21ST CENTURY HOLDING CO
Form 10-K
March 16, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549
FORM 10-K

x Annual Report under Section 13 or 15(d) of the Securities Act of 1934
For the fiscal year ended December 31, 2008
or
¨ Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period of _____________to_______________

Commission file number: 0-2500111
21st Century Holding Company
(Exact name of registrant as specified in its Charter)

Florida	65-0248866
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No)

3661 West Oakland Park Boulevard, Suite 300, Lauderdale Lakes, Florida 33311
(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code (954) 581-9993

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.01 per share	NASDAQ Global Market, LLC

Securities registered pursuant to Section 12(g) of the Exchange Act:
None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yesx No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See the definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.
Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

The aggregate market value of the Registrant's common stock held by non-affiliates was $57,775,675 on June 30, 2008, computed on the basis of the closing sale price of the Registrant's common stock on that date.

As of March 16, 2009, the total number of common shares outstanding of Registrant's common stock was 8,013,894.

DOCUMENTS INCORPORATED BY REFERENCE
Portions of the definitive Proxy Statement for the 2009 Annual Meeting of the Shareholders are incorporated by reference into Part III, of this Form 10K.

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PART I

SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by words "believes," "project," "expects," "anticipates," "estimates," "intends," "strategy," "plan," "may," "will," "would," "will be," "will continue," "will likely resu expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in the section entitled "Risk Factors" in Part I, Item 1A of this Annual Report. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 1 BUSINESS

GENERAL

21st Century Holding Company ("21st Century", "Company", "we", "us") is an insurance holding company, which, through our subsidiaries and our contractual relationships with our independent agents and general agents, controls substantially all aspects of the insurance underwriting, distribution and claims processes. We are authorized to underwrite fire, allied lines, homeowners' property and casualty insurance, commercial general liability insurance, commercial multi peril, inland marine, personal automobile insurance and commercial automobile insurance in various states with various lines of authority through our wholly owned subsidiaries, Federated National Insurance Company ("Federated National") and American Vehicle Insurance Company ("American Vehicle"). We market and distribute our own and third-party insurers' products and our other services primarily in Florida, through contractual relationships with a network of approximately 1,500 independent agents and a select number of general agents.

The insurable events during 2008, 2007 and 2006 did not include any weather related catastrophic events such as the well publicized series of hurricanes that occurred in Florida during 2005 and 2004. During 2008, 2007 and 2006 we processed property and liability claims stemming from our homeowners', commercial general liability and private passenger automobile lines of business. Our automobile claims generally will exceed commercial general liability and homeowners' claims with respect to frequency of claimant activity; however the per-claim severity in connection with our commercial general liability and homeowner lines would be expected to exceed the automobile line. Our reinsurance strategy serves to smooth the liquidity requirements imposed by the most severe insurable events and for all other insurable events we manage, at a micro and macro perspective, in the normal course of business.

Federated National is authorized to underwrite fire, allied lines, personal automobile, and homeowners' property and casualty insurance in Florida as an admitted carrier. American Vehicle is authorized to underwrite commercial multi peril, inland marine and personal and commercial automobile insurance in Florida as an admitted carrier. In addition, American Vehicle is authorized to underwrite commercial general liability insurance in fifteen states, of which eleven states had ongoing operations in 2008, as either an admitted or non-admitted carrier. American Vehicle will continue its expansion of commercial general liability insurance into new states.

An admitted carrier is an insurance company that has received a license from the state department of insurance giving the company the authority to write specific lines of insurance in that state. These companies are also bound by rate and form regulations, and are strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud. Admitted carriers are also required to financially contribute to the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders.

A non-admitted carrier is not licensed by the state, but is allowed to do business in that state and is strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud. Sometimes, non-admitted carriers are referred to as “excess and surplus” lines carriers. Non-admitted carriers are subject to considerably less regulation with respect to policy rates and forms.

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The table below denotes American Vehicle's authority by state.

States	Admitted carrier	Non-Admitted Carrier
Alabama	ü	
Arkansas		ü
California		ü
Florida	ü	
Georgia		ü
Kentucky		ü
Louisiana	ü	
Maryland		ü
Missouri		ü
Nevada		ü
Oklahoma		ü
South Carolina		ü
Tennessee		ü
Texas	ü	
Virginia		ü

During 2007 American Vehicle applied for and was granted, by the State of Florida in 2008, a license to underwrite commercial multiple peril and inland marine lines of business as an admitted carrier. We believe these new lines of authority will bode well with American Vehicle's existing customers. Operations under American Vehicle's newly granted lines of authority are expected to begin during 2009.

During 2008 Federated National applied for and was granted, by the State of Florida, a license to underwrite fire and allied lines insurance as an admitted carrier. Operations under Federated National's newly granted allied lines began in 2008 as a cedant for the insurance policies it underwrites for federal flood program. Operations under Federated National's newly granted fire line of business is pending approval by the Florida Office of Insurance Regulation ("OIR") and we expect to begin operations in 2009.

During the year ended December 31, 2008, 68.8%, 27.0%, 3.7% and 0.6% of the premiums we underwrote were for homeowners' property and casualty insurance, commercial general liability insurance, federal flood, and personal automobile insurance, respectively. During the year ended December 31, 2007, 74.5%, 24.1% and 1.4% of the premiums we underwrote were for homeowners' property and casualty insurance, commercial general liability insurance and personal automobile insurance, respectively.

Our business, results of operations and financial condition are subject to fluctuations due to a variety of factors. Abnormally high severity or frequency of claims in any period could have a material adverse effect on our business, results of operations and financial condition. In addition, if our estimated liabilities for unpaid losses and loss adjustment expenses ("LAE") are less than actual losses and LAE, we will be required to increase reserves with a corresponding reduction in our net income in the period in which the deficiency is identified. We internally process claims made by our insureds through our wholly owned claims adjusting company, Superior Adjusting, Inc. ("Superior").

Our executive offices are located at 3661 West Oakland Park Boulevard, Suite 300, Lauderdale Lakes, Florida and our telephone number is (954) 581-9993.

Our web site is located at www.21centuryholding.com. Information on our website is not incorporated by reference into this Form 10-K and should not be considered part of this Annual Report on Form 10-K or any other filing that we make with the SEC. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to such reports are available, free of charge, through our website as soon as reasonably practicable after we electronically file or furnish such material to the Securities and Exchange Commission ("SEC"). Further, a copy of this annual report on Form 10-K is located at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding our filings at www.sec.gov.

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RECENT DEVELOPMENTS

Proposed Florida Legislation

Throughout 2008 industry leaders and lawmakers have met to discuss legislative options including a significant reduction of capacity in the Florida Hurricane Catastrophe Fund (“FHCF”), substantially increasing members’ co-insurance participation and the reorganization of the FHCF under the Florida Cabinet. Efforts by the Governor and Commissioner of Insurance at the Federal level to secure post catastrophic event liquidity commitments remain ongoing.

Additionally, the Board of Directors of the Florida Insurance Guaranty Association (“FIGA”) held separate meetings to discuss their continued financial challenges in connection with the insolvency of a particular insurance company that was assumed subsequent to the 2005 – 2006 hurricane season. At this time, we do not know if any new laws or regulations will be adopted in Florida which will impact our property and casualty insurance business in fiscal 2009 or any subsequent years.

BUSINESS STRATEGY

We expect that in 2009 we will capitalize on our operational efficiencies and business practices by:

- expanding our lines of business, such as our recent approval to write allied line insurance and last year’s approval for commercial multi-peril and inland marine insurance in the State of Florida. While new lines of operations are in various stages of deployment, we expect to introduce many of these new insurance products during 2009;

- continued expansion of our commercial general liability insurance product into additional states. In addition to our ongoing operations in eleven states, we expect to commence operations in four states where we obtained licenses to underwrite and sell commercial general liability insurance in 2008;

- employing our business practices developed and used in Florida in our expansion to other selected states;

- maintaining a commitment to provide high quality customer service to our agents and insureds;

- expansion of our marketing efforts by retaining key personnel and implementing direct marketing technologies;

- offering attractive incentives to our agents to place a high volume of high quality business with our companies;

- assumption of existing risks from other carriers;

- additional strategies that may include possible acquisitions or further dispositions of assets, and development of procedures to improve claims history and mitigate losses from claims.

There can be no assurances, however, that any of the foregoing strategies will be developed or successfully implemented or, if implemented, that they will positively affect our results of operations.

Additionally, State of Florida legislative initiatives, increased competition, softening general market conditions, an unfolding economic downturn and additional loss development from catastrophic events over two years old suggest that continued financial challenges exist in 2009.

INSURANCE OPERATIONS AND RELATED SERVICES

General

We are authorized to underwrite fire, allied lines, homeowners' property and casualty insurance, commercial general liability insurance, commercial multi peril, inland marine, personal automobile insurance and commercial automobile insurance in various states with various lines of authority through our wholly owned subsidiaries, Federated National and American Vehicle.

Federated National is authorized to underwrite fire, allied lines, personal automobile, and homeowners' property and casualty insurance in Florida as an admitted carrier.

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American Vehicle is authorized to underwrite commercial multi peril, inland marine and personal and commercial automobile insurance in Florida as an admitted carrier. In addition, American Vehicle is authorized to underwrite commercial general liability insurance in fifteen states, of which eleven states had ongoing operations in 2008, as either an admitted or non-admitted carrier. American Vehicle will continue its expansion of commercial general liability insurance into new states.

In January 2008, the Florida OIR granted American Vehicle licenses to underwrite commercial multiple peril and inland marine lines of business as an admitted carrier.

The following tables set forth the amount and percentages of our gross premiums written, premiums ceded to reinsurers and net premiums written by line of business for the periods indicated.

	Years Ended December 31,					
	2008		2007		2006	
	Premium	Percent	Premium	Percent	Premium	Percent
	(Dollars in Thousands)					
Gross written premiums:						
Automobile	$ 487	0.6%	$ 1,867	1.4%	$ 6,064	4.0%
Federal Flood	3,263	3.7%	-	0.0%	-	0.0%
Homeowners'	60,709	68.7%	99,502	74.5%	114,388	74.9%
Commercial General Liability	23,790	27.0%	32,222	24.1%	32,213	21.1%
Total gross written premiums	$ 88,248	100.0%	$ 133,591	100.0%	$ 152,665	100.0%
Ceded premiums:						
Automobile	$ -	0.0%	$ -	0.0%	$ -	0.0%
Federal Flood	3,263	9.4%	-	0.0%	-	0.0%
Homeowners'	31,291	90.6%	44,551	100.0%	67,520	100.0%
Commercial General Liability	-	0.0%	-	0.0%	-	0.0%
Total ceded premiums	$ 34,553	100.0%	$ 44,551	100.0%	$ 67,520	100.0%
Net written premiums						
Automobile	$ 487	0.9%	$ 1,867	2.1%	$ 6,064	7.2%
Federal Flood	-	0.0%	-	0.0%	-	0.0%
Homeowners'	29,418	54.8%	54,952	61.7%	46,868	55.0%
Commercial General Liability	23,790	44.3%	32,222	36.2%	32,213	37.8%
Total net written premiums	$ 53,695	100.0%	$ 89,041	100.0%	$ 85,145	100.0%

We marketed our insurance products through our network of independent agents and general agents during fiscal years 2008, 2007 and 2006.

Homeowners' Property and Casualty Insurance

We underwrite homeowners' insurance principally in South and Central Florida. Homeowners' insurance generally protects an owner of real and personal property against covered causes of loss to that property. The table that follows reflects the number of homeowner policies in-force by South Florida counties and all other Florida counties and reflects our concentrations of risk from catastrophic events.

	As of the years ended December 31 In-force policy count					
	2008		2007		2006	
County	Amount	Percentage	Amount	Percentage	Amount	Percentage
Dade	2,981	9.7%	4,587	12.7%	9,151	21.6%
Broward	3,629	11.8%	4,446	12.3%	6,629	15.6%
West Palm Beach	14,152	45.7%	14,969	41.3%	13,539	31.9%
All others	10,122	32.8%	12,239	33.7%	13,099	30.9%
Total	30,884	100.0%	36,241	100.0%	42,418	100.0%

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Our homeowner insurance products typically provide maximum coverage in the amount of $750,000, with the aggregate maximum policy limit being approximately $1,350,000. We continually subject these limits to review though there were no changes during 2008. The approximate average premium on the policies currently in-force is $2,016, as compared with $2,769 for 2007, and the typical deductible is either $2,500 or $1,000 for non-hurricane-related claims and generally 2% of the coverage amount for the structure for hurricane-related claims.

Premium rates charged to our homeowner insurance policyholders are continually evaluated to assure that they meet the expectation, are actuarially sound and produce a reasonable level of profit (neither excessive nor inadequate). In Florida, premium rates are also regulated by the Florida OIR, and rate increases must be approved by the Florida OIR.

Our May 2008 “file and use” rate filing reflects an average rate decrease of 11.3%. The June 2007 rate filing resulted in an average rate reduction of 15.2%.

Commercial General Liability

We underwrite commercial general liability insurance for approximately 250 classes of artisan and mercantile trades (excluding home-builders and developers), habitational exposures and certain special events. The limits of liability range from $100,000 per occurrence with a $200,000 policy aggregate to $1.0 million per occurrence with a $2.0 million policy aggregate. We continually subject these limits to review, though there were no changes during 2008. We market the commercial general liability insurance products through independent agents and a limited number of general agencies unaffiliated with the Company. The average annual premium on policies, with deductibles of $250 to $500 per claim, and currently in-force is approximately $798, as compared with $989 in 2008 and 2007, respectively.

The following table sets forth the amounts and percentages of our gross premiums written in connection with our commercial general liability program by state:

	Years Ended December 31,					
	2008		2007		2006	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
	(Dollars in Thousands)					
State						
Alabama	$ 117	0.49%	$ 26	0.08%	$ -	0.00%
Arkansas	12	0.05%	-	0.00%	-	0.00%
California	269	1.13%	23	0.07%	-	0.00%
Florida	16,011	67.30%	21,192	65.77%	22,965	71.29%
Georgia	568	2.39%	1,023	3.17%	1,805	5.60%
Kentucky	1	0.00%	8	0.03%	9	0.03%
Louisiana	4,481	18.84%	5,595	17.36%	5,743	17.83%
Maryland	2	0.01%	-	0.00%	-	0.00%
South Carolina	70	0.29%	182	0.57%	77	0.24%
Texas	2,252	9.47%	4,127	12.81%	1,604	4.98%
Virginia	7	0.03%	46	0.14%	10	0.03%
Total	$ 23,790	100.00%	$ 32,222	100.00%	$ 32,213	100.00%

In order to expand our commercial general liability business, we entered into a 100% quota-share reinsurance treaty with Republic Underwriters Insurance Company (“Republic”) on March 28, 2006. This agreement was in place for approximately one year until March 31, 2007, when it was cancelled at the request of Republic. Republic is domiciled in the State of Texas and licensed both directly and on a surplus lines basis in approximately 32 states. This

arrangement would have facilitated the policyholder who requires their commercial general liability insurance policy to come from an insurance company with a satisfactory A.M. Best Company (“A.M. Best”) rating.

Our arrangement with Republic allowed for a 4.75% commission on net written premium and reimbursement for all other costs in connection with the treaty such as premium taxes and assessments. We also remitted a 1% commission to the intermediary broker on the same net written premium. Under this agreement, the Company assumed approximately $325,000 and $23,000 in premiums in connection with its operations in the State of Texas in 2007 and 2006, respectively. Our operations in Texas began in December 2006. During the three months ended March 31, 2007, this 100% quota-sharing reinsurance treaty with Republic was cancelled, on a run-off basis, at their request, effective June 30, 2007. All premiums in connection with this program have been fully earned, and $0.2 million of Loss and LAE remain unpaid.

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We are currently in the process of replacing the Republic quota-share reinsurance treaty with another “A” rated A.M. Best carrier. This agreement is currently pending Florida OIR approval.

Personal Automobile

Personal automobile insurance markets can be divided into two categories, standard automobile and nonstandard automobile. Standard personal automobile insurance is principally provided to insureds who present an average risk profile in terms of driving record, vehicle type and other factors. Nonstandard personal automobile insurance is principally provided to insureds that are unable to obtain standard insurance coverage because of their driving record, age, vehicle type or other factors, including market conditions. The average annual premium on policies currently in force is approximately $1,292, as compared with $1,075 for 2007, and the nonstandard personal automobile insurance lines represents 100% and more than 99.5% of our written premiums for personal automobile insurance in 2008 and 2007, respectively.

Limits on standard personal automobile insurance are generally significantly higher than those for nonstandard coverage, but typically provide for deductibles and other restrictive terms. Underwriting criteria for standard coverage has become more restrictive, thereby requiring more insureds to seek nonstandard coverage and contributing to the increase in the size of the nonstandard automobile market. Nonstandard automobile insurance, however, generally involves the potential for increased loss exposure and higher claims experience. Loss exposure is mitigated because premiums usually are written at higher rates than those written for standard insurance coverage.

Both of our insurance subsidiaries currently underwrite nonstandard personal automobile insurance in Florida, where the maximum exposures are predominantly $10,000 per individual, $20,000 per accident for bodily injury, $10,000 per accident for property damage, and predominantly $50,000 for comprehensive and collision. American Vehicle’s commercial automobile program in Florida is expected to experience managed growth in 2009. The maximum exposure is predominantly $25,000 on a combined single limit basis.

Federated National underwrites new and renewal policies for this coverage on primarily an annual basis and to a much lesser extent, on a semi-annual basis.

American Vehicle underwrites only renewal policies for this coverage on primarily an annual basis and to a much lesser extent, on a semi-annual basis.

Due to the purchasing habits of nonstandard automobile insureds (for example, nonstandard automobile insureds tend to seek the least expensive insurance required of the policyholder by statute that satisfies the requirements of state laws to register a vehicle), policy renewal rates tend to be low compared with standard policies. Our experience has been that a significant number of existing nonstandard policyholders allow their policies to lapse and then reapply for insurance as new policyholders.

Federated National underwrites standard personal automobile insurance policies providing coverage no higher than $100,000 per individual, $300,000 per accident for bodily injury, $50,000 per accident for property damage and comprehensive and collision up to $50,000 per accident, with deductibles ranging from $200 to $1,000. The average premium on the policies in-force was $1,346 for 2007, and represented approximately 0.5% of our written premiums for personal automobile insurance in 2007. They were no standard personal automobile insurance policies offered during 2008.

Flood

Federated National writes flood insurance through the National Flood Insurance Program ("NFIP"). We write the policy for the NFIP, which assumes 100% of the flood risk while we retain a commission for our service. The average flood policy premium is approximately $400 with limits up to $250,000. Commissions in connection with this program totaled $0.2 million, $0.3 million and $0.3 million in 2008, 2007 and 2006, respectively. Pursuant to the Florida OIR regulations, we are required to report write-your-own-flood premiums on a direct and ceded basis for 2008 and subsequent years. Prior to 2008, we reported only the commissions income associated with this program.

Assurance Managing General Agents, Inc. ("Assurance MGA")

Assurance MGA, a wholly owned subsidiary, acts as Federated National's and American Vehicle's exclusive managing general agent in the state of Florida. As American Vehicle continues its expansion into other states, we intend to retain other general agents to market our commercial general liability insurance products. During the year ended December 31, 2008, Assurance MGA became licensed in the states of Alabama, Arkansas, Georgia, Illinois, Mississippi, Missouri, Nevada, North Carolina, Texas and Virginia.

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Assurance MGA currently provides underwriting policy administration, marketing, accounting and financial services to Federated National and American Vehicle, and participates in the negotiation of reinsurance contracts. For the above-mentioned services, Assurance MGA generates revenue through a 6% commission fee from the insurance companies' gross written premium, policy fee income of $25 per policy and other administrative fees. The 6% commission fee from Federated National and American Vehicle was made effective January 1, 2005. Assurance MGA plans to establish relationships with additional carriers and add additional insurance products in the future.

