 10,015	\$ 19,825
Payable after one year through five years	4,016	5,539
Payable after five years through ten years	1,750	1,566
Payable after ten years	<u>2,413</u>	<u>2,159</u>
Total insurance-related assessments	18,194	29,089
Other taxes and fees	<u>3,625</u>	<u>1,684</u>
Total assessments, taxes, and fees payable	<u>\$ 21,819</u>	<u>\$ 30,773</u>

No anticipated premium tax offsets were available to reduce liabilities recorded as of December 31, 2010 and 2009.

Adjustments to accruals for guaranty fund assessments of \$6,561,221 and \$458,830 were credited to operations during 2010 and 2009, respectively. We expect to pay guaranty fund assessments in the future and have recorded liabilities totaling \$769,418 as of December 31, 2010.

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 we report 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 (nonadmitted assets).

Under statutory accounting, the Company's insurance company subsidiaries had capital and surplus of \$648,219,261 as of December 31, 2010, and \$689,922,568 as of December 31, 2009. Statutory net (loss) income for the years ended December 31, 2010 and 2009, was \$(55,372,932) and \$48,854,180, 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. RBC determines minimum capital and surplus requirements through an analysis of various risk factors related to each company's operations. As of December 31, 2010 and 2009, 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, 2010, the maximum amount of dividends the Company may receive from the insurance company subsidiaries during 2011, without prior approval, is \$64,822,000. 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, 2010 and 2009, consists of the following (in thousands):

	2010	2009
Unrealized holding gains arising during the year	\$ 59,186	\$ 65,340
Reclassification adjustment for investment gains included in net income	<u>(33,223)</u>	<u>(30,383)</u>
Net unrealized gains on investments	25,963	34,957
Increase in additional minimum pension liability	(10,329)	(236)
Income tax expense related to items of other comprehensive income	<u>(5,200)</u>	<u>(12,153)</u>
Other comprehensive income — net of tax	<u>\$ 10,434</u>	<u>\$ 22,568</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 all events subsequent to the balance sheet date of December 31, 2010, through the date of issuance of these consolidated financial statements, March 15, 2011, and has determined that there are no subsequent events that require disclosure under FASB ASC 855, *Subsequent Events*.

* * * * *