Superior

Superior processes claims made by insureds from Federated National and American Vehicle. Our agents have no authority to settle claims or otherwise exercise control over the claims process. Furthermore, we believe that the retention of independent adjusters, in cooperation with our employment of salaried claims personnel, results in reduced ultimate loss payments, lower LAE and improved customer service for our policyholders. We also employ an in-house legal department to cost-effectively manage claims-related litigation and to monitor our claims handling practices for efficiency and regulatory compliance.

Federated Premium Finance, Inc. ("Federated Premium")

Federated Premium provides premium financing to Federated National's, American Vehicle's and third-party's insureds. Premium financing has been marketed through our distribution network of general agents and independent agents.

Premiums for property and casualty insurance, in certain circumstances, are payable at the time a policy is placed in force or renewed. Federated Premium's services allow the insured to pay a portion of the premium when the policy is placed in force and the balance in monthly installments over a specified term, generally between six and nine months. As security, Federated Premium retains a contractual right, if a premium installment is not paid when due, to cancel the insurance policy and to receive the unearned premium from the insurer, or in the event of insolvency of an insurer, from FIGA, subject to a $100 per policy deductible. In the event of cancellation, Federated Premium applies the unearned premium towards the payment obligation of the insured.

The following table sets forth the amount and percentages of premiums financed for Federated National, American Vehicle and other insurers for the periods indicated:

	Years Ended December 31, (Dollars in Thousands)					
	2008		2007		2006	
	Premium	Percent	Premium	Percent	Premium	Percent
Federated National	$ 311	41.3%	$ 2,547	62.7%	$ 6,279	56.2%
American Vehicle	175	23.3%	169	4.2%	1,981	17.7%
Other insurers	267	35.4%	1,346	33.1%	2,917	26.1%
Total	$ 753	100.00%	$ 4,062	100.00%	$ 11,177	100.00%

Federated Premium's operations were funded by a revolving loan agreement ("Revolving Agreement") with FlatIron Funding Company LLC ("Flatiron"). The Revolving Agreement was structured as a sale of contracts receivable under a sale and assignment agreement with Westchester Premium Acceptance Corporation ("WPAC") (a wholly-owned subsidiary of FlatIron), which gave WPAC the right to sell or assign these contracts receivable. Federated Premium, which serviced these contracts, recorded transactions under the Revolving Agreement as secured borrowings. There

were no outstanding borrowings under the Revolving Agreement as of December 31, 2008 and 2007. Outstanding borrowings under the Revolving Agreement as of December 31, 2006 were approximately $0.01 million. This credit facility terminated, at our request, during 2007.

Finance contracts receivable decreased $0.2 million, or 52.3%, to $02 million as of December 31, 2008, compared with $0.4 million as of December 31, 2007. We anticipate a continued decline in the short-term in connection with premium financed contracts. The Company anticipates continued use of the direct bill feature associated with Federated National and American Vehicle lines of business.

The direct billing opportunity is very similar to the premium finance arrangement with respect to down payments and scheduled monthly payments. Direct billing is when the insurance company accepts from the insured, as a receivable, a promise to pay the premium, as opposed to requiring payment of the full amount of the policy, either directly from the insured or from a premium finance company. We believe that the direct billing program does not increase our risk because the insurance policy, which serves as collateral, is managed by our computer system. Underwriting criteria are designed with down payment requirements and monthly payments that create policyholder equity in the insurance policy. The equity in the policy is collateral for the extension of credit to the insured. Through our monitoring systems, we track delinquent payments and, in accordance with the terms of the extension of credit, cancel if payment is not made. If any excess premium remains after cancellation of the policy and deduction of applicable penalties, this excess is refunded to the policyholder. Similarly, we believe that the premium financing that we offer to our own insureds involves limited credit risk. By primarily financing policies underwritten by our own insurance carriers, our credit risks are reduced because we can more securely rely on the underwriting processes of our own insurance carriers. Furthermore, the direct bill program enables us to closely manage our risk while providing credit to our insureds.

Insure-Link, Inc. (“Insure-Link”)

Insure-Link was formed in March 2008. Insure-Link was created to serve as an independent insurance agency. The insurance agency markets to the general public to serve all of their insurance needs. Insure-Link will acquire new business through marketing and acquisition.

MARKETING AND DISTRIBUTION

We are focusing our marketing efforts on continuing to expand our distribution network and market our products and services throughout Florida and in other states by establishing relationships with additional independent agents and general agents. As this occurs, we will seek to replicate our distribution network in those states. There can be no assurance, however, that we will be able to obtain the required regulatory approvals to offer additional insurance products or expand into other states.

Our independent agents and general agents have the authority to sell and bind insurance coverage in accordance with procedures established by Assurance MGA. Assurance MGA reviews all coverage bound by the agents promptly and generally accepts all coverage that falls within stated underwriting criteria. For automobile and commercial general liability policies, Assurance MGA also has the right, within a period that varies by state between 60 days and 120 days from a policy's inception, to cancel any policy, upon an advanced notice provided in accordance with statutory specific guidelines, even if the risk falls within our underwriting criteria.

During 2008, the Company formed a wholly owned Florida insurance agency named Insure-Link and operations began during the second quarter of 2008. Insure-Link has binding authority for Federated National and American Vehicle as well as many national and local insurance carriers. There were no other agency relationships with affiliated captive or franchised agents in 2008, 2007 and 2006.

During periods under emergency order as defined by the Florida OIR, there typically exists a moratorium on cancellations and non-renewals of various types of insurance coverage. The homeowner policy provides Assurance MGA the right to cancel any policy within a period of 90 days from the policy's inception with 25 days’ notice, or after 90 days from policy inception with 95 days’ notice, even if the risk falls within our underwriting criteria.

We believe that our integrated computer system, which allows for rapid automated premium quotation and policy issuance by our agents, is a key element in providing quality service to both our agents and insureds. For example,

upon entering a customer's basic personal information, the customer's driving record is accessed and a premium rate is quoted. If the customer chooses to purchase the insurance, the system can generate the policy on-site.

We believe that the management of our distribution system now centers on our ability to capture and maintain relevant data by producing agents, none of whom are affiliated with us. We believe that information management of agent production, coupled with loss experience, will enable us to maximize profitability.

REINSURANCE

As is common practice within the insurance industry, we transfer a portion of the risks insured under our policies to other companies through the purchase of reinsurance. This reinsurance is maintained to protect our insurance subsidiary against the severity of losses on individual claims, unusually serious occurrences in which a number of claims produce an aggregate extraordinary loss and catastrophic events. Although reinsurance does not discharge our insurance subsidiary from its primary obligation to pay for losses insured under the policies it issues, reinsurance does make the assuming reinsurer liable to the insurance subsidiary for the reinsured portion of the risk. A credit exposure exists with respect to ceded losses to the extent that any reinsurer is unable or unwilling to meet the obligations assumed under the reinsurance contracts. The collectibility of reinsurance is subject to the solvency of the reinsurers, interpretation of contract language and other factors. A reinsurer's insolvency or inability to make payments under the terms of a reinsurance contract could have a material adverse effect on our results of operations and financial condition.

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The availability and costs associated with the acquisition of reinsurance will vary year to year. These fluctuations, which can be significant, are not subject to our control and may limit our ability to purchase adequate coverage. The recovery of increased reinsurance costs through rate action is not immediate and can not be presumed, as it is subject to Florida OIR approval.

For the 2008-2009 hurricane season, the excess of loss and FHCF treaties will insure us for approximately $310.0 million of aggregate catastrophic losses and LAE with a maximum single event coverage totaling approximately $245.0 million, with the Company retaining the first $3.0 million of losses and LAE. Our reinsurance program included coverage purchased from the private market, which afforded optional Reinstatement Premium Protection that provides coverage beyond the first event, along with coverage from the FHCF. Coverage afforded by the FHCF totals approximately $167.0 million or 54% of the $310.0 million of aggregate catastrophic losses and LAE. The FHCF affords coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event.

Our reinsurance structure has significant risks, including the fact that the FHCF may not be able to raise sufficient money to pay their claims or impair their ability to pay their claims in a timely manner. This could result in significant financial, legal and operational challenges to all companies, including ours.

Therefore, in the event of a catastrophic loss, we may become dependent upon the FHCF's ability to pay, which may, in turn, be dependent upon the FHCF's ability to issue bonds in amounts that would be required to meet its reinsurance obligations in the event of such a catastrophic loss. There is no assurance that the FHCF will be able to do this. The Florida Senate Banking and Insurance Committee (“Senate Committee”) recently published an insurance-related Interim Report entitled Status of the Florida Hurricane Catastrophe Fund. Notable findings in the report include:

- The total liability of the FHCF could be up to $28.0 billion for a single season storm
- The FHCF has approximately $10.3 billion in liquidity, which includes the $4.0 billion “put” option. The “putt” option is the guarantee arrangement with Berkshire Hathaway approved by the State Board of Administration this summer
- The FHCF has “potential obligations that it can not pay of approximately $14.5 billion in the event of a major storm”

Additionally, the FHCF treaty contains an exclusion that specifically states “Losses in excess of the sum of the Balance of the Fund as of December 31 of the Contract Year and the amount the SBA is able to raise through the issuance of revenue bonds or by the use of other financing mechanisms, up to the limit pursuant to Section 215.555(4) (c), Florida Statutes.”

The Senate Committee on Banking and Insurance released a report in early December 2008 that was meant to enlighten lawmakers before the legislative session begin in March 2009. The Senate Committee reported that the FHCF has a possible $19.0 billion deficit in 2009. Even though Florida remained largely unscathed in 2008, the insurance industry as a whole was battered by various natural catastrophes and a global financial crisis that undercut its profits more than at any time in the past 20 years. Experts say that the FHCF’s ability to come up with money after a storm would be dependent on its ability to market and sell bonds, an option that is severely limited by the global credit crunch that intensified this past fall.

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The 2008-2009 private reinsurance companies and their respective A. M. Best rating are listed in the table as follows:

Reinsurer	A.M. Best Rating		
UNITED STATES			
Everest Reinsurance Company	A+		
GMAC Re/Motors Insurance Corporation	A-		
Munich Reinsurance America, Inc.	A+		
QBE Reinsurance Corporation	A	*	
BERMUDA			
Actua Re Limited	NR	*	(1)
Ariel Reinsurance Company Limited	A-	*	
DaVinci Reinsurance Limited	A	*	
Flagstone Reinsurance Limited	A-		
Hiscox Insurance Company Limited	A-		
Max Bermuda Limited	A-		
New Castle Reinsurance Company Limited	A-	*	
Renaissance Reinsurance Limited	A+	*	
Amlin Bermuda Limited	A		
EUROPE			
Lansforsakringar Sak Forsakringsaktiebolag	NR		(2)
SCOR Switzerland AG	A-		

* 2008 Reinstatement Premium Protection Program Participants

(1) Participant has funded a trust agreement for their unearned premium with approximately $1.3 million of cash and U.S. Government obligations of American institutions at fair market value.

(2) Standard & Poor's rated "A" (investment grade - economic situation can affect finance)

Subsequent to December 31, 2008 and pursuant to the provisions of our reinsurance treaties, we elected to cancel the contract with New Castle Reinsurance Company Limited (“New Castle”) and funds considered immaterial are in the process of settlement. New Castle’s participation in our reinsurance program represented approximately 1% of the aggregate catastrophic loss exposure. We are in the process of replacing this coverage however there can be no assurances that we can be successful, though our increased exposure is limited.

For the 2007-2008 hurricane season, the excess of loss and FHCF treaties insured us for approximately $403.0 million of aggregate catastrophic losses and LAE with a maximum single event coverage totaling approximately $320.0 million, with the Company retaining the first $3.0 million of losses and LAE. Our reinsurance program included coverage purchased from the private market, which afforded optional Reinstatement Premium Protection that provided coverage beyond the first event, along with coverage from the FHCF. Coverage afforded by the FHCF totaled approximately $261.0 million or 65% of the $403.0 million of aggregate catastrophic losses and LAE. The FHCF afforded coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event.

The 2007-2008 private reinsurance companies and their respective A. M. Best rating are listed in the table as follows:

Reinsurer	A.M. Best Rating
UNITED STATES	
Everest Reinsurance Company	A+
Folksamerica Reinsurance Company	A-
GMAC Re/Motors Insurance Corporation	A-
Munich Reinsurance America, Inc.	A
Odyssey America Reinsurance Corporation	A
QBE Reinsurance Corporation	A
BERMUDA	
ACE Tempest Reinsurance Limited, Bermuda	A+
Amlin Bermuda Limited	A-
Ariel Reinsurance Company Limited, Bermuda	A-
DaVinci Reinsurance Ltd, Bermuda	A
Flagstone Reinsurance Limited	A-
Max Bermuda Limited	A-
New Castle Reinsurance Company Limited	A-
Renaissance Reinsurance Ltd, Bermuda	A
UNITED KINGDOM	
Amlin Syndicate No. 2001 (AML)	A
Ascot Underwriting Syndicate No. 1414 (RTH)	A
G.S. Christensen and Others Syndicate No. 958 (GSC)	A
MAP Underwriting Syndicate No. 2791 (MAP)	A
Talbot Underwriting Syndicate No. 1183 (TAL)	A
EUROPE	
Converium Limited, Switzerland	B++

The cost to the Company for these reinsurance products for the 2008–2009 and 2007–2008 hurricane seasons, including the prepaid automatic premium reinstatement protection totals approximately $31.3 million and $44.6 million, respectively.

Our reinsurance structure has significant risks, including the fact that the FHCF may not be able to raise sufficient money to pay their claims or impair their ability to pay their claims in a timely manner. This could result in significant financial, legal and operational challenges to all companies, including ours. It is our understanding, based upon a memo from The Florida House of Representatives, Committee on Insurance, to House Speaker Marco Rubio, dated April 2, 2008, that it is probable, under the current FHCF structure, that hundreds of millions of dollars of FHCF claims in Florida will go unpaid for some time. The FHCF currently has limited cash available to pay claims in connection with a catastrophic event. The FHCF has the authority to raise additional cash to pay claims through the issuance of FHCF bonds. The retirement of these bonds would be funded by imposing additional assessments on future insurance premiums written in the state. In the current economic climate, it is not clear if FHCF would be able to raise funds through a bond issuance.

To date, there have been no claims asserted against the reinsurers in connection with the 2007-2008 excess of loss and FHCF treaties.

We are selective in choosing reinsurers and consider numerous factors, the most important of which are the financial stability of the reinsurer, their history of responding to claims and their overall reputation. In an effort to minimize our exposure to the insolvency of a reinsurer, we evaluate the acceptability and review the financial condition of the reinsurer at least annually.

In order to expand our commercial general liability business, we entered into a 100% quota-share reinsurance treaty with Republic on March 28, 2006. This agreement was in place for approximately one year until March 31, 2007, when it was cancelled at the request of Republic. Republic is domiciled in the State of Texas and licensed both directly and on a surplus lines basis in approximately 32 states. This arrangement would have facilitated the policyholder who requires their commercial general liability insurance policy to come from an insurance company with a satisfactory A.M. Best rating. We are currently in the process of replacing the Republic quota-share reinsurance treaty with another “A” rated A.M. Best carrier. This agreement with the other carrier is currently pending Florida OIR approval.

Our arrangement with Republic allowed for a 4.75% commission on net written premium and reimbursement for all other costs in connection with the treaty such as premium taxes and assessments. We also remitted a 1% commission to the intermediary broker on the same net written premium. Under this agreement, the Company assumed approximately $325,000 and $23,000 in premiums in connection with its operations in the State of Texas in 2007 and 2006, respectively. Our operations in Texas began in December 2006. During the three months ended March 31, 2007, this 100% quota-sharing reinsurance treaty with Republic was cancelled, on a run-off basis, at their request, effective June 30, 2007. All premiums in connection with this program have been fully earned, and $0.2 million of Loss and LAE remain unpaid.

LIABILITY FOR UNPAID LOSSES AND LAE

We are directly liable for loss and LAE payments under the terms of the insurance policies that we write. In many cases, there may be a time lag between the occurrence and reporting of an insured loss and our payment of that loss. As required by insurance regulations and accounting rules, we reflect the liability for the ultimate payment of all incurred losses and LAE by establishing a liability for those unpaid losses and LAE for both reported and unreported claims, which represent estimates of future amounts needed to pay claims and related expenses.

When a claim, other than personal automobile, involving a probable loss is reported, we establish a liability for the estimated amount of our ultimate losses and LAE payments. The estimate of the amount of the ultimate loss is based upon such factors as the type of loss, jurisdiction of the occurrence, knowledge of the circumstances surrounding the claim, severity of injury or damage, potential for ultimate exposure, estimate of liability on the part of the insured, past experience with similar claims and the applicable policy provisions.

All newly reported claims received with respect to personal automobile policies are set up with an initial average liability. The average liability for these claims is determined by dividing the number of reported claims into the total amount paid during the same period. If a claim is open more than 45 days, that open case liability is evaluated and the liability is adjusted upward or downward according to the facts and circumstances of that particular claim.

In addition, management provides for a liability on an aggregate basis to provide for losses Incurred But Not Reported ("IBNR"). We utilize independent actuaries to help establish liability for unpaid losses and LAE. We do not discount the liability for unpaid losses and LAE for financial statement purposes.

The estimates of the liability for unpaid losses and LAE are subject to the effect of trends in claims severity and frequency and are continually reviewed. As part of this process, we review historical data and consider various factors, including known and anticipated legal developments, changes in social attitudes, inflation and economic conditions. As experience develops and other data become available, these estimates are revised, as required, resulting in increases or decreases to the existing liability for unpaid losses and LAE. Adjustments are reflected in results of operations in the period in which they are made and the liabilities may deviate substantially from prior estimates.

Among our classes of insurance, the automobile and homeowners' liability claims historically tend to have longer time lapses between the occurrence of the event, the reporting of the claim and the final settlement, than do automobile physical damage and homeowners' property claims. These liability claims often involve parties filing suit and therefore may result in litigation. By comparison, property damage claims tend to be reported in a relatively shorter period of time and settled in a shorter time frame with less occurrence of litigation.

There can be no assurance that our liability for unpaid losses and LAE will be adequate to cover actual losses. If our liability for unpaid losses and LAE proves to be inadequate, we will be required to increase the liability with a corresponding reduction in our net income in the period in which the deficiency is identified. Future loss experience

substantially in excess of established liability for unpaid losses and LAE could have a material adverse effect on our business, results of operations and financial condition.

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The following table sets forth a reconciliation of beginning and ending liability for unpaid losses and LAE as shown in our consolidated financial statements for the periods indicated.

	Years Ended December 31,		
	2008	2007	2006
Balance at January 1:	$ 59,684,790	$ 39,615,478	$ 154,038,543
Less reinsurance recoverables	(20,133,375)	(12,382,028)	(128,419,923)
Net balance at January 1	$ 39,551,415	$ 27,233,450	$ 25,618,620
Incurred related to:			
Current year	$ 37,397,179	$ 38,452,431	$ 35,105,812
Prior years	4,471,081	9,166,491	9,294,096
Total incurred	$ 41,868,260	$ 47,618,922	$ 44,399,908
Paid related to:			
Current year	$ 13,277,261	$ 15,628,017	$ 17,420,147
Prior years	16,072,908	19,672,941	25,364,930
Total paid	$ 29,350,169	$ 35,300,958	$ 42,785,077
Net balance at year-end	$ 52,069,506	$ 39,551,415	$ 27,233,450
Plus reinsurance recoverables	12,712,980	20,133,375	12,382,028
Balance at year-end	$ 64,782,486	$ 59,684,790	$ 39,615,478

As shown above, and as a result of our review of liability for losses and LAE, which includes a re-evaluation of the adequacy of reserve levels for prior year's claims, we increased the liability for losses and LAE for claims occurring in prior years by $4.5 million, $9.2 million and $9.3 million for the years ended December 31, 2008, 2007 and 2006, respectively.

In 2008, we increased incurred losses and LAE for claims in connection with the hurricanes in 2005 and 2004 by approximately $0.4 million and increased the incurred loss and LAE in connection with our automobile and commercial general liability lines of business by $4.1 million.

In 2007, we increased incurred losses and LAE for claims in connection with the hurricanes in 2005 and 2004 by approximately $1.2 million and increased the incurred loss and LAE in connection with our automobile and commercial general liability lines of business by $8.0 million.

There can be no assurance concerning future adjustments of reserves, positive or negative, for claims incurred through December 31, 2008.

Based upon discussions with our independent actuarial consultants and their statements of opinion on losses and LAE, we believe that the liability for unpaid losses and LAE is currently adequate to cover all claims and related expenses which may arise from incidents reported and IBNR.

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The following table presents total unpaid loss and LAE, net, and total reinsurance recoverable, on a run-off basis, due from our automobile reinsurers as shown in our consolidated financial statements for the periods indicated.

	As of December 31,	
	2008	2007
Transatlantic Reinsurance Company (A+ A.M. Best Rated):		
Reinsurance recoverable on paid losses and LAE	$ 4,521	$ 20,823
Unpaid losses and LAE	92,931	137,546
	$ 97,452	$ 158,369
Amounts due from reinsurers consisted of amounts related to:		
Unpaid losses and LAE	$ 92,931	$ 137,546
Reinsurance recoverable on paid losses and LAE	4,521	20,823
	$ 97,452	$ 158,369

In addition to reinsurance due from our automobile reinsurers, we also have reinsurance due from our catastrophic reinsurance companies. These reinsurance recoverables relate to Hurricane Katrina and Hurricane Wilma from 2005 and to the four hurricanes that occurred in August and September of 2004. The following table presents total unpaid loss and LAE, net, and total reinsurance recoverable due from our catastrophic reinsurers as shown in our consolidated financial statements.

	As of December 31,	
	2008	2007
Catastrophe Excess of Loss (Various participants) and FHCF		
Reinsurance recoverable on paid losses and LAE	$ 4,262,572	$ 2,771,624
Unpaid losses and LAE	12,612,804	19,971,394
	$ 16,875,376	$ 22,743,018
Amounts due from reinsurers consisted of amounts related to:		
Unpaid losses and LAE	$ 12,612,804	$ 19,971,394
Reinsurance recoverable on paid LAE	4,262,572	2,771,624
Reinsurance payable	(11,088,023)	(12,605,238)
	$ 5,787,353	$ 10,137,780

The following table presents the liability for unpaid losses and LAE for the years ended December 31, 1999 through 2008 and does not distinguish between catastrophic and non-catastrophic events. The top line of the table shows the estimated net liabilities for unpaid losses and LAE at the balance sheet date for each of the periods indicated. These figures represent the estimated amount of unpaid losses and LAE for claims arising in all prior years that were unpaid at the balance sheet date, including losses that had been IBNR. The portion of the table labeled "Cumulative paid as of" shows the net cumulative payments for losses and LAE made in succeeding years for losses incurred prior to the balance sheet date. The lower portion of the table shows the re-estimated amount of the previously recorded liability based on experience as of the end of each succeeding year.

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Years Ended December 31, (Dollars in Thousands)	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
Balance Sheet Liability	$ 52,070	$ 39,551	$ 27,259	$ 25,733	$ 37,390	$ 15,314	$ 9,422	$ 6,207	$ 6,976	$ 4,428
Cumulative paid as of:										
One year later		7,666	19,331	25,465	35,114	10,466	8,101	5,283	8,160	4,224
Two years later			26,997	34,073	48,285	12,499	9,857	7,215	9,487	5,666
Three years later				39,012	53,621	14,220	10,417	7,711	10,094	6,182
Four years later					56,926	15,033	11,410	7,953	10,352	6,394
Five years later						15,261	11,725	8,171	10,476	6,542
Six years later							11,763	8,296	10,641	6,563
Seven years later								8,270	10,749	6,576
Eight years later									10,720	6,587
Nine years later										6,586
										6,586
Re-estimated net liability as of:										
End of year	$ 52,070	$ 39,551	$ 27,259	$ 25,733	$ 37,390	$ 15,314	$ 9,422	$ 6,207	$ 6,976	$ 4,428
One year later		44,440	35,370	35,618	44,690	14,256	10,897	6,954	9,445	5,872
Two years later			40,796	41,280	52,317	14,273	10,625	7,842	10,200	6,284
Three years later				45,131	56,147	14,890	10,770	8,069	10,425	6,605
Four years later					59,583	15,854	11,650	8,312	10,616	6,561
Five years later						16,304	12,365	8,542	10,782	6,664
Six years later							12,410	8,621	10,945	6,644
Seven years later								8,458	11,241	6,743
									10,644	7,228

Eight years later									
Nine years later									5,967
Cumulative redundancy (deficiency)	$ (4,888)	$ (13,537)	$ (19,398)	$ (22,193)	$ (991)	$ (2,988)	$ (2,251)	$ (3,668)	$ (1,539)
Cumulative redundancy (-) deficiency as a % of reserves originally established	-12.4%	-49.7%	-75.4%	-59.4%	-6.5%	-31.7%	-36.3%	-52.6%	-34.8%

The cumulative redundancy or deficiency represents the aggregate change in the estimates over all prior years. A deficiency indicates that the latest estimate of the liability for losses and LAE is higher than the liability that was originally estimated and a redundancy indicates that such estimate is lower. It should be emphasized that the table presents a run-off of balance sheet liability for the periods indicated rather than accident or policy loss development for those periods. Therefore, each amount in the table includes the cumulative effects of changes in liability for all prior periods. Conditions and trends that have affected liabilities in the past may not necessarily occur in the future.

As noted above, we have since experienced a $4.9 million cumulative deficiency in connection with the re-estimation of all loss that occurred in 2007 and a $13.5 million cumulative deficiency in connection with the re-estimation of all loss that occurred in 2006. Relative to the $4.9 million deficiency, our homeowner and commercial general liability losses totaled $1.1 million and $4.4 million, respectively, and our automobile benefit totaled $0.7 million. Relative to the $13.5 million deficiency, our homeowner and commercial general liability and automobile losses totaled $5.5 million, $6.6 million and $1.4 million, respectively.

As noted last year, we had since experienced an $8.2 million cumulative deficiency in connection with the re-estimation of all loss that occurred in 2006 and a $15.7 million cumulative deficiency in connection with the re-estimation of all loss that occurred in 2005. Relative to the $8.2 million deficiency, our homeowner, commercial general liability and automobile losses totaled $2.2, $4.0 and $2.0, respectively. Relative to the $15.7 million deficiency, our homeowner and commercial general liability and automobile losses totaled $9.4 million, $3.4 million and $2.8 million, respectively.

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As noted in our Form 10-K for the fiscal year ended December 31, 2006, we experienced a $15.2 million cumulative deficiency recognized in 2006 and 2005 in connection with the re-estimation of all loss that occurred in 2004 and a $10.0 million cumulative deficiency recognized in 2006 in connection with the re-estimation of all loss that occurred in 2005. Relative to the $15.2 million deficiency, our homeowner and commercial general liability losses totaled $15.4 million and $0.6 million, respectively offset by automobile redundancies totaling $0.9 million. Relative to the $10.0 million deficiency, our homeowner and commercial general liability and automobile losses totaled $7.3 million, $1.7 million and $1.0 million, respectively.

The table below sets forth the differences between loss and LAE reserves as disclosed for Generally Accepted Accounting Principles ("GAAP") basis compared with Statutory Accounting Principles ("SAP") basis of presentation for the years ended 2008, 2007 and 2006.

	Years Ended December 31,		
	2008	2007	2006
	(Dollars in Thousands)		
GAAP basis Loss and LAE reserves	$ 64,782	$ 59,685	$ 39,615
Less unpaid Losses and LAE ceded	12,713	20,133	12,401
Balance Sheet Liability	52,070	39,552	27,214
Add Insurance Apportionment Plan	25	37	45
SAP basis Loss and LAE reserves	$ 52,094	$ 39,589	$ 27,259

The table below sets forth the differences between loss and LAE incurred as disclosed for GAAP basis compared with SAP basis presentation for the years ended 2008, 2007 and 2006.

	Years Ended December 31,		
	2008	2007	2006
	(Dollars in Thousands)		
GAAP basis Loss and LAE incurred	$ 41,868	$ 47,619	$ 44,400
Intercompany adjusting and other expenses	4,313	7,361	6,465
Insurance apportionment plan	4	12	(294)
SAP basis Loss and LAE incurred	$ 46,185	$ 54,992	$ 50,571

Underwriting results of insurance companies are frequently measured by their Combined Ratios. However, investment income, federal income taxes and other non-underwriting income or expense are not reflected in the Combined Ratio. The profitability of property and casualty insurance companies depends on income from underwriting, investment and service operations. Underwriting results are considered profitable when the Combined Ratio is under 100% and unprofitable when the Combined Ratio is over 100%.

The following table sets forth Loss Ratios, Expense Ratios and Combined Ratios for the periods indicated for the insurance business of Federated National and American Vehicle for 2008, 2007 and 2006. The ratios, inclusive of Unallocated Loss Adjustment Expenses ("ULAE"), are shown in the table below, and are computed based upon SAP.

	Years Ended December 31,		
	2008	2007	2006
Loss Ratio	69.1%	54.6%	54.8%

Expense Ratio	43.9%	38.9%	42.5%
Combined Ratio	113.0%	93.5%	97.3%

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COMPETITION

We operate in highly competitive markets and face competition from national, regional and residual market insurance companies in the property and casualty, commercial general liability and automobile markets, many of whom are larger and have greater financial and other resources, have better ratings and offer more diversified insurance coverage. Our competitors include companies that market their products through agents, as well as companies that sell insurance directly to their customers. Large national writers may have certain competitive advantages over agency writers, including increased name recognition, increased loyalty of their customer base and reduced policy acquisition costs. Competition is having a material adverse effect on our business, results of operations and financial condition.

Significant competition has emerged as a result of the January 2007 emergency Florida legislation session wherein it passed, and the Governor signed into law, a bill known as "CS/HB-1A.". This law made fundamental changes to the property and casualty insurance business in Florida and undertook a multi-pronged approach to address the cost of residential property insurance in Florida. First, the law increased the capacity of reinsurance that stabilized the reinsurance market to the benefit of the insurance companies writing properties lines in the state of Florida. Secondly, the law provided for rate relief to all policyholders.

The law also authorized the state-owned insurance company, Citizens Property Insurance Corporation ("Citizens"), which is free of many of the restraints on private carriers such as surplus, ratios, income taxes and reinsurance expense, to reduce its premium rates and begin competing against private insurers in the residential property insurance market and expands the authority of Citizens to write commercial insurance.

Additionally, in an effort to foster competition in the Florida homeowners' property insurance market, the State of Florida created a Capital Build-Up incentive program in response to the catastrophic events that occurred during 2004 and 2005. This program provides matching statutory capital to any new or existing carrier licensed to write homeowners insurance in the state of Florida. This Capital Build-Up incentive program has certain default covenants that require participating carriers to maintain minimum net written premium ratios.

Finally, during 2007 and 2008, approximately two dozen new homeowner insurance companies have received authority by the Florida OIR to commence business as admitted carriers in the state of Florida.

We believe that these aggressive marketplace changes have forced some carriers to pursue market share based on "best case" pricing models that may ultimately prove unprofitable from an underwriting perspective.

We have not participated in the Capital Build-Up incentive program and therefore have been able to remain committed to the discipline of writing business that is profitable from an underwriting perspective. This commitment has resulted in a significant erosion of our homeowners' property insurance market share in 2007 and 2008. Although our pricing is inevitably influenced to some degree by that of our competitors, we believe that it is generally not in our shareholders' best interest to compete solely on price. We compete on the basis of underwriting criteria, our distribution network and superior service to our agents and insureds.

In Florida, more than 200 companies are authorized to underwrite homeowners' insurance. National and regional companies that compete with us in the homeowners' market include Allstate Insurance Company and First Floridian Insurance Company. In addition to these nationally recognized names, we also compete with several Florida domestic property and casualty companies such as Universal Insurance Company of North America, Universal Property and Casualty Insurance Company, Royal Palm Insurance Company, Edison Insurance Company, Olympus Insurance Company, St. Johns Insurance Company, Cypress Property and Casualty Insurance Company, Tower Hill Insurance

Company, Florida Family Insurance Company and American Strategic Insurance Company.

Comparable companies which compete with us in the commercial general liability insurance market include Century Surety Insurance Company, Atlantic Casualty Insurance Company, Colony Insurance Company and Burlington/First Financial Insurance Companies. We also face new competition in Florida from such companies as Seminole Property and Casualty Insurance Company, Cypress Property and Casualty Company and U.S. Security Insurance Company.

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With respect to automobile insurance in Florida, we intentionally market only to our existing policyholders by offering to renew the existing policy. Presently, we have chosen not to compete with more than 100 companies, which underwrite personal automobile insurance in Florida. Comparable companies in the personal automobile insurance market include U.S. Security Insurance Company, United Automobile Insurance Company, Direct General Insurance Company and Security National Insurance Company, as well as major insurers such as Progressive Casualty Insurance Company.

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REGULATION

General

We are, or will be, subject to the laws and regulations in Alabama, Arkansas, California, Florida, Georgia, Kentucky, Louisiana, Maryland, Missouri, Nevada, Ohio, Oklahoma, South Carolina, Tennessee, Texas and Virginia and regulations of any other states in which we seek to conduct business in the future. The regulations cover all aspects of our business and are generally designed to protect the interests of insurance policyholders, as opposed to the interests of shareholders. Such regulations relate to authorized lines of business, capital and surplus requirements, allowable rates and forms, investment parameters, underwriting limitations, transactions with affiliates, dividend limitations, changes in control, market conduct, maximum amount allowable for premium financing service charges and a variety of other financial and non-financial components of our business. Our failure to comply with certain provisions of applicable insurance laws and regulations could have a material adverse effect on our business, results of operations or financial condition. In addition, any changes in such laws and regulations, including the adoption of consumer initiatives regarding rates charged for coverage, could materially and adversely affect our operations or our ability to expand.

A recent example of such consumer initiatives may be found with Florida’s property insurers’ operating under a new emergency rule which requires existing premium rates as of January 25, 2007, to remain in effect until a rate filing reflecting the provisions as provided in Florida’s newly enacted property insurance legislation. The legislation, which among other issues, provided low cost reinsurance to member insurance companies, accelerated rate filings to reflect the reduced reinsurance costs and expanded the role of Citizens in the market place. Other provisions contained in the emergency rule prevent non-renewals and cancellation (except for material misrepresentation and non-payment of premium) and new restrictions on coverage are prohibited. We are aware of the continued financial challenges that face the State of Florida in connection with the current consumer initiatives. The consumer initiatives stem from the catastrophic hurricanes during 2004 and 2005. The financial challenges have affected our business, results of operations and financial condition in the past and there can be no assurance that they will not continue to affect business, results of operations and financial condition in the future. We are unaware of any other jurisdictions with similar consumer initiatives that could have a material adverse effect on our business, results of operations or financial condition.

Most states have also enacted laws which restrict an insurer’s underwriting discretion, such as the ability to terminate policies, terminate agents or reject insurance coverage applications, and many state regulators have the power to reduce, or to disallow increases, in premium rates. These laws may adversely affect the ability of an insurer to earn a profit on its underwriting operations.

Most states also have insurance laws requiring that rate schedules and other information be filed with the state's insurance regulatory authority, either directly or through a rating organization with which the insurer is affiliated. The regulatory authority may disapprove a rate filing if it finds that the rates are inadequate, excessive or unfairly discriminatory. Rates, which are not necessarily uniform for all insurers, vary by class of business, hazard covered, and size of risk. Certain states have recently adopted laws or are considering proposed legislation which, among other things, limit the ability of insurance companies to effect rate increases or to cancel, reduce or non-renew insurance coverage with respect to existing policies, particularly personal automobile insurance. As discussed above, the recent consumer initiatives with Florida’s property insurers’ demonstrate the State of Florida’s ability to adopt such laws. Also, the Florida legislature may adopt additional laws of this type in the future, which may adversely affect the Company's business.

Most states require licensure or regulatory approval prior to the marketing of new insurance products. Typically, licensure review is comprehensive and includes a review of a company's business plan, solvency, reinsurance, character of its officers and directors, rates, forms and other financial and non-financial aspects of a company. The regulatory authorities may prohibit entry into a new market by not granting a license or by withholding approval.

All insurance companies must file quarterly and annual statements with certain regulatory agencies and are subject to regular and special examinations by those agencies. The last regulatory examination conducted by the Florida OIR on Federated National covered the three-year period ended on December 31, 2004. The last regulatory examination conducted by the Florida OIR on American Vehicle covered the three-year period ended on December 31, 2005.

Federated National's 2004 regularly scheduled statutory triennial examination for the three years ended December 31, 2004 was performed by the Florida OIR in 2005. American Vehicle's examination was for the three years ended December 31, 2005 was also performed by the Florida OIR, in 2006. A loss reserve deficiency totaling approximately $1.3 million (net of income taxes) was recorded in the fourth quarter of 2006 on American Vehicle in connection with the Florida OIR examination. We may be the subject of additional targeted examinations or analysis. These examinations or analysis may result in one or more corrective orders being issued by the Florida OIR.

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Federated National anticipates a regularly scheduled statutory examination by the Florida OIR to occur during 2010 for the five years ended December 31, 2009. American Vehicle anticipates a regularly scheduled statutory examination by the Florida OIR to occur during 2011 for the five years ended December 31, 2010. We have not received any notice of such examinations.

In some instances, various states routinely require deposits of assets for the protection of policyholders either in those states or for all policyholders. As an example, the Florida OIR requires Federated National and American Vehicle to have securities with a fair market value of $1.0 million held in escrow. As of December 31, 2008, Federated National and American Vehicle held investment securities with a fair value of approximately $1.1 million, each as deposits with the State of Florida. Additionally, as of December 31, 2008 American Vehicle has cash deposits totaling, $409,640 with the State of Alabama, $167,109 with the State of Arkansas and $116,715 with the State of Louisiana.

As of December 31, 2007, Federated National and American Vehicle held investment securities with a fair value of approximately $1.1 million, each as deposits with the State of Florida. Additionally, as of December 31, 2007 American Vehicle has cash deposits totaling, $397,102 with the State of Alabama, $153,750 with the State of Arkansas and $113,614 with the State of Louisiana.

Restrictions in Payments of Dividends by Domestic Insurance Companies

Under Florida law, a domestic insurer may not pay any dividend or distribute cash or other property to its shareholders except out of that part of its available and accumulated capital surplus funds which is derived from realized net operating profits on its business and net realized capital gains. A Florida domestic insurer may not make dividend payments or distributions to shareholders without prior approval of the Florida OIR if the dividend or distribution would exceed the larger of (i) the lesser of (a) 10.0% of its capital surplus or (b) net income, not including realized capital gains, plus a two-year carryforward, (ii) 10.0% of capital surplus with dividends payable constrained to unassigned funds minus 25% of unrealized capital gains or (iii) the lesser of (a) 10.0% of capital surplus or (b) net investment income plus a three-year carryforward with dividends payable constrained to unassigned funds minus 25.0% of unrealized capital gains.

Alternatively, a Florida domestic insurer may pay a dividend or distribution without the prior written approval of the Florida OIR (i) if the dividend is equal to or less than the greater of (a) 10.0% of the insurer’s capital surplus as regards policyholders derived from realized net operating profits on its business and net realized capital gains or (b) the insurer’s entire net operating profits and realized net capital gains derived during the immediately preceding calendar year, (ii) the insurer will have policy holder capital surplus equal to or exceeding 115.0% of the minimum required statutory capital surplus after the dividend or distribution, (iii) the insurer files a notice of the dividend or distribution with the Florida OIR at least ten business days prior to the dividend payment or distribution and (iv) the notice includes a certification by an officer of the insurer attesting that, after the payment of the dividend or distribution, the insurer will have at least 115% of required statutory capital surplus as to policyholders. Except as provided above, a Florida domiciled insurer may only pay a dividend or make a distribution (i) subject to prior approval by the Florida OIR or (ii) 30 days after the Florida OIR has received notice of such dividend or distribution and has not disapproved it within such time.

No dividends were paid by Federated National or American Vehicle in 2008, 2007 or 2006, and none are anticipated in 2009. Although we believe that amounts required to meet our financial and operating obligations will be available from sources other than dividends from our insurance subsidiaries, there can be no assurance in this regard. Further, there can be no assurance that, if requested, the Florida OIR will allow any dividends in excess of the amount available, to be paid by Federated National and American Vehicle to us, the parent company, in the future. The

maximum dividends permitted by state law are not necessarily indicative of an insurer's actual ability to pay dividends or other distributions to a parent company, which also may be constrained by business and regulatory considerations, such as the impact of dividends on capital surplus, which could affect an insurer's competitive position, the amount of premiums that can be written and the ability to pay future dividends. Further, state insurance laws and regulations require that the statutory capital surplus of an insurance company following any dividend or distribution by it be reasonable in relation to its outstanding liabilities and adequate for its financial needs.

While the non-insurance company subsidiaries (Assurance MGA, Superior and any other affiliate) are not subject directly to the dividend and other distribution limitations, insurance holding company regulations govern the amount that any affiliate within the holding company system may charge any of the insurance companies for service (e.g., management fees and commissions).

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National Association of Insurance Commissioners ("NAIC") Risk Based Capital Requirements

In order to enhance the regulation of insurer solvency, the NAIC established risk-based capital requirements for insurance companies that are designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policy holders. These requirements measure three major areas of risk facing property and casualty insurers: (i) underwriting risks, which encompass the risk of adverse loss developments and inadequate pricing; (ii) declines in asset values arising from credit risk; and (iii) other business risks from investments. Insurers having less statutory surplus than required will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. The Florida OIR, which follows these requirements, could require Federated National or American Vehicle to cease operations in the event they fail to maintain the required statutory capital.

Based upon the 2008 statutory financial statements for Federated National and American Vehicle, statutory surplus exceeded all regulatory action levels established by the NAIC's risk-based capital requirements.

Based upon the 2007 statutory financial statements for Federated National and American Vehicle, statutory surplus exceeded all regulatory action levels established by the NAIC's risk-based capital requirements.

Based on risk-based capital requirements, the extent of regulatory intervention and action increases as the ratio of an insurer's statutory surplus to its Authorized Control Level ("ACL"), as calculated under the NAIC's requirements, decreases. The first action level, the Company Action Level, requires an insurer to submit a plan of corrective actions to the insurance regulators if statutory surplus falls below 200.0% of the ACL amount. The second action level, the Regulatory Action Level, requires an insurer to submit a plan containing corrective actions and permits the insurance regulators to perform an examination or other analysis and issue a corrective order if statutory surplus falls below 150.0% of the ACL amount. The third action level, ACL, allows the regulators to rehabilitate or liquidate an insurer in addition to the aforementioned actions if statutory surplus falls below the ACL amount. The fourth action level is the Mandatory Control Level, which requires the regulators to rehabilitate or liquidate the insurer if statutory surplus falls below 70.0% of the ACL amount. Federated National's ratio of statutory surplus to its ACL was 739.4%, 653.0 % and 165.4% at December 31, 2008, 2007 and 2006, respectively. American Vehicle's ratio of statutory surplus to its ACL was 402.5%, 448.5% and 444.2% at December 31, 2008, 2007 and 2006, respectively.

NAIC Insurance Regulatory Information Systems Ratios

The NAIC has also developed Insurance Regulatory Information Systems ("IRIS") ratios to assist state insurance departments in identifying companies which may be developing performance or solvency problems, as signaled by significant changes in the companies' operations. Such changes may not necessarily result from any problems with an insurance company, but may merely indicate changes in certain ratios outside the ranges defined as normal by the NAIC. When an insurance company has four or more ratios falling outside "usual ranges," state regulators may investigate to determine the reasons for the variance and whether corrective action is warranted.

As of December 31, 2008, Federated National was outside NAIC's usual ranges with respect to its IRIS tests on two out of thirteen ratios. There was one exception in connection with change in net written premium and one in connection with two year reserve development to policyholders' surplus. As of December 31, 2007, Federated National was outside NAIC's usual ranges with respect to its IRIS tests on three out of thirteen ratios. There were two exceptions in connection with surplus growth and one exception in connection with adverse homeowner claims in connection with the hurricanes of 2004 and 2005.

As of December 31, 2008, American Vehicle was outside NAIC's usual range for two of thirteen ratios. There was one exception in connection with the two year overall operating ratio and one in connection with two year reserve development to policyholders' surplus. As of December 31, 2007, American Vehicle was outside NAIC's usual range for two of thirteen ratios. The exceptions were in connection with reserve development in connection with our commercial general liability program.

There was no action taken by the Florida OIR in connection with the December 31, 2007 IRIS ratio results. We do not currently believe that the Florida OIR will take any significant action with respect to Federated National or American Vehicle regarding the 2008 IRIS ratios, although there can be no assurance that will be the case.

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Insurance Holding Company Regulation

We, the parent company, are subject to laws governing insurance holding companies in Florida where Federated National and American Vehicle are domiciled. These laws, among other things, (i) require us to file periodic information with the Florida OIR, including information concerning our capital structure, ownership, financial condition and general business operations, (ii) regulate certain transactions between us and our affiliates, including the amount of dividends and other distributions, the terms of surplus notes and amounts that our affiliates can charge the holding company for services such as management fees or commissions, (iii) restrict the ability of any one person to acquire certain levels of our voting securities without prior regulatory approval. Any purchaser of 5% or more of the outstanding shares of our Common Stock will be presumed to have acquired control of Federated National and American Vehicle unless the Florida OIR, upon application, determines otherwise.

Finance Company Regulation

Our financing program remains subject to certain laws governing the operation of premium finance companies. These laws pertain to such matters as books and records that must be kept, forms, licensing, fees and charges. For example, in Florida, the maximum late payment fee Federated Premium may charge for personal line policies is $10 per month.

Underwriting and Marketing Restrictions

During the past several years, various regulatory and legislative bodies have adopted or proposed new laws or regulations to address the cyclical nature of the insurance industry, catastrophic events and insurance capacity and pricing. These regulations include (i) the creation of "market assistance plans" under which insurers are induced to provide certain coverages, (ii) restrictions on the ability of insurers to rescind or otherwise cancel certain policies in mid-term, (iii) advance notice requirements or limitations imposed for certain policy non-renewals and (iv) limitations upon or decreases in rates permitted to be charged.

Legislation

From time to time, new regulations and legislation are proposed to limit damage awards, to control plaintiffs' counsel fees, to bring the industry under regulation by the Federal government, to control premiums, policy terminations and other policy terms and to impose new taxes and assessments. It is not possible to predict whether, in what form or in what jurisdictions, any of these proposals might be adopted, or the effect, if any, on us.

During February 2008 Florida’s House Insurance Committee held a workshop on a proposal and legislation developed by the Florida Department of Financial Services (“DFS”) regarding a significant reduction of capacity in the FHCF, substantially increasing members’ co-insurance participation and the reorganization of the FHCF under the Florida Cabinet. Additionally, the Board of Directors of FIGA held separate meetings to discuss their continued financial challenges in connection with the insolvency of a particular insurance company that was assumed subsequent to the 2005 – 2006 hurricane season. Additional assessments by regulatory agencies are possible though not quantifiable at this time.

Industry Ratings Services

Third-party rating agencies assess and rate the ability of insurers to pay their claims. These financial strength ratings are used by the insurance industry to assess the financial strength and quality of insurers. These ratings are based on criteria established by the rating agencies and reflect evaluations of each insurer's profitability, debt and cash levels,

customer base, adequacy and soundness of reinsurance, quality and estimated market value of assets, adequacy of reserves, and management. Ratings are based upon factors of concern to agents, reinsurers and policyholders and are not directed toward the protection of investors, such as purchasers of our common stock.

In August 2004, A.M. Best notified us that Federated National and American Vehicle were being placed under review with negative implications. In connection with this review, we requested that A.M. Best cease its ratings of these subsidiaries and assign a rating of “NR-4 – Not rated, company’s request” to each. The withdrawal of our ratings could limit or prevent us from writing or renewing desirable insurance policies, obtaining adequate reinsurance or borrowing on our line of credit.

Federated National and American Vehicle are currently rated by Demotech as "A" ("Exceptional"), which is the third of seven ratings, and defined as “Regardless of the severity of a general economic downturn or deterioration in the insurance cycle, insurers earning a Financial Stability Rating of “A” possess “Exceptional” financial stability related to maintaining surplus as regards to policyholders”. Demotech’s ratings are based upon factors of concern to agents, reinsurers and policyholders and are not primarily directed toward the protection of investors. However, our Demotech rating could be jeopardized by such other factors including adverse development and various surplus related ratio exceptions.

In a letter from Demotech's Chief Executive Officer, dated January 15, 2009, Demotech warned Florida policymakers, including Florida Insurance Council representatives that "The potential inability of the FHCF to honor meritorious claims related to a significant event adversely influences the Financial Stability Rating of each of the carriers that are heavily dependent on the reinsurance provided by the FHCF. Under current circumstances and conditions, we will provide, monitor and support Financial Stability Ratings through the period ending May 15, 2009. An extension of financial Stability Ratings beyond May 15, 2009, will require definitive financial information regarding participation in the FHCF, documentation of bridge loans or alternative financing mechanisms that provide liquidity during a period in which the FHCF would be raising capital and other precaution or protection regarding reinsurance collectibility or catastrophe reinsurance."

The withdrawal of our ratings could limit or prevent us from writing or renewing desirable insurance policies, from competing with insurers who have higher ratings, from obtaining adequate reinsurance, or from borrowing on a line of credit. Furthermore, a withdrawal of the rating could cause the Company's insurance policies to no longer be acceptable to the secondary marketplace and mortgage lenders, which could cause a material adverse effect of the Company's results of operations and financial position.

EMPLOYEES

As of December 31, 2008, we had approximately 110 employees, including three executive officers. We are not a party to any collective bargaining agreement and we have not experienced work stoppages or strikes as a result of labor disputes. We consider relations with our employees to be satisfactory.

SENIOR MANAGEMENT

Set forth below is certain information concerning our executive officers who are not also directors, as of December 31, 2008:

Mr. Stephen C. Young (age 34), has served as the Company's President from June 2007 through the present date, and as President of Federated Premium from January 1998 through the present date. Mr. Young served as Vice President of Operations of the Company from June 2006 through May 2007.

ITEM 1A RISK FACTORS

We are subject to certain risks in our business operations which are described below. Careful consideration of these risks should be made before making an investment decision. The risks and uncertainties described below are not the only ones facing 21st Century. Additional risks and uncertainties not presently known or currently deemed immaterial may also impair our business operations.

Risks Related to Our Business

Our financial condition could be adversely affected by the occurrence of natural and man-made disasters.

We write insurance policies that cover homeowners', business owners and automobile owners for losses that result from, among other things, catastrophes. Catastrophic losses can be caused by hurricanes, tropical storms, tornadoes, wind, hail, fires, riots and explosions, and their incidence and severity are inherently unpredictable. The extent of losses from a catastrophe is a function of two factors: the total amount of the insurance company's exposure in the area affected by the event and the severity of the event. Our policyholders are currently concentrated in South and Central

Florida, which is especially subject to adverse weather conditions such as hurricanes and tropical storms.

In 2004 and 2005, the state of Florida experienced nine hurricanes. One of our subsidiaries, Federated National, incurred significant losses relative to its homeowners' and mobile homeowners' insurance lines of business in connection with these catastrophic weather events. Aggregate losses in connection with these storms involved over 23,000 claims at a cost in excess of $69.9 million, net of our reinsurance participation.

The occurrence of claims from catastrophic events could result in substantial volatility in our results of operations or financial condition for any fiscal quarter or year. Increases in the values and concentrations of insured property may also increase the severity of these occurrences in the future. Although we attempt to manage our exposure to such events through the use of underwriting controls and the purchase of third-party reinsurance, catastrophic events are inherently unpredictable and the actual nature of such events when they occur could be more frequent or severe than contemplated in our pricing and risk management expectations. As a result, the occurrence of one or more catastrophic events could have a material adverse effect on our results of operations or financial condition.

Although we follow the industry practice of reinsuring a portion of our risks, our costs of obtaining reinsurance fluctuates and we may not be able to successfully alleviate risk through reinsurance arrangements.

The state of Florida has a history of exposure to extremely volatile weather related catastrophic events including hurricanes and tornados. The frequency and severity of these events can have a profound impact on our balance sheet and statements of operations and cash flows. Though the Company attempts to mitigate the impact of these events, there can be no assurance that we will be successful.

We have a reinsurance structure that is a combination of private reinsurance and the FHCF. Our reinsurance structure is comprised of several reinsurance companies with varying levels of participation providing coverage for loss and LAE at pre-established minimum and maximum amounts. Losses incurred in connection with a catastrophic event below the minimum and above the maximum are the responsibility of Federated National.

As a result of the nine hurricanes experienced in Florida during the fourteen month period between August 2004 and October 2005, and changes in Florida law in 2007 regarding the pricing and availability of reinsurance, we continue to review, and may determine to modify, our reinsurance structure.

Though there has been no occurrence of hurricanes in Florida within the last three hurricane seasons, some weather analysts believe that we have entered a period of greater hurricane activity while others suggest a diminished expectation for the near future. To address this risk, we are exploring alternatives to reduce our exposure to these types of storms. Although these measures may increase operating expenses, management believes that they will assist us in protecting long-term profitability, although there can be no assurances that will be the case.

The availability and costs associated with the acquisition of reinsurance will vary year to year. These fluctuations, which can be significant, are not subject to our control and may limit our ability to purchase adequate coverage. The recovery of increased reinsurance costs through rate action is not immediate and can not be presumed, as it is subject to Florida OIR approval.

Insolvency of our primary reinsurer or any of our other current or future reinsurers including the FHCF, or their inability otherwise to pay claims, would increase the claims that we must pay, thereby potentially harming significantly our balance sheet, results of operations and cash flow. In addition, prevailing market conditions have increased the availability and limited the cost of reinsurance, although there can be no assurances that these conditions will persist.

Subsequent to December 31, 2008 and pursuant to the provisions of our reinsurance treaties, we elected to cancel the contract with New Castle and funds considered immaterial are in the process of settlement. New Castle’s participation in our reinsurance program represented approximately 1% of the aggregate catastrophic loss exposure. We are in the process of replacing this coverage however there can be no assurances that we can be successful, though our increased exposure is limited.

We face a risk of non-collectibility of reinsurance, which could materially and adversely affect our business, results of operations and/or financial condition.

As is common practice within the insurance industry, we transfer a portion of the risks insured under our policies to other companies through the purchase of reinsurance. This reinsurance is maintained to protect our insurance subsidiary against the severity of losses on individual claims, unusually serious occurrences in which a number of claims produce an aggregate extraordinary loss and catastrophic events. Although reinsurance does not discharge our

insurance subsidiary from its primary obligation to pay for losses insured under the policies it issues, reinsurance does make the assuming reinsurer liable to the insurance subsidiary for the reinsured portion of the risk. A credit exposure exists with respect to ceded losses to the extent that any reinsurer is unable or unwilling to meet the obligations assumed under the reinsurance contracts. The collectibility of reinsurance is subject to the solvency of the reinsurers, interpretation of contract language and other factors. A reinsurer's insolvency or inability to make payments under the terms of a reinsurance contract could have a material adverse effect on our results of operations and financial condition.

The availability and costs associated with the acquisition of reinsurance will vary year to year. These fluctuations, which can be significant, are not subject to our control and may limit our ability to purchase adequate coverage. The recovery of increased reinsurance costs through rate action is not immediate and can not be presumed, as it is subject to Florida OIR approval.

For the 2008-2009 hurricane season, the excess of loss and FHCF treaties will insure us for approximately $310.0 million of aggregate catastrophic losses and LAE with a maximum single event coverage totaling approximately $245.0 million, with the Company retaining the first $3.0 million of losses and LAE. Our reinsurance program included coverage purchased from the private market, which afforded optional Reinstatement Premium Protection that provides coverage beyond the first event, along with coverage from the FHCF. Coverage afforded by the FHCF totals approximately $167.0 million or 54% of the $310.0 million of aggregate catastrophic losses and LAE. The FHCF affords coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event.

Our reinsurance structure has significant risks, including the fact that the FHCF may not be able to raise sufficient money to pay their claims or impair their ability to pay their claims in a timely manner. This could result in significant financial, legal and operational challenges to our company.

Therefore, in the event of a catastrophic loss, we may become dependent upon the FHCF's ability to pay, which may, in turn, be dependent upon the FHCF's ability to issue bonds in amounts that would be required to meet its reinsurance obligations in the event of such a catastrophic loss. In this economic climate, there is no assurance that the FHCF will be able to do this. Please see “Business-Reinsurance” for more information about FHCF.

We may experience financial exposure from climate change.

Our financial exposure from climate change is most notably associated with losses in connection with the occurrence of hurricanes striking Florida. We mitigate the risk of financial exposure from climate change by restrictive underwriting criteria, sensitivity to geographic concentrations and reinsurance.

Restrictive underwriting criteria can include, but are not limited to, higher premiums and deductibles and more specifically excluded policy risks such as fences and screened-in enclosures. New technological advances in computer generated geographical mapping afford us an enhanced perspective as to geographic concentrations of policyholders and proximity to flood prone areas. Our amount of maximum reinsurance coverage is determined by subjecting our homeowner and mobile homeowner exposures to statistical forecasting models that are designed to quantify a catastrophic event in terms of the frequency of a storm occurring once in every “n” years. Our reinsurance coverage contemplated a catastrophic event occurring once every 100 years. Our amount of losses retained (our deductible) in connection with a catastrophic event is determined by market capacity, pricing conditions and surplus preservation.

Our loss reserves may be inadequate to cover our actual liability for losses, causing our results of operations to be adversely affected.

We maintain reserves to cover our estimated ultimate liabilities for loss and LAE. These reserves are estimates based on historical data and statistical projections of what we believe the settlement and administration of claims will cost based on facts and circumstances then known to us. Actual loss and LAE reserves, however, may vary significantly from our estimates.

Factors that affect unpaid loss and LAE include the estimates made on a claim-by-claim basis known as “case reserves” coupled with bulk estimates known as IBNR. Periodic estimates by management of the ultimate costs required to settle all claim files are based on our analysis of historical data and estimations of the impact of numerous factors such as (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that past experience, adjusted for the effects of current developments and anticipated

trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors.

Because of the uncertainties that surround estimated loss reserves, we cannot be certain that our reserves will be adequate to cover our actual losses. If our reserves for unpaid losses and LAE are less than actual losses and LAE, we will be required to increase our reserves with a corresponding reduction in our net income in the period in which the deficiency is identified. For example, during the quarter ended December 31, 2006 we increased our reserves in connection with our homeowners’ and commercial general liability insurance programs upon the advice of our newly appointed actuaries. Future loss experience substantially in excess of our reserves for unpaid losses and LAE could substantially harm our results of operations and financial condition.

Our revenues and operating performance will fluctuate due to statutorily approved assessments that support property and casualty insurance pools and associations.

We operate in a regulatory environment where certain entities and organizations have the authority to require us to participate in assessments. Currently these entities and organizations include, but are not limited to, the Florida Joint Underwriters Association (“JUA”), FIGA, Citizens and the FHCF. The current assessments stem from the catastrophic effects to the property insurance industry in the state of Florida from the hurricanes that occurred during the fourteen months between August 2004 and October 2005.

Most of the recent assessments result in a charge to current operations. The insurance companies will then pass the assessments on to insurance policies, in the form of a policy surcharge, and reflect the collection of these assessments as fully earned credits to operations in the period collected. The collection of these fees may adversely affect our over all marketing strategy due to the competitive landscape in Florida. All other pricing considerations remaining the same, a newly formed property insurance company would not be subject to the recoupment of previously imposed assessments.

Future assessments are likely, however the impact of these assessments on our balance sheet, results of operations or cash flow are undeterminable at this time.

Our investment portfolio may suffer reduced returns or losses, which would significantly reduce our earnings.

As do other insurance companies, we depend on income from our investment portfolio for a substantial portion of our earnings. During the time that normally elapses between the receipt of insurance premiums and any payment of insurance claims, we invest the funds received, together with our other available capital, primarily in fixed-maturity investments and to a lesser extent in equity securities, in order to generate investment income.

In connection with our equity securities, we determined that certain securities qualified for other than temporary impairment status in 2008. In connection with this process we charged to operations a net realized investment loss that totaled approximately $9.9 million, net of an estimated provisional tax effect of approximately $3.7 million. Most of these investments were subsequently sold during the third and fourth quarter of the year, and, we recognized an additional $0.2 million loss, net of an estimated tax benefit of approximately $0.1 million.

Our investment portfolio contains interest rate sensitive instruments, such as bonds, which may be adversely affected by changes in interest rates. A significant increase in interest rates or decrease in credit worthiness could have a material adverse effect on our financial condition or results of operations. Generally, bond prices decrease as interest rates rise. Changes in interest rates could also have an adverse effect on our investment income and results of operations. For example, if interest rates decline, investment of new premiums received and funds reinvested will earn less than expected.

We may experience a loss due to the concentration of credit risk.

Financial instruments that potentially subject the Company to significant concentration of credit risk consist of cash and cash equivalents held in a mutual fund money market account. Management believes that the financial institution holding the Company’s mutual fund money market account is credit worthy and accordingly minimal credit risk exists with respect to those investments.

As of December 31, 2008, the Company had approximately $121.4 million invested in the MTB Prime Money Market-Inst Fund Number 142, for which the NAIC classification is Class 1. A money market fund is eligible for listing on the Class 1 List if the fund meets the following conditions:

- The fund maintains a rating of Am or better from Standard and Poor's or a rating of A or better from Moody's Investor's Services ("Moody's") or an equivalent or better rating from another NAIC ARO;
- The fund maintains a constant net asset value of $1.00 at all times;
- The fund allows a maximum of seven-day redemption of proceeds; and
- The fund invests at least ninety-five percent (95%) of its total assets in any combination of: the U.S. Government securities listed in Section 14 of the Appendix, securities rated in the highest short term rating category by an NAIC ARO, unrated securities determined by the fund's Board to be of comparable quality, securities of money market funds that are registered investment companies and collateralized repurchase agreements comprised of such obligations at all times. The remaining five percent (5%) may be invested in Second Tier Securities as that phrase is defined by Rule 2a-7 of the Investment Company Act of 1940 (17 CFR 270.2a-7).

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Subsequent to year end these funds were invested in long and short term investments with yields that best match our liquidity needs.

We face risks in connection with potential material weakness resulting from our Sarbanes-Oxley Section 404 management report and any related remedial measures that we undertake.

In conjunction with our ongoing reporting obligations as a public company and the requirements of Section 404 of the Sarbanes-Oxley Act, management reported on the effectiveness of our internal control over financial reporting as of December 31, 2008. In order to identify any material weaknesses in our internal control over financial reporting, we engaged in a process to document, evaluate and test our internal controls and procedures, including corrections to existing controls and implement additional controls and procedures that we may deem necessary. As a result of this evaluation and testing process, no material financial reporting deficiencies were noted.

Although we did not have any material weaknesses in our internal controls for our fiscal year ended December 31, 2008, we can not be certain that there will be none in the future. In future periods, if the process required by Section 404 of the Sarbanes-Oxley Act reveals significant deficiencies or material weaknesses, the correction of any such significant deficiencies or material weaknesses could require additional remedial measures that could be costly and time-consuming. In addition, the discovery of material weaknesses could also require the restatement of prior period operating results. If a material weakness exists as of a future period year-end (including a material weakness identified prior to year-end for which there is an insufficient period of time to evaluate and confirm the effectiveness of the corrections or related new procedures), our management will be unable to report favorably as of such future period year-end as to the effectiveness of our control over financial reporting and we could lose investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our stock price and potentially subject us to litigation.

The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or our results of operations.

Various provisions of our policies, such as limitations or exclusions from coverage which have been negotiated to limit our risks, may not be enforceable in the manner we intend. At the present time we employ a variety of endorsements to our policies that limit exposure to known risks, including, but not limited to, exclusions relating to types of vehicles we insure, specific artisan activities and homes in close proximity to the coast line.

In addition, the policies we issue contain conditions requiring the prompt reporting of claims to us and our right to decline coverage in the event of a violation of that condition. While our insurance product exclusions and limitations reduce the loss exposure to us and help eliminate known exposures to certain risks, it is possible that a court or regulatory authority could nullify or void an exclusion or legislation could be enacted modifying or barring the use of such endorsements and limitations in a way that would adversely effect our loss experience, which could have a material adverse effect on our financial condition or results of operations.

The effects of emerging claim and coverage issues on our business are uncertain.

As industry practices and legal, judicial, social and other conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until some time after we have issued insurance contracts that are affected by the changes. As a result, the full extent of liability under our insurance contracts may not be known for many years after a contract is

issued.

Our failure to pay claims accurately could adversely affect our business, financial results and capital requirements.

We must accurately evaluate and pay claims that are made under our policies. Many factors affect our ability to pay claims accurately, including the training and experience of our claims representatives, the culture of our claims organization and the effectiveness of our management, our ability to develop or select and implement appropriate procedures and systems to support our claims functions and other factors. Our failure to pay claims accurately could lead to material litigation, undermine our reputation in the marketplace, impair our image and negatively affect our financial results.

In addition, if we do not train new claims adjusting employees effectively or if we lose a significant number of experienced claims adjusting employees, our claims department's ability to handle an increasing workload as we grow could be adversely affected. In addition to potentially requiring that growth be slowed in the affected markets, we could suffer decreased quality of claims work, which in turn could lower our operating margins.

If we are unable to continue our growth because our capital must be used to pay greater than anticipated claims, our financial results may suffer.

Our future growth will depend on our ability to expand the types of insurance products we offer and the geographic markets in which we do business, both balanced by the business risks we chose to assume and cede. We believe that our Company is sufficiently capitalized to operate our business as it now exists and as we currently plan to expand it. Our existing sources of funds include possible sales of our investment securities and our earnings from operations and investments. Unexpected catastrophic events in our market areas, such as the hurricanes experienced in Florida, have resulted and may result in greater claims losses than anticipated, which could require us to limit or halt our growth while we redeploy our capital to pay these unanticipated claims.

We may require additional capital in the future which may not be available or only available on unfavorable terms.

Our future capital requirements depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. To the extent that our present capital is insufficient to meet future operating requirements and/or cover losses, we may need to raise additional funds through financings or curtail our growth. Based on our current operating plan, we believe current capital, together with our anticipated retained earnings, will support our operations without the need to raise additional capital. However, we cannot provide any assurance in that regard, since many factors will affect our capital needs and their amount and timing, including our growth and profitability, our claims experience, and the availability of reinsurance, as well as possible acquisition opportunities, market disruptions and other unforeseeable developments.

If we had to raise additional capital, equity or debt financing may not be available at all or may be available only on terms that are not favorable to us. In the case of equity financings, dilution to our stockholders' ownership could result, and in any case such securities may have rights, preferences and privileges that are senior to those of existing shareholders. If we cannot obtain adequate capital on favorable terms or at all, our business, financial condition or results of operations could be materially adversely affected.

Our business is heavily regulated, and changes in regulation may reduce our profitability and limit our growth.

We are subject to extensive regulation in the states in which we conduct business. This regulation is generally designed to protect the interests of policyholders, as opposed to shareholders and other investors, and relates to authorization for lines of business, capital and surplus requirements, investment limitations, underwriting limitations, transactions with affiliates, dividend limitations, changes in control, premium rates and a variety of other financial and non-financial components of an insurance company's business. The NAIC and state insurance regulators are constantly reexamining existing laws and regulations, generally focusing on modifications to holding company regulations, interpretations of existing laws and the development of new laws.

From time to time, some states in which we conduct business have considered or enacted laws that may alter or increase state authority to regulate insurance companies and insurance holding companies. In other situations, states in which we conduct business have considered or enacted laws that impact the competitive environment and marketplace for property and casualty insurance. For example, in 2007 Florida enacted legislation that requires us to charge rates

for homeowners insurance that we believe are inadequate to cover the related underwriting risk. This same legislation authorizes a state-owned insurance company to reduce its premium rates and begin competing against private insurers in the Florida residential property insurance market.

Currently the federal government does not directly regulate the insurance business. However, in recent years the state insurance regulatory framework has come under increased federal scrutiny. Congress and some federal agencies from time to time investigate the current condition of insurance regulation in the United States to determine whether to impose federal regulation or to allow an optional federal charter, similar to banks. In addition, changes in federal legislation and administrative policies in several areas, including changes in the Gramm-Leach-Bliley Act, financial services regulation and federal taxation, can significantly impact the insurance industry and us.

We cannot predict with certainty the effect any enacted, proposed or future state or federal legislation or NAIC initiatives may have on the conduct of our business. Furthermore, there can be no assurance that the regulatory requirements applicable to our business will not become more stringent in the future or result in materially higher costs than current requirements. Changes in the regulation of our business may reduce our profitability, limit our growth or otherwise adversely affect our operations.

Our insurance companies are subject to minimum capital and surplus requirements, and our failure to meet these requirements could subject us to regulatory action.

Our insurance companies are subject to risk-based capital standards and other minimum capital and surplus requirements imposed under applicable state laws, including the laws of their state of domicile, Florida. The risk-based capital standards, based upon the Risk Based Capital Model Act adopted by the NAIC require our insurance companies to report their results of risk-based capital calculations to state departments of insurance and the NAIC. These risk-based capital standards provide for different levels of regulatory attention depending upon the ratio of an insurance company's total adjusted capital, as calculated in accordance with NAIC guidelines, to its authorized control level risk-based capital. Authorized control level risk-based capital is the number determined by applying the NAIC's risk-based capital formula, which measures the minimum amount of capital that an insurance company needs to support its overall business operations.

Any failure by one of our insurance companies to meet the applicable risk-based capital or minimum statutory capital requirements imposed by the laws of Florida or other states where we do business could subject it to further examination or corrective action imposed by state regulators, including limitations on our writing of additional business, state supervision or liquidation. As of December 31, 2008, American Vehicle and Federated National were in compliance with the NAIC risk-based capital requirements (see "Business-Regulation" for further discussion).

Any changes in existing risk-based capital requirements or minimum statutory capital requirements may require us to increase our statutory capital levels, which we may be unable to do.

Our revenues and operating performance may fluctuate with business cycles in the property and casualty insurance industry.

Historically, the financial performance of the property and casualty insurance industry has tended to fluctuate in cyclical patterns characterized by periods of significant competition in pricing and underwriting terms and conditions, which is known as a "soft" insurance market, followed by periods of lessened competition and increasing premium rates, which is known as a "hard" insurance market. Although an individual insurance company's financial performance is dependent on its own specific business characteristics, the profitability of most property and casualty insurance companies tends to follow this cyclical market pattern, with profitability generally increasing in hard markets and decreasing in soft markets. At present, we are experiencing a soft market in the property and casualty market in Florida because of regulatory changes. We cannot predict, however, how long these market conditions will persist. We do not compete entirely on price or targeted market share. Our ability to compete is governed by our ability to assess and price an insurance product with an acceptable risk for obtaining profit.

We may not obtain the necessary regulatory approvals to expand the types of insurance products we offer or the states in which we operate.

The insurance industry is highly regulated. Prior to selling a new insurance product in a state, we must obtain approval from the applicable state insurance regulators. The insurance regulators in states to which we might apply may request

additional information, add conditions to the license that we find unacceptable, or deny our application. This would delay or prevent us from operating in that state. If we want to operate in any additional states, we must file similar applications for licenses, which we may not be successful in obtaining.

We are named as a defendant in a securities class action lawsuit and a derivative lawsuit and it may have an adverse impact on our business.

We are named as a defendant in a securities class action lawsuit and a shareholder’s derivative lawsuit. For more information about the status of these lawsuits, see “Part I, Item 3 Legal Proceedings.” An unfavorable resolution of this pending litigation could have a material adverse effect on our financial condition. Litigation may result in substantial costs and expenses and significantly divert the attention of the Company's management regardless of the outcome. There can be no assurance that the Company will be able to achieve a favorable settlement of pending litigation or obtain a favorable resolution of litigation if it is not settled. In addition, current litigation could lead to increased costs or interruptions of normal business operations of the Company.

Adverse ratings by insurance rating agencies may adversely impact our ability to write new policies, renew desirable policies or obtain adequate insurance, which could limit or halt our growth and harm our business.

Third-party rating agencies assess and rate the ability of insurers to pay their claims. These financial strength ratings are used by the insurance industry to assess the financial strength and quality of insurers. These ratings are based on criteria established by the rating agencies and reflect evaluations of each insurer's profitability, debt and cash levels, customer base, adequacy and soundness of reinsurance, quality and estimated market value of assets, adequacy of reserves, and management. Ratings are based upon factors of concern to agents, reinsurers and policyholders and are not directed toward the protection of investors, such as purchasers of our common stock.

Demotech has publicly stated that the potential inability of the Florida Hurricane Catastrophe Fund to honor its obligations to carriers in Florida who are dependent on its reinsurance has impacted its ratings process. See Business-Ratings. The withdrawal of our ratings could limit or prevent us from writing or renewing desirable insurance policies, from competing with insurers who have higher ratings, from obtaining adequate reinsurance, or from borrowing on our line of credit Furthermore, a withdrawal of the rating could cause the Company's insurance policies to no longer be acceptable to the secondary marketplace and mortgage lenders, which could cause a material adverse effect of the Company's results of operations and financial position.

We rely on independent and general agents to write our insurance policies, and if we are not able to attract and retain independent and general agents, our revenues would be negatively affected.

We currently market and distribute Federated National's and American Vehicle's products and services through contractual relationships with a network of approximately 1,500 independent agents and a selected number of general agents. Our independent agents are our primary source for our automobile and property insurance policies. Many of our competitors also rely on independent agents. As a result, we must compete with other insurers for independent agents' business. Our competitors may offer a greater variety of insurance products, lower premiums for insurance coverage, or higher commissions to their agents. If our products, pricing and commissions do not remain competitive, we may find it more difficult to attract business from independent agents to sell our products. A material reduction in the amount of our products that independent agents sell could negatively affect our revenues.

We rely on our information technology and telecommunications systems, and the failure of these systems could disrupt our operations.

Our business is highly dependent upon the successful and uninterrupted functioning of our current information technology and telecommunications systems. We rely on these systems to process new and renewal business, provide customer service, make claims payments and facilitate collections and cancellations, as well as to perform actuarial and other analytical functions necessary for pricing and product development. As a result, the failure of these systems could interrupt our operations and adversely affect our financial results.

Nonstandard automobile insurance historically has a higher frequency of claims than standard automobile insurance, thereby increasing our potential for loss exposure beyond what we would be likely to experience if we offered only standard automobile insurance.

Nonstandard automobile insurance is provided to insureds that are unable to obtain preferred or standard insurance coverage because of their payment histories, driving records, age, vehicle types, or prior claims histories. This type of automobile insurance historically has a higher frequency of claims than does preferred or standard automobile insurance policies, although the average dollar amount of the claims is usually smaller under nonstandard insurance

policies. As a result, we are exposed to the possibility of increased loss exposure and higher claims experience than would be the case if we offered only standard automobile insurance.

Florida's personal injury protection insurance statute contains provisions that favor claimants, causing us to experience a higher frequency of claims than might otherwise be the case if we operated only outside of Florida.

Florida's personal injury protection insurance statute limits an insurer's ability to deny benefits for medical treatment that is unrelated to the accident, that is unnecessary, or that is fraudulent. In addition, the statute allows claimants to obtain awards for attorney's fees. Although this statute has been amended several times in recent years, primarily to address concerns over fraud, the Florida legislature has been only marginally successful in implementing effective mechanisms that allow insurers to combat fraud and other abuses. We believe that this statute contributes to a higher frequency of claims under nonstandard automobile insurance policies in Florida, as compared with claims under standard automobile insurance policies in Florida and nonstandard and standard automobile insurance polices in other states. Although we believe that we have successfully offset these higher costs with premium increases, because of competition, we may not be able to do so with as much success in the future.

Our success depends on our ability to accurately price the risks we underwrite.

The results of our operations and the financial condition of our insurance companies depend on our ability to underwrite and set premium rates accurately for a wide variety of risks. Rate adequacy is necessary to generate sufficient premiums to pay losses, LAE and underwriting expenses and to earn a profit. In order to price our products accurately, we must collect and properly analyze a substantial amount of data; develop, test and apply appropriate rating formulas; closely monitor and timely recognize changes in trends; and project both severity and frequency of losses with reasonable accuracy. Our ability to undertake these efforts successfully, and as a result price our products accurately, is subject to a number of risks and uncertainties, some of which are outside our control, including:

- the availability of sufficient reliable data and our ability to properly analyze available data;
- the uncertainties that inherently characterize estimates and assumptions;
- our selection and application of appropriate rating and pricing techniques;
- changes in legal standards, claim settlement practices, medical care expenses and restoration costs; and
- legislatively imposed consumer initiatives.

Consequently, we could under-price risks, which would negatively affect our profit margins, or we could overprice risks, which could reduce our sales volume and competitiveness. In either event, the profitability of our insurance companies could be materially and adversely affected.

Current operating resources are necessary to develop future new insurance products.

We currently intend to expand our product offerings by underwriting additional insurance products and programs, and marketing them through our distribution network. Expansion of our product offerings will result in increases in expenses due to additional costs incurred in actuarial rate justifications, software and personnel. Offering additional insurance products may also require regulatory approval, further increasing our costs. There can be no assurance that we will be successful bringing new insurance products to our marketplace.

Our business strategy is to avoid competition based on price to the extent possible. This strategy, however, may result in the loss of business in the short term.

In Florida, more than 200 companies are authorized to underwrite homeowners' insurance. National and regional companies that compete with us in the homeowners' market include Allstate Insurance Company and First Floridian Insurance Company. In addition to these nationally recognized names, we also compete with several Florida domestic property and casualty companies such as Universal Insurance Company of North America, Universal Property and Casualty Insurance Company, Royal Palm Insurance Company, Edison Insurance Company, Olympus Insurance Company, St. Johns Insurance Company, Cypress Property and Casualty Insurance Company, Tower Hill Insurance Company, Florida Family Insurance Company and American Strategic Insurance Company.

Significant competition has emerged as a result of the January 2007 emergency Florida legislation session wherein it passed, and the Governor signed into law, a bill known as "CS/HB-1A.". This law made fundamental changes to the property and casualty insurance business in Florida and undertook a multi-pronged approach to address the cost of residential property insurance in Florida. First, the law increased the capacity of reinsurance that stabilized the reinsurance market to the benefit of the insurance companies writing properties lines in the state of Florida. Secondly,

the law provided for rate relief to all policyholders.

The law also authorized the state-owned insurance company, Citizens, which is free of many of the restraints on private carriers such as surplus, ratios, income taxes and reinsurance expense, to reduce its premium rates and begin competing against private insurers in the residential property insurance market and expands the authority of Citizens to write commercial insurance.

Finally, during 2007 and 2008, approximately two dozen new homeowner insurance companies have received authority by the Florida OIR to commence business as admitted carriers in the state of Florida.

We face increased competition from existing carriers and new entrants in our niche markets. In an effort to foster competition, the State of Florida has loaned money to multiple carriers with certain debt covenants including the maintenance of minimum written premium. Our competition has attempted to gain market share through aggressive pricing and generous policy acquisition costs which has had an adverse affect on our ability to maintain market share. Although our pricing is inevitably influenced to some degree by that of our competitors, we believe that it is generally not in our best interest to compete solely on price. We compete on the basis of underwriting criteria, our distribution network and superior service to our agents and insureds.

Comparable companies which compete with us in the commercial general liability insurance market include Century Surety Insurance Company, Atlantic Casualty Insurance Company, Colony Insurance Company and Burlington/First Financial Insurance Companies. We also face new competition in Florida from such companies as Seminole Property and Casualty Insurance Company, Cypress Property and Casualty Company and U.S. Security Insurance Company.

With respect to automobile insurance in Florida, we intentionally market only to our existing policyholders by offering to renew the existing policy. Presently, we have chosen not to compete with more than 100 companies, which underwrite personal automobile insurance in Florida. Comparable companies in the personal automobile insurance market include U.S. Security Insurance Company, United Automobile Insurance Company, Direct General Insurance Company and Security National Insurance Company, as well as major insurers such as Progressive Casualty Insurance Company.

Competition could have a material adverse effect on our business, results of operations and financial condition. If we do not meet the prices offered by our competitors, we may lose business in the short term, which could also result in reduced revenues.

Our senior management team is critical to the strategic direction of our company. If there were an unplanned loss of service by any of our officers our business could be harmed.

We depend, and will continue to depend, on the services of our executive management team which includes Michael Braun, our Chief Executive Officer and President of Federated National, Peter Prygelski, our Chief Financial Officer and Stephen Young, our President. Our success also will depend in part upon our ability to attract and retain qualified executive officers, experienced underwriting talent and other skilled employees who are knowledgeable about our business. If we were to lose the services of members of our executive management team, our business could be adversely affected. We believe we have been successful in attracting and retaining key personnel throughout our history. We have employment agreements with select members of our executive management team.

Nevertheless, because of the executive management role and involvement in developing and implementing our current business strategy, any unplanned loss of service could substantially harm our business.

Risks Related to an Investment in Our Shares

Our largest shareholders currently control approximately 8.6% of the voting power of our outstanding common stock, which could discourage potential acquirers and prevent changes in management.

Edward J. Lawson and Michele V. Lawson beneficially own approximately 8.6% of our outstanding common stock. This information is based on the beneficial owner's filing with the Securities and Exchange Commission under Section 13 and/or Section 16 of the Securities Exchange Act of 1934. As our largest shareholders, the Lawson's have significant influence over the outcome of any shareholder vote. This voting power may discourage takeover attempts, changes in our officers and directors or other changes in our corporate governance that other shareholders may desire.

We have authorized but unissued preferred stock, which could affect rights of holders of common stock.

Our articles of incorporation authorize the issuance of preferred stock with designations, rights and preferences determined from time to time by our board of directors. Accordingly, our board of directors is empowered, without shareholder approval, to issue preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the voting power or other rights of the holders of common stock. In addition, the preferred stock could be issued as a method of discouraging a takeover attempt. Although we do not intend to issue any preferred stock at this time, we may do so in the future.

Our articles of incorporation, bylaws and Florida law may discourage takeover attempts and may result in entrenchment of management.

Our articles of incorporation and bylaws contain provisions that may discourage takeover attempts and may result in entrenchment of management.

- Our board of directors is elected in classes, with only two or three of the directors elected each year. As a result, shareholders would not be able to change the membership of the board in its entirety in any one year. Shareholders would also be unable to bring about, through the election of a new board of directors, changes in our officers.

- Our articles of incorporation prohibit shareholders from acting by written consent, meaning that shareholders will be required to conduct a meeting in order to vote on any proposals or take any action.

- Our bylaws require at least 60 days' notice if a shareholder desires to submit a proposal for a shareholder vote or to nominate a person for election to our board of directors.

In addition, Florida has enacted legislation that may deter or frustrate takeovers of Florida corporations, such as our company.

- The Florida Control Share Act provides that shares acquired in a "control share acquisition" will not have voting rights unless the voting rights are approved by a majority of the corporation's disinterested shareholders. A "control share acquisition" is an acquisition, in whatever form, of voting power in any of the following ranges: (a) at least 20% but less than 33-1/3% of all voting power, (b) at least 33-1/3% but less than a majority of all voting power; or (c) a majority or more of all voting power.

- The Florida Affiliated Transactions Act requires supermajority approval by disinterested shareholders of certain specified transactions between a public company and holders of more than 10% of the outstanding voting shares of the corporation (or their affiliates).

As a holding company, we depend on the earnings of our subsidiaries and their ability to pay management fees and dividends to the holding company as the primary source of our income.

We are an insurance holding company whose primary assets are the stock of our subsidiaries. Our operations, and our ability to service future potential debt, are limited by the earnings of our subsidiaries and their payment of their earnings to us in the form of management fees, commissions, dividends, loans, advances or the reimbursement of expenses. These payments can be made only when our subsidiaries have adequate earnings. In addition, dividend payments made to us by our insurance subsidiaries are restricted by Florida law governing the insurance industry. Generally, Florida law limits the dividends payable by insurance companies under complicated formulas based on the subsidiary's available capital and earnings.

We may not continue making dividend payments on our common stock.

During 2008 and 2007, we paid quarterly dividends of $0.18 per share. In the first quarter of 2009, we lowered our dividend to $0.06 per share. We can not assure you that we will continue to make quarterly dividend payments. Payment of dividends in the future will depend on our earnings, financial position and such other factors, as our Board of Directors deems relevant. Moreover, our ability to continue to pay dividends may be restricted by regulatory limits on the amount of dividends that Federated National and American Vehicle are permitted to pay the parent company.

ITEM 1B UNRESOLVED STAFF COMMENTS

None

ITEM 2 PROPERTIES

Our executive offices are located at 3661 West Oakland Park Boulevard, Lauderdale Lakes, Florida in a 39,250 square feet office facility. All of our operations are consolidated within this facility.

Effective March 1, 2005, Federated National sold its interest in the Lauderdale Lakes property to 21st Century at the property's net book value of approximately $2.9 million. Effective on or about March 1, 2006, 21st Century sold the property to an unrelated party for approximately $5.0 million cash and a $0.9 million six year 5% note. As part of the transaction, 21st Century has agreed to lease the same facilities for a six year term. Our lease for this office space expires in December 2011.

We believe that the facilities are well maintained, in substantial compliance with environmental laws and regulations, and adequately covered by insurance. We also believe that these leased facilities are not unique and could be replaced, if necessary, at the end of the lease term.

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ITEM 3 LEGAL PROCEEDINGS

We are involved in various claims and legal actions arising in the ordinary course of business. These proceedings are set forth below as either resolved or ongoing.

Resolved legal proceeding:

Specifically related to our ordinary course of business, we were a party to four lawsuits in connection with coverage disputes associated with claims resulting from Hurricanes Ivan and Jeanne. Hurricane Ivan occurred on September 14, 2004. Hurricane Jeanne occurred on September 25, 2004. During the three months ended September 30, 2006, the resolution of other lawsuits involving similarly styled coverage issues involving other property insurers came to fruition. Accordingly, based on the resolution of these lawsuits involving similarly styled coverage issues we charged operations with approximately $3.9 million of additional loss and LAE during the quarter ended September 30, 2006. Additional development for approximately $1.0 million occurred relative to these claims during the three months ended March 31, 2007. Predominately, only the underlying legal fees associated with these particular proceedings remain uncertain and continue to be negotiated.

In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

Ongoing legal proceedings:

From July 27, 2007 to August 7, 2007, several securities class action lawsuits were filed against the Company and certain of its executive officers in the United States District Court for the Southern District of Florida (“District Court”) on behalf of all persons and entities (the “plaintiff’s”) who purchased the Company's securities during the various class periods specified in the complaints. A consolidated amended complaint was filed on behalf of the class on January 22, 2008. The complaint alleges that the defendants made false and misleading statements and failed to accurately project the Company's business and financial performance during the putative class period. The plaintiffs seek an unspecified amount of damages and claim violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5.

On November 7, 2008, the District Court granted in part and denied in part the Company's motion to dismiss the consolidated class complaint with leave to amend by December 8, 2009 or the allegations dismissed would be deemed dismissed with prejudice without further order of the Court. Lead plaintiffs did not seek to amend the consolidated complaint and the defendants have answered. The action will proceed on allegations with respect to the company's setting of loss reserves for the year ending 2006 and first quarter of 2007.

The District Court granted both defendants' motion to dismiss the plaintiff’s derivative complaint and the Company’s subsequent motion to stay the amended derivative complaint.

While the Company believes that the allegations in the complaint are without merit, an unfavorable resolution of pending litigation could have a material adverse effect on our financial condition. Litigation may result in substantial costs and expenses and significantly divert the attention of the Company's management regardless of the outcome. There can be no assurance that the Company will be able to achieve a favorable settlement of pending litigation or obtain a favorable resolution of this litigation if it is not settled. In addition, current litigation could lead to increased costs or interruptions of normal business operations of the Company.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

PART II

ITEM 5 MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock has been listed for trading on the NASDAQ Global Market under the symbol "TCHC" since November 5, 1998. The following table sets out the high and low closing sale prices as reported on the NASDAQ Global Market. These reported prices reflect inter-dealer prices without adjustments for retail markups, markdowns or commissions.

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Quarter Ended	High	Low
March 31, 2008	$ 14.05	$ 10.98
June 30, 2008	$ 12.98	$ 8.17
September 30, 2008	$ 8.88	$ 5.19
December 31, 2008	$ 5.42	$ 3.62
March 31, 2007	$ 23.03	$ 17.60
June 30, 2007	$ 19.99	$ 9.85
September 30, 2007	$ 14.60	$ 10.03
December 31, 2007	$ 17.31	$ 12.38

As of March 16, 2009, there were 48 holders of record of our common stock. We believe that the number of beneficial owners of our common stock is in excess of 4,800.

DIVIDENDS

During 2008 and 2007 we have paid quarterly dividends of $0.18 per share. Payment of dividends in the future will depend on our earnings and financial position and such other factors, as our Board of Directors deems relevant. Moreover, our ability to continue to pay dividends may be restricted by regulatory limits on the amount of dividends that Federated National and American Vehicle are permitted to pay to the parent company.

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The following table summarizes our equity compensation plans as of December 31, 2008. All equity compensation plans were approved by stock holders.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by stock holders*	788,250	$ 14.08	146,997

* Includes options from the 1998 Stock Option Plan and the 2002 Stock Option Plan.

For additional information concerning our capitalization please see Footnote 16 to our Consolidated Financial Statements included under Item 8 of this Report on Form 10-K.

ISSUER REPURCHASES

On May 14, 2007, the Company's Board of Directors authorized, pursuant to Section 12 of the Securities Exchange Act, the repurchase of up to $5.0 million of its common stock. Acting upon the Board's authorization, the Company repurchased, for approximately $0.1 million, 12,308 shares for an average price of $11.65 on February 13, 2008; $1.8 million, 135,277 shares for an average price of $13.44 between November 12, 2007 and November 28, 2007; for approximately $0.5 million, 47,433 shares for an average price of $10.16 between July 12, 2007 and July 18, 2007; and for approximately $1.5 million, 138,261 shares for an average price of $11.01 between May 16, 2007 and May 21, 2007. The Company may purchase up to an additional $1.1 million of its common stock.

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SALES OF UNREGISTERED SECURITIES

During the fourth quarter of 2008, there were no options exercised under our various stock option plans.

STOCK PERFORMANCE GRAPH

The following graph shows the cumulative total shareholder return on our common stock over the last five fiscal years as compared with the total returns of the NASDAQ Composite Index and the SNL Property & Casualty Insurance Index. In accordance with SEC rules, this graph includes indices that we believe are comparable and appropriate.

	Period Ending					
Index	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08
21st Century Holding Company	100.00	99.65	119.70	170.60	100.79	37.92
NASDAQ Composite	100.00	108.59	110.08	120.56	132.39	78.72
SNL Insurance P&C	100.00	109.61	119.82	139.67	150.81	116.73

Source : SNL Financial LC, Charlottesville, VA (434) 977-1600
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Returns are based on the change in year-end to year-end price. The graph assumes $100 was invested on December 31, 2003 in our common stock, the NASDAQ Composite Index and the SNL Property & Casualty Insurance Index and that all dividends were reinvested. Past performance is not necessarily an indicator of future results.

Our filings with the SEC may incorporate information by reference, including this Form 10-K. Unless we specifically state otherwise, the information under this heading "Stock Performance Graph" shall not be deemed to be "soliciting materials" and shall not be deemed to be "filed" with the SEC or incorporated by reference into any of our filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934.

21st Century Holding Company

ITEM 6 SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this Annual Report on Form 10-K.

	As of the years ended December 31, (Amounts in 000's except Book value per share)				
	2008	2007	2006	2005	2004
Balance sheet data					
Total assets	$ 197,109	$ 219,361	$ 207,897	$ 290,155	$ 163,601
Investments	26,065	136,224	124,834	100,086	84,382
Cash and short term investments	124,577	22,524	17,917	6,071	6,128
Finance contracts, consumer loans and pay advances receivable, net	201	420	1,831	7,313	8,289
Total liabilities	120,878	138,104	141,704	249,387	138,625
Unpaid losses and LAE	64,782	59,685	39,615	154,039	46,571
Unearned premiums	40,508	56,394	77,829	61,839	50,153
Total shareholders' equity	76,231	81,257	66,193	40,767	24,977
Book value per share	$ 9.51	$ 10.32	$ 8.38	$ 6.02	$ 4.13

21st Century Holding Company

	Years Ended December 31, (Amounts in 000's except EPS and Dividends)				
	2008	2007	2006	2005	2004
Operations Data:					
Revenue:					
Gross premiums written	$ 88,248	$ 133,591	$ 152,665	$ 119,440	$ 100,662
Gross premiums ceded	(34,553)	(44,551)	(67,520)	(31,414)	(15,486)
Net premiums written	53,695	89,041	85,145	88,026	85,176
(Decrease) Increase in prepaid reinsurance premiums	(4,451)	(11,251)	20,193	6,623	(2,905)
Decrease (Increase) in unearned premiums	15,886	21,435	(15,990)	(11,686)	(16,030)
Net change in prepaid reinsurance premiums and unearned premiums	11,435	10,184	4,203	(5,063)	(18,935)
Net premiums earned	65,130	99,224	89,348	82,963	66,241
Commission income	1,612	7,214	1,679	409	-
Finance revenue	350	545	1,686	3,567	3,668
Managing general agent fees	1,745	2,035	2,625	2,420	2,040
Net investment income	6,354	7,964	5,933	3,841	3,172
Net realized investment (losses) gains	(10,593)	(145)	1,063	458	689
Regulatory assessments recovered	2,104	1,655	132	-	-
Other income	654	641	1,449	1,010	762
Total revenue	67,357	119,132	103,915	94,669	76,571
Expenses:					
Losses and LAE	41,868	47,619	44,400	48,336	74,993
Operating and underwriting expenses	7,102	12,684	13,160	8,219	8,140
Salaries and wages	7,428	6,732	7,011	6,384	6,134
Interest expense	-	173	656	1,398	1,087
Policy acquisition costs, net of amortization	14,760	19,420	17,395	14,561	8,423
Total expenses	71,159	86,627	82,622	78,899	98,777
(Loss) income from continuing operations before provision for income tax (benefit) expense	(3,802)	32,505	21,293	15,771	(22,206)
Provision for income tax (benefit) expense	(1,324)	11,226	7,396	4,690	(8,601)
Net (loss) income from continuing operations	(2,478)	21,280	13,896	11,081	(13,605)
Discontinued operations:					
	-	-	-	1,630	4,484

Income from discontinued operations (including 2005 and 2004 gain on disposal of $1,630 and $5,384, respectively)										
Provision for income tax expense		-		-		-		595		1,737
Income from discontinued operations		-		-		-		1,035		2,747
Net (loss) income	$	(2,478)	$	21,280	$	13,896	$	12,116	$	(10,858)
Earnings per share data										
Basic net (loss) income per share from continuing operations	$	(0.31)	$	2.69	$	1.84	$	1.78	$	(2.33)
Basic net income per share from discontinued operations	$	-	$	-	$	-	$	0.17	$	0.47
Basic net (loss) income per share	$	(0.31)	$	2.69	$	1.84	$	1.95	$	(1.86)
Fully diluted net (loss) income per share from continuing operations	$	(0.31)	$	2.65	$	1.72	$	1.67	$	(2.33)
Fully diluted net income per share from discontinued operations	$	-	$	-	$	-	$	0.16	$	0.47
Fully diluted net (loss) income per share	$	(0.31)	$	2.65	$	1.72	$	1.83	$	(1.86)
Dividends paid per share	$	0.72	$	0.72	$	0.48	$	0.32	$	0.32

ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

21st Century is an insurance holding company, which, through our subsidiaries and our contractual relationships with our independent agents and general agents, controls substantially all aspects of the insurance underwriting, distribution and claims processes. We are authorized to underwrite fire, allied lines, homeowners' property and casualty insurance, commercial general liability insurance, commercial multi peril, inland marine, personal automobile insurance and commercial automobile insurance in various states with various lines of authority through our wholly owned subsidiaries, Federated National and American Vehicle. We market and distribute our own and third-party insurers' products and our other services primarily in Florida, through contractual relationships with a network of approximately 1,500 independent agents and a select number of general agents.

The insurable events during 2008, 2007 and 2006 did not include any weather related catastrophic events such as the well publicized series of hurricanes that occurred in Florida during 2005 and 2004. During 2008, 2007 and 2006 we processed property and liability claims stemming from our homeowners', commercial general liability and private passenger automobile lines of business. Our automobile claims generally will exceed commercial general liability and homeowners' claims with respect to frequency of claimant activity; however the per-claim severity in connection with our commercial general liability and homeowner lines would be expected to exceed the automobile line. Our reinsurance strategy serves to smooth the liquidity requirements imposed by the most severe insurable events and for all other insurable events we manage, at a micro and macro perspective, in the normal course of business.

We are not certain how hurricanes and other insurable events will affect our future results of operations and liquidity. Loss and LAE are affected by a number of factors including:

- the quality of the insurable risks underwritten;
- the nature and severity of the loss;
- weather-related patterns;
- the availability, cost and terms of reinsurance;
- underlying settlement costs, including medical and legal costs;
- legal and political factors such as legislative initiatives and public opinion.

We continue to manage the foregoing to the extent within our control. Many of the foregoing are partially, or entirely, outside our control.

Assurance MGA, a wholly owned subsidiary, acts as Federated National's and American Vehicle's exclusive managing general agent in the state of Florida. As American Vehicle continues its expansion into other states we shall contract with general agents to market our commercial general liability insurance product beyond the state of Florida. Assurance MGA currently provides underwriting policy administration, marketing, accounting and financial services to Federated National and American Vehicle, and participates in the negotiation of reinsurance contracts.

Assurance MGA generates revenue through a 6% commission fee from the insurance companies' gross written premium, policy fee income of $25 per policy and other administrative fees from the marketing of company products through the Company's distribution network. The 6% commission fee from Federated National and American Vehicle was made effective January 1, 2005. Assurance MGA plans to establish relationships with additional carriers and servicing additional insurance products in the future.

Our business, results of operations and financial condition are subject to fluctuations due to a variety of factors. Abnormally high severity or frequency of claims in any period could have a material adverse effect on our business, results of operations and financial condition. Also, if our estimated liabilities for unpaid losses and LAE are less than actual losses and LAE, we will be required to increase reserves with a corresponding reduction in our net income in the period in which the deficiency is identified.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with management's evaluation of the determination of liability for unpaid losses and LAE and the amount and recoverability of amortization of Deferred Policy Acquisition Costs ("DPAC"). In addition, significant estimates form the basis for our reserves with respect to finance contracts, premiums receivable and deferred income taxes. Various assumptions and other factors underlie the determination of these significant estimates, which are described in greater detail at Footnote 2 in this Form 10-K.

Except as described below, we believe that in 2008 there were no significant changes in those critical accounting policies and estimates. Senior management has reviewed the development and selection of our critical accounting policies and estimates and their disclosure in this Form 10-K with the Audit Committee of our Board of Directors.

The process of determining significant estimates is fact specific and takes into account factors such as historical experience, current and expected economic conditions, and in the case of unpaid losses and LAE, an actuarial valuation. Management regularly reevaluates these significant factors and makes adjustments where facts and circumstances dictate. In selecting the best estimate, we utilize various actuarial methodologies. Each of these methodologies is designed to forecast the number of claims we will be called upon to pay and the amounts we will pay on average to settle those claims. In arriving at our best estimate, our actuaries consider the likely predictive value of the various loss development methodologies employed in light of underwriting practices, premium rate changes and claim settlement practices that may have occurred, and weight the credibility of each methodology. Our actuarial methodologies take into account various factors, including, but not limited to, paid losses, liability estimates for reported losses, paid allocated LAE, salvage and other recoveries received, reported claim counts, open claim counts and counts for claims closed with and without payment of loss.

Accounting for loss contingencies pursuant to Statements of Financial Accounting Standards ("SFAS") Number 5, Accounting for Contingencies ("SFAS No. 5") involves the existence of a condition, situation or set of circumstances involving uncertainty as to possible loss that will ultimately be resolved when one or more future event(s) occur or fail to occur. Additionally, accounting for a loss contingency requires management to assess each event as probable, reasonably possible or remote. Probable is defined as the future event or events are likely to occur. Reasonably possible is defined as the chance of the future event or events occurring is more than remote but less than probable, while remote is defined as the chance of the future event or events occurring is slight. An estimated loss in connection with a loss contingency shall be recorded by a charge to current operations if both of the following conditions are met: First, the amount can be reasonably estimated, and second, the information available prior to issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability.

SFAS Number 115, Accounting for Certain Investments in Debt and Equity Securities ("SFAS No. 115") addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. SFAS No. 115 requires that these securities be classified into one of three categories, Held-to-maturity, Trading securities or Available-for-sale.

Investments classified as held-to-maturity include debt securities wherein the Company's intent and ability are to hold the investment until maturity. The accounting treatment for held-to-maturity investments is to carry them at amortized cost without consideration to unrealized gains or losses. Investments classified as trading securities include debt and equity securities bought and held primarily for the sale in the near term. The accounting treatment for trading securities is to carry them at fair value with unrealized holding gains and losses included in current period operations. Investments classified as available-for-sale include debt and equity securities that are not classified as held-to-maturity or as trading security investments. The accounting treatment for available-for-sale securities is to carry them at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income".

The following is an overview of management's loss reserving process

The Company's loss reserves can generally be categorized into two distinct groups. One group is short-tail classes of business consisting principally of property risks in connection with homes and automobiles. The other group is long-tail casualty classes of business which include primarily commercial general liability and to a much lesser extent, homeowner and automobile liability. For operations writing short-tail coverages our loss reserves were generally geared toward determining an expected loss ratio for current business rather than maintaining a reserve for the outstanding exposure. Estimations of ultimate net loss reserves for long-tail casualty classes of business is a more complex process and depends on a number of factors including class and volume of business involved. Experience in the more recent accident years of long-tail casualty classes of business shows limited statistical credibility in reported net losses because a relatively low proportion of net losses would be reported claims and expenses and even smaller percentage would be net losses paid. Therefore, IBNR would constitute a relatively high proportion of net losses.

Additionally, the different methodologies are utilized the same, regardless of the line of business. However, the final selection of ultimate loss and LAE is certain to vary by both line of business and by accident period maturity. There is no prescribed combination of line of business, accident year maturity, and methodologies; consistency in results of the different methodologies and reasonableness of the result are the primary factors that drive the final selection of ultimate loss and LAE.

Methods used to estimate Loss & LAE reserves

The methods we use for our short-tail business do not differ from the methods we use for our long-tail business. The Incurred and Paid Development Methods intrinsically recognize the unique development characteristics contained within the historical experience of each material short-tail and long-tail line of business. The Incurred and Paid Cape Cod Methods reflect similar historical development unique to each material short-tail and long-tail line of business.

We apply the following general methods in projecting loss and LAE reserves:

- Paid and Incurred Loss Development Method
- Paid and Incurred Cape Cod Method

Description of ultimate loss estimation methods

The estimated Ultimate Loss and Defense & Cost Containment Expense ("DCCE") is based on an analysis by line of business, coverage and by accident quarter performed using data as of December 31, 2008. The analysis relies primarily on four actuarial methods: Incurred Loss & DCCE Development Method, Paid Loss & DCCE Development Method, Bornhuetter-Ferguson Incurred Method, and Bornhuetter-Ferguson Paid Method. Each method relies on company experience, and, where relevant, the analysis includes comparisons to industry experience. The following is a description of each of these methods:

Incurred Loss & DCCE Development Method – This reserving method is based on the assumption that the historical incurred loss & DCCE development pattern as reflected by the Company is appropriate for estimating the future loss & DCCE development. Incurred paid plus case amounts separated by accident quarter of occurrence and at quarterly evaluations are used in this analysis. Case reserves do not have to be adequately stated for this method to be effective; they only need to have a fairly consistent level of adequacy at all stages of maturity. Historical "age-to-age" loss development factors were calculated to measure the relative development of an accident quarter from one maturity point to the next. Loss & DCCE development factors ("LDF") are selected based on a review of the historical relationships between incurred loss & DCCE at successive valuations and based on industry patterns. The LDFs are

multiplied together to derive cumulative LDF's that, when multiplied by actual incurred loss & DCCE, produce estimates of ultimate loss & DCCE.

Paid Loss & DCCE Development Method – This method is similar to the Incurred Loss & DCCE Development Method only paid loss & DCCE and paid patterns are substituted for the incurred loss & DCCE and incurred patterns.

Bornhuetter-Ferguson Incurred Method – This reserving method combines estimated initial expected unreported loss & DCCE with the actual loss & DCCE to yield the ultimate loss & DCCE estimate. Expected unreported loss & DCCE are equal to expected total loss & DCCE times the expected unreported percentage of loss & DCCE for each policy year. The incurred loss & DCCE emergence pattern used to determine the unreported percentages in our projections is based on the selected LDF's from the Incurred Loss & DCCE Development Method described above. The estimate of initial expected total loss & DCCE is based on the historical loss ratio for more mature accident years. While this approach reduces the independence of the Bornhuetter-Ferguson Method from the loss & DCCE development methods for older policy years, it is used primarily for estimating ultimate loss & DCCE for more recent, less mature, policy years.

Bornhuetter-Ferguson Paid Method – This method is similar to the Bornhuetter-Ferguson Incurred Method only paid loss & DCCE and paid patterns are substituted for the incurred loss & DCCE and incurred patterns.

We select an estimate of ultimate loss & DCCE for each accident quarter after considering the results of each projection method for the quarter and the relative maturity of the quarter (the time elapsed between the start of the quarter and December 31, 2008). Reserves for unpaid loss & DCCE for each quarter are the differences between these ultimate estimates and the amount already paid. The reserves for each quarter and each coverage are summed, and the result is the overall estimate of unpaid loss & DCCE liability for the company.

We also produce an estimate of unpaid Adjusting and Other Expense ("A&O"), as a reserve is required under statutory accounting principles even if this expense has been pre-paid or with an unconsolidated affiliate. Although we do not prepay for A&O, the majority of the A&O incurred is with an affiliated company and eliminated under the accounting principles for consolidation. The unpaid A&O is added to unpaid loss & DCCE, resulting in total unpaid loss and LAE.

The validity of the results from using a loss development approach can be affected by many conditions, such as internal claim department processing changes, a shift between single and multiple claim payments, legal changes, or variations in a company's mix of business from year to year. Also, since the percentage of losses paid for immature years is often low, development factors can be volatile. A small variation in the number of claims paid can have a leveraging effect that could lead to significant changes in estimated ultimate values. Accordingly, our reserves are estimates because there are uncertainties inherent in the determination of ultimate losses. Court decisions, regulatory changes and economic conditions can affect the ultimate cost of claims that occurred in the past as well as create uncertainties regarding future loss cost trends. We compute our estimated ultimate liability using the most appropriate principles and procedures applicable to the lines of business written. However, because the establishment of loss reserves is an inherently uncertain process, we cannot be certain that ultimate losses will not exceed the established loss reserves and have a material adverse effect on our results of operations and financial condition.

A key assumption underlying the estimation of the reserve for loss and LAE is that past experience serves as the most reliable estimator of future events. This assumption may materially affect the estimates when the insurance market, the regulatory environment, the legal environment, the economic environment, the book of business, the claims handling department, or other factors (known or unknown) have varied over time during the experience period and / or will vary (expectedly or unexpectedly) in the future. Changes in estimates, or differences between estimates and amounts ultimately paid, are reflected in the operating results of the period during which such adjustments are made. Therefore, the ultimate liability for unpaid loss and LAE will likely differ from the amount recorded at December 31, 2008.

The following describes the extent of our procedures for determining the reserve for loss and LAE on both an annual and interim reporting basis:

Annually - Our policy is to select a single point estimate that best reflects our in-house actuarial determination for unpaid loss and LAE. Our independent actuaries, examining the exact same data set, will independently select a point estimate which determines a high point and low point range. Both processes rely on objective and subjective determinations. If our point estimate falls within the range determined from the point estimate of our actuaries, then no adjustments by management would be required. In consideration thereof, management does not have a policy for adjusting the liability for unpaid loss and LAE to an amount that is different than an amount set forth within the range determined by the independent actuaries.

Interim – During 2008 our interim approach was very similar to the annual process noted above. During 2007 for Federated National's homeowners' program, our selection of loss reserves was weighted more to the Paid Loss Development Method and the Incurred Loss Development Method. American Vehicle's commercial general liability program relied upon the Cape Cod Method on a paid and incurred basis as well as the Paid Loss Development Method and the Incurred Loss Development Method. During the year-end process for 2007, we were able to employ long-tail methodologies to our commercial general liability program's loss reserve process based on no specific event other than newly available in-house resources.

A number of other actuarial assumptions are generally made in the review of reserves for each class of business. For the long-tail classes of business, other actuarial assumptions generally are made with respect to the following:

- Loss trend factors which are used to establish expected loss ratios for subsequent accident years based on the projected loss ratio for prior accident years.

- Expected loss ratios for the latest accident year and, in some cases for accident years prior to the latest accident year. The expected loss ratio generally reflects the projected loss ratio from prior accident years, adjusted for the loss trend and the effect of rate changes and other quantifiable factors on the loss ratio.

In practice there are factors that change over time; however, many (such as inflation) are intrinsically reflected in the historical development patterns, and others typically do not materially affect the estimate of the reserve for unpaid loss and LAE. Therefore, no specific adjustments have been incorporated for such contingencies projecting future development of losses and LAE. There are no key assumptions as of December 31, 2008 premised on future emergence inconsistent with historical loss reserve development patterns.

The table below distinguishes total loss reserves between IBNR, as discussed above, and case estimates for specific claims as established by routine claims management.

Reserves for unpaid loss and LAE net of reinsurance recoverable as of December 31, 2008	Case Loss Reserves	Case LAE Reserves	Total Case Reserves	IBNR Reserves (Including LAE)	Reinsurance Recoverable on Unpaid Loss and Loss Expenses	Net Reserves
			(Dollars in Thousands)			
Homeowners'	$ 7,132	$ 899	$ 8,031	$ 19,677	$ 12,613	$ 15,095
Commercial General Liability	6,166	1,364	7,530	27,323	-	34,853
Automobile	412	255	667	1,555	100	2,122
Total	$ 13,710	$ 2,518	$ 16,228	$ 48,555	$ 12,713	$ 52,070

Reserves for unpaid loss and LAE net of reinsurance recoverable as of December 31, 2007	Case Loss Reserves	Case LAE Reserves	Total Case Reserves	IBNR Reserves (Including LAE)	Reinsurance Recoverable on Unpaid Loss and Loss Expenses	Net Reserves
			(Dollars in Thousands)			
Homeowners'	$ 6,995	$ 781	$ 7,776	$ 22,909	$ 19,971	$ 10,713
Commercial General Liability	4,780	635	5,415	17,890	-	23,305
Automobile	373	157	530	5,165	162	5,533
Total	$ 12,148	$ 1,573	$ 13,721	$ 45,964	$ 20,133	$ 39,551

Our reported results, financial position and liquidity would be affected by likely changes in key assumptions that determine our net loss reserves. The table below illustrates the change to equity that would occur as a result of a change in loss and LAE reserves, net of reinsurance.

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Management's Discussion and Analysis of Financial Condition and Results of Operations

	Years Ended December 31, 2008		Years Ended December 31, 2007	
Change in loss and LAE reserves, net of reinsurance	Adjusted loss and LAE reserves, net of reinsurance	Percentage change in equity (1)	Adjusted loss and LAE reserves, net of reinsurance	Percentage change in equity (1)
-10.0%	46,863	-12.8%	35,596	-9.2%
-7.5%	48,164	-9.6%	36,585	-6.9%
-5.0%	49,466	-6.4%	37,574	-4.6%
-2.5%	50,768	-3.2%	38,563	-2.3%
Base	52,070	-	39,551	-
2.5%	53,371	3.2%	40,540	2.3%
5.0%	54,673	6.4%	41,529	4.6%
7.5%	55,975	9.6%	42,518	6.9%
10.0%	57,276	12.8%	43,507	9.2%

(1) Net of tax

For the year ended December 31, 2008 our actuarial firm determined range of loss and LAE reserves on a net basis range from a low of $47.8 million to a high of $58.5 million, with a best estimate of $53.1 million. The Company's net loss and LAE reserves are carried at $52.4 million. Management's point estimate of reserves is 1.5% below our actuary's best estimate in recognition of the inherent uncertainty in assessing the potential ultimate liabilities given legal developments as well as evolution in its operations.

For the year ended December 31, 2007 the actuarial firm engaged by the Company determined range of loss and LAE reserves on a net basis range from a low of $37.9 million to a high of $45.6 million, with a best estimate of $42.1 million. The Company's net loss and LAE reserves are carried at $40.0 million. Management's point estimate of reserves are 5.2% below our actuary's best estimate in recognition of the inherent uncertainty in assessing the potential ultimate liabilities given legal developments as well as evolution in its operations.

We are required to review the contractual terms of all our reinsurance purchases to ensure compliance with SFAS No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts ("SFAS No. 113"). The statement establishes the conditions required for a contract with a reinsurer to be accounted for as reinsurance and prescribes accounting and reporting standards for those contracts. Contracts that do not result in the reasonable possibility that the reinsurer may realize a significant loss from the insurance risk assumed generally do not meet the conditions for reinsurance accounting and must be accounted for as deposits. SFAS No. 113 also requires us to disclose the nature, purpose and effect of reinsurance transactions, including the premium amounts associated with reinsurance assumed and ceded. It also requires disclosure of concentrations of credit risk associated with reinsurance receivables and prepaid reinsurance premiums.

Please see Footnote 2 of the Notes to Consolidated Financial Statements for additional discussions regarding critical accounting policies.

RECENT ACCOUNTING PRONOUNCEMENTS

In March 2008, the Financial Accounting Standards Board ("FASB") issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133 ("SFAS No. 161"). SFAS

No. 161 changes the disclosure requirement for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 Accounting for Derivatives Instruments and Hedging Activities ("SFAS No. 133") and its related interpretations, and, how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The Company does not utilize derivative instruments, as such; there is no impact to our consolidated financial statements for the year ended December 31, 2008.

In June 2006, FASB issued Interpretation No. 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes which clarifies the accounting for income tax reserves and contingencies recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes ("SFAS No. 109"). This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. We adopted FIN 48 as of January 1, 2007. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no benefit is recorded. The Company evaluated the impact that FIN 48 will have on its Consolidated Financial Statements. Additionally, we have developed a process to capture and quantify any such effect that FIN 48 could have on the Company and concluded there was no impact on our consolidated financial statements for the year ended December 31, 2008.

See Note 2(n), "Summary of Significant Accounting Policies – Recent Accounting Pronouncements" in the Notes to the Condensed Consolidated Financial Statements for a discussion of recent accounting pronouncements and their effect, if any, on the Company.

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ANALYSIS OF FINANCIAL CONDITION
As of December 31, 2008 Compared with December 31, 2007

Total Investments

SFAS No. 115 addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. SFAS No. 115 requires that these securities be classified into one of three categories: (i) held-to-maturity, (ii) trading securities or (iii) available-for-sale.

Investments classified as held-to-maturity include debt securities wherein the Company's intent and ability are to hold the investment until maturity. The accounting treatment for held-to-maturity investments is to carry them at amortized cost without consideration to unrealized gains or losses. Investments classified as trading securities include debt and equity securities bought and held primarily for the sale in the near term. The accounting treatment for trading securities is to carry them at fair value with unrealized holding gains and losses included in current period operations. Investments classified as available-for-sale include debt and equity securities that are not classified as held-to-maturity or as trading security investments. The accounting treatment for available-for-sale securities is to carry them at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income".

Total Investments decreased $110.2 million, or 80.9%, to $26.1 million as of December 31, 2008, compared with $136.2 million as of December 31, 2007. Our fixed income portfolio contained callable features exercised in 2008. The proceeds from these called securities are currently in cash and short-term investments, of which approximately $121.4 million are invested in the MTB Prime Money Market-Inst Fund Number 142. We are currently evaluating long and short- term investment options for best yields that match our liquidity needs.

Subsequent to December 31, 2008, the Company engaged external asset managers and the funds were invested in long and short term investments with yields that best match our liquidity needs.

The fixed maturities and the equity securities that are available for sale and carried at fair value represent 48% of total investments as of December 31, 2008, compared with 85% as of December 31, 2007.

Below is a summary of net unrealized gains and (losses) at December 31, 2008 and December 31, 2007 by category.

	Unrealized Gains and (Losses)	
	December 31, 2008	December 31, 2007
Fixed maturities:		
U.S. government obligations	$ -	$ (68,975)
Obligations of states and political subdivisions	(147,907)	(1,706)
	(147,907)	(70,681)
Corporate securities:		
Communications	(278,692)	(3,481)
Financial	(660,612)	(16,984)
Other	2,883	(25,852)
	(936,421)	(46,317)
Equity securities:		
Common stocks	(818,645)	(3,989,319)

Total fixed, corporate and equity securities	$	(1,902,973)	$	(4,106,317)

Pursuant to FASB SFAS No. 115, the Company records the unrealized losses, net of estimated income taxes that are associated with that part of our portfolio classified as available for sale through the shareholders' equity account titled "Other Comprehensive Income". Management periodically reviews the individual investments that comprise our portfolio in order to determine whether a decline in fair value below our cost either is other than temporary or permanently impaired. Factors used in such consideration include, but are not limited to, the extent and length of time over which the market value has been less than cost, the financial condition and near-term prospects of the issuer and our ability and intent to keep the investment for a period sufficient to allow for an anticipated recovery in market value.

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In reaching a conclusion that a security is either other than temporary or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as Standard and Poor's and Moody's, as well as information released via the general media channels. In 2008, in connection with this process, we have charged to operations a net realized investment loss totaling approximately $9.9 million with an estimated provisional tax effect of approximately $3.7 million. The charge relates to short-term investments in connection with the common stocks of financial and pharmaceutical industries.

The investments held at December 31, 2008 and December 31, 2007 were comprised mainly of United States government and agency bonds, as well as municipal bonds which are viewed by the Company as conservative and less risky holdings, though sensitive to interest rate changes. There is a smaller concentration of corporate bonds, predominantly held in the financial and conglomerate industries. At December 31, 2008, approximately 89% of the equity holdings are in mutual funds and 11% are in equities related to the financial industry and insurance industry.

The following table summarizes, by type, our investments as of December 31, 2008 and 2007.

	December 31, 2008		December 31, 2007	
	Carrying Amount	Percent of Total	Carrying Amount	Percent of Total
	(Dollars in Thousands)			
Fixed maturities, at market:				
U.S. government agencies and authorities	$ 4,544	17.43%	$ 61,308	45.01%
Obligations of states and political subdivisions	5,331	20.45%	17,777	13.05%
Corporate securities	13,050	50.07%	40,609	29.81%
Total fixed maturities	22,925	87.95%	119,694	87.87%
Equity securities, at market	3,140	12.05%	16,530	12.13%
Total investments	$ 26,065	100.00%	$ 136,224	100.00%

All of our securities, except as noted above, are in good standing and are not impaired as defined by FASB SFAS No. 115.

In 2008, we reclassified $14.2 million of our bond portfolio as held-to-maturity because we decided that we had the ability to hold them until maturity. During the three months ended December 31, 2008, we reclassified $3.4 million to available-for-sale because a collateralized requirement was reduced.

As of December 31, 2008 we have classified $13.5 million of our bond portfolio as held-to-maturity. The decision to classify this layer of our bond portfolio as held-to-maturity was predicated on our intention and ability to hold these securities until maturity. Additionally, we have and may continue to use this position to secure irrevocable letters of credit to facilitate business opportunities in connection with our commercial general liability program. During April 2006, American Vehicle finalized a $15.0 million irrevocable letter of credit in conjunction with the 100% Quota Share Reinsurance Agreement with Republic which was terminated in April 2007. As of December 31, 2007 the letter of credit in favor of Republic totaled $10.0 million. . As of December 31, 2008 the letter of credit in favor of Republic totaled $3.0 million.

Cash and Short Term Investments

Cash and short term investments, which include cash, certificates of deposits, and money market accounts, increased $102.1 million, or 453.1%, to $124.6 million as of December 31, 2008, compared with $22.5 million as of December 31, 2007. Our excess cash and cash equivalents are invested in accordance with our long-term liquidity requirements.

Our daily closing cash balance of approximately $1.0 million is swept into an overnight Repurchase Agreement ("Repo") account backed by U.S. Government securities.

Our fixed income portfolio contained callable features exercised in 2008. The proceeds from these called securities are currently in cash and short-term investments, of which approximately $121.4 million are invested in the MTB Prime Money Market-Inst Fund Number 142. We are currently evaluating long and short- term investment securities for best yields that match our liquidity needs.

Receivable for Investments Sold

Receivable for investments sold decreased to nothing, as of December 31, 2008, compared with $6.4 million as of December 31, 2007.

Finance Contracts Receivable, Net of Allowance for Credit Losses

Finance contracts receivable, net of allowance for credit losses, decreased $0.2 million, or 52.3%, to $0.2 million as of December 31, 2008, compared with $0.4 million as of December 31, 2007. The decrease is primarily due to our sale in December 2004 of our assets related to our non-standard automobile insurance agency business in Florida and the associated financed contracts. We anticipate a continued decline in the financed contracts receivable, net over the future short term and its related conversion to cash and short term investments and investments.

Prepaid Reinsurance Premiums

Prepaid reinsurance premiums decreased $2.9 million, or 34.6%, to $5.5 million as of December 31, 2008, compared with $8.5 million as of December 31, 2007. The decrease is due to our payments and amortization of prepaid reinsurance premiums, which are reduced as compared with the prior year, associated with our homeowners' book of business.

Premiums Receivable, Net of Allowance for Credit Losses

Premiums receivable, net of allowance for credit losses, decreased $0.4 million, or 11.7%, to $3.4 million as of December 31, 2008, compared with $3.8 million as of December 31, 2007.

Our homeowners' insurance premiums receivable increased $0.5 million, or 43.2%, to $1.7 million as of December 30, 2008, compared with $1.2 million as of December 31, 2007. The increase can be attributed to the seasonality of the purchasing patterns of our policyholders.

Our commercial general liability insurance premiums receivable decreased $0.9 million, or 34.1%, to $1.7 million as of December 30, 2008, compared with $2.6 million as of December 31, 2007.

Premiums receivable in connection with our automobile line of business decreased $0.2 million, or 68.8%, to $0.1 million as of December 31, 2008, compared with $0.4 million as of December 31, 2007.

The activity in the allowance for credit losses for premiums receivable was as follows:

	Years Ended December 31,	
	2008	2007
Allowance for credit losses at beginning of year	$ 288,373	$ 66,125
Additions charged to bad debt expense	(299,667)	854,005
Write-downs charged against the allowance	132,979	(631,757)
Allowance for credit losses at end of year	$ 121,685	$ 288,373

Reinsurance Recoverable, Net of Allowance for Credit Losses

Reinsurance recoverable, net of allowance for credit losses, decreased $6.1 million, or 26.4%, to $16.9 million as of December 31, 2008, compared with $22.9 million as of December 31, 2007. The decrease is due to payment patterns by our reinsurers. All amounts are current and deemed collectable, except for a particular reinsurer in connection with the 2005 – 2006 reinsurance treaties, for whom we have recorded a $0.2 million pretax valuation allowance.

Deferred Policy Acquisition Costs

Deferred policy acquisition costs decreased $2.4 million, or 26.8%, to $6.6 million as of December 31, 2008, compared with $9.0 million as of December 31, 2007. The recent decreased production volume for both the homeowners' and commercial general liability product lines is the reason for the decrease in this asset.

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An analysis of deferred acquisition costs follows:

	Years Ended December 31,	
	2008	2007
Balance, beginning of year	$ 8,958,195	$ 11,153,168
Acquisition costs deferred	12,360,291	17,224,942
Amortization expense during year	(14,760,249)	(19,419,915)
Balance, end of year	$ 6,558,237	$ 8,958,195

Deferred Income Taxes, net

Deferred income taxes, net, increased $2.9 million, or 51.2%, to $8.5 million as of December 31, 2008, compared with $5.6 million as of December 31, 2007. Significant components of our net deferred tax asset are as follows:

	Years Ended December 31,	
	2008	2007
Deferred tax assets:		
Unpaid losses and LAE	$ 2,186,840	$ 1,675,398
Unearned premiums	1,770,709	2,670,007
Unrealized loss on investment securities	716,089	1,510,438
Allowance for credit losses	140,683	122,819
Allowance for impairments	1,410,105	-
Regulatory assessments	1,312,440	2,096,050
Discount on advance premiums	-	30,349
Depreciation	155,495	-
Capital Loss Carryover	2,656,626	-
Deferred gain on sale and leaseback	452,786	607,738
Stock option expense per FASB 123R	237,065	173,056
Total deferred tax assets	11,038,837	8,885,855
Deferred tax liabilities:		
Deferred acquisition costs, net	(2,467,865)	(3,331,949)
Discount on advance premiums	(40,902)	-
Depreciation	-	86,498
Prepaid expenses	-	(584)
Total deferred tax liabilities	(2,508,767)	(3,246,035)
Net deferred tax asset	$ 8,530,070	$ 5,639,820

Income Taxes Receivable

Income taxes receivable increased to $2.3 million, as of December 31, 2008, compared with nothing as of December 31, 2007. The increase is due to tax payment patterns in connection with our tax liabilities.

The Company's consolidated federal income tax returns for 2003 and 2002 have been examined by the IRS and there have been no material changes in the tax liability for those years. See income taxes payable, below.

Property, Plant and Equipment, net

Property, plant and equipment, net, decreased $0.2 million, or 18.3%, to $0.9 million as of December 31, 2008, compared with $1.0 million as of December 31, 2007. The decrease is primarily due to depreciation and amortization of our existing property, plant and equipment.

Other Assets

Other assets decreased $0.6 million, or 22.2%, to $2.3 million as of December 31, 2008, compared with $2.9 million as of December 31, 2007. Major components of other assets are as follows:

	December 31, 2008	December 31, 2007
Accrued interest income receivable	$ 242,906	$ 1,429,844
Notes receivable	703,109	807,275
Prepaid expenses	747,930	547,542
Insurance Receivables	282,000	-
Other	295,894	133,639
Total	$ 2,271,839	$ 2,918,300

Unpaid Losses and LAE

Unpaid losses and LAE increased $5.1 million, or 8.5%, to $64.8 million as of December 31, 2008, compared with $59.7 million as of December 31, 2007. The increase in unpaid losses and LAE relates primarily to our loss reserve strengthening relative to the commercial general liability and property lines of business. The composition of unpaid loss and LAE by product line is as follows:

	December 31, 2008			December 31, 2007		
	Case	Bulk	Total	Case	Bulk	Total
Homeowners'	$ 8,030,680	$ 19,687,271	$ 27,717,951	$ 7,775,769	$ 24,599,143	$ 32,374,912
Commercial General Liability	7,530,756	27,303,049	34,833,805	5,414,633	17,870,404	23,285,037
Automobile	666,921	1,563,809	2,230,730	530,308	3,494,533	4,024,841
Total	$ 16,228,357	$ 48,554,129	$ 64,782,486	$ 13,720,710	$ 45,964,080	$ 59,684,790

Factors that affect unpaid losses and LAE include the estimates made on a claim-by-claim basis known as “case reserves” coupled with bulk estimates known as IBNR. Periodic estimates by management of the ultimate costs required to settle all claim files are based on the Company’s analysis of historical data and estimations of the impact of numerous factors such as (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation.

Management revises its estimates based on the results of its analysis. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors.

The process of determining significant unpaid losses and LAE estimates is fact specific and takes into account factors such as historical experience, current and expected economic conditions, and an actuarial valuation. Management regularly reevaluates these significant factors and makes adjustments where facts and circumstances dictate. In selecting the best estimate, we utilize various actuarial methodologies. Each of these methodologies is designed to forecast the number of claims we will be called upon to pay and the amounts we will pay on average to settle those claims. In arriving at our best estimate, our actuaries consider the likely predictive value of the various loss

development methodologies employed in light of underwriting practices, premium rate changes and claim settlement practices that may have occurred, and weight the credibility of each methodology. Our actuarial methodologies take into account various factors, including, but not limited to, paid losses, liability estimates for reported losses, paid allocated LAE, salvage and other recoveries received, reported claim counts, open claim counts and counts for claims closed with and without payment of loss.

The incurred loss development method relies on the assumption that, at any given state of maturity, ultimate losses can be predicted by multiplying cumulative reported losses (paid losses plus case reserves) by a cumulative development factor. The validity of the results of this method depends on the stability of claim reporting and settlement rates, as well as the consistency of case reserve levels. Case reserves do not have to be adequately stated for this method to be effective; they only need to have a fairly consistent level of adequacy at all stages of maturity. Historical “age-to-age” loss development factors were calculated to measure the relative development of an accident year from one maturity point to the next. We then selected appropriate age-to-age loss development factors based on these historical factors and use the selected factors to project the ultimate losses.

Unearned Premium

Unearned premiums decreased $15.9 million, or 28.2%, to $40.5 million as of December 31, 2008, compared with $56.4 million as of December 31, 2007. The decrease was due to a $13.1 million decrease in unearned homeowners' insurance premiums, a $4.0 million decrease in unearned commercial general liability premiums, a $1.7 million increase in Federal Flood unearned premiums and a $0.4 million decrease in unearned automobile premiums. Generally, as is in this case, a decrease in unearned premium directly relates to a decrease in written premium on a rolling twelve-month basis. Conversely, in periods of increased written premium on a rolling twelve-month basis, unearned premium generally would be expected to rise. Competition could continue to negatively affect our unearned premium.

Premium Deposits and Customer Credit Balances

Premium deposits and customer credit balances decreased $1.1 million, or 38.4%, to $1.7 million as of December 31, 2008, compared with $2.8 million as of December 31, 2007. Premium deposits are monies received on policies not yet in force as of December 31, 2008.

Bank Overdraft

Bank overdraft remained unchanged at $8.7 million as of December 31, 2008, compared with December 31, 2007. The bank overdraft relates primarily to loss and LAE disbursements paid but not yet presented for payment by the policyholder or vendor. The balance relates to our payment patterns in relationship to the rate at which those cash disbursements are presented to the bank for payment.

Income Taxes Payable

Income taxes payable decreased to nothing as of December 31, 2008, compared with $4.2 million as of December 31, 2007. The change is due to tax payment patterns in connection with our tax liabilities. See income taxes receivable, above.

Deferred Gain from Sale of Property

Deferred gain from sale of property decreased $0.5 million, or 25.2%, to $1.5 million as of December 31, 2008, compared with $2.0 million as of December 31, 2007. In accordance with the provisions of SFAS No. 13, we are amortizing the deferred gain over the term of the leaseback, which is scheduled to end in December 2011.

Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses decreased $0.6 million, or 14.9%, to $3.7 million as of December 31, 2008, compared with $4.3 million as of December 31, 2007. This decrease is due to our cash management efforts and timing of payments with our trade vendors.

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RESULTS OF OPERATIONS
Year Ended December 31, 2008 Compared with Year Ended December 31, 2007

Gross Premiums Written

Gross premiums written decreased $45.3 million, or 33.9%, to $88.2 million for the year ended December 31, 2008 (“2008”), compared with $133.6 million for year ended December 31, 2007 (“2007”). The following table denotes gross premiums written by major product line.

	Years Ended December 31,			
	2008		2007	
	Amount	Percentage	Amount	Percentage
Homeowners'	$ 60,708,773	68.79%	$ 99,502,479	74.48%
Commercial General Liability	23,789,581	26.96%	32,221,551	24.12%
Federal Flood	3,262,719	3.70%	-	0.00%
Automobile	486,908	0.55%	1,867,304	1.40%
Gross written premiums	$ 88,247,981	100.00%	$ 133,591,334	100.00%

The Company’s sale of homeowners’ policies decreased $38.8 million, or 39.0% to $60.7 million in 2008, compared with $99.5 million in 2007. The significant erosion is primarily due to the soft market conditions prevailing in the state of Florida. The soft market conditions are lead by Citizens, the state run insurance company. We believe that these marketplace conditions have forced some carriers to pursue market share based on “best case” pricing models that may ultimately prove unprofitable from an underwriting perspective. We do not intend to compete with others solely based on pricing. We will continue to market our property insurance product in territories in Florida where our rates are competitive.

The Company experienced a decrease in homeowners’ gross premiums written in 2008 primarily because of the effects of state mandated homeowner’s rates reduction and wind mitigation discounts.

As previously discussed, a rate decrease required by the Florida Legislature resulted in a rate decrease averaging 15.2% statewide on homeowners' policies that was integrated into our rates on June 1, 2007. The effect of this rate decrease on existing policies and the corresponding premium decrease in direct written premium was fully recognized in policies by May 31, 2008. In addition, a rate decrease of 11.3% statewide for homeowners' policies was approved by the Florida OIR and implemented with an effective date of May 1, 2008 for new business and June 1, 2008 for renewal business for the homeowners' program. The effect of this rate decrease is flowing through the Company’s book of business such that a full impact of the premium decreases on direct written premium should be realized by April 2009 for the homeowners' program. These rate decreases have had an adverse effect on premium volume.

In addition, we implemented higher premium discounts in response to wind mitigation efforts by policyholders. Such discounts, which were required by the Florida Legislature and became effective on December 15, 2007 for new business and renewal business, have also had a significant effect on premium. As of December 31, 2007, 30.0% of our homeowners’ policyholders were receiving wind mitigation credits totaling $2.0 million, (a 2.0% reduction of in-force premium), while 50.0% of our homeowners’ policyholders were receiving wind mitigation credits totaling $17.0 million, (a 27.6% reduction of in-force premium), at December 31, 2008.

Pursuant to the Florida OIR regulations, we are required to report write-your-own-flood premiums on a direct and ceded basis for 2008 and subsequent years. Prior to 2008, we reported only the commissions income associated with this program.

Federated National and American Vehicle are currently rated by Demotech as "A" ("Exceptional"), which is the third of seven ratings, and defined as “Regardless of the severity of a general economic downturn or deterioration in the insurance cycle, insurers earning a Financial Stability Rating of “A” possess “Exceptional” financial stability related to maintaining surplus as regards to policyholders”. Demotech’s ratings are based upon factors of concern to agents, reinsurers and policyholders and are not primarily directed toward the protection of investors. However, our Demotech rating could be jeopardized by such other factors including adverse development and various surplus related ratio exceptions.

The Company’s sale of commercial general liability policies decreased by $8.4 million to $23.8 million in 2008, compared with $32.2 million in 2007. This decrease is due to increased competition in the commercial general liability market. The following table sets forth the amounts and percentages of our gross premiums written in connection with our commercial general liability program by state:

	Years Ended December 31,					
	2008			2007		
	Amount		Percentage	Amount		Percentage
	(Dollars in Thousands)					
State						
Alabama	$	117	0.49%	$	26	0.08%
Arkansas		12	0.05%		-	0.00%
California		269	1.13%		23	0.07%
Florida		16,011	67.30%		21,192	65.77%
Georgia		568	2.39%		1,023	3.17%
Kentucky		1	0.00%		8	0.03%
Louisiana		4,481	18.84%		5,595	17.36%
Maryland		2	0.01%		-	0.00%
South Carolina		70	0.29%		182	0.57%
Texas		2,252	9.47%		4,127	12.81%
Virginia		7	0.03%		46	0.14%
Total	$	23,790	100.00%	$	32,222	100.00%

The Company's sale of auto insurance policies decreased by $1.4 million, or 73.9%, to $0.5 million in 2008, compared with $1.9 million in 2007. American Vehicle markets automobile insurance in Florida only to its existing policyholders by offering to renew the existing policy. Federated National markets its automobile insurance in Florida to both existing and new policyholders.

Gross Premiums Ceded

Gross premiums ceded decreased $10.0 million, or 22.4%, to $34.6 million in 2008, compared with $44.6 million in 2007.

(Decrease) Increase in Prepaid Reinsurance Premiums

The (decrease) increase in prepaid reinsurance premiums was ($4.5) million in 2008, compared with ($11.3) million in 2007. The change in this account is primarily associated with the timing of our reinsurance payments measured against the term of the underling reinsurance policies.

Decrease (Increase) in Unearned Premiums

The decrease (increase) in unearned premiums was $15.9 million in 2008, compared with $21.4 million in 2007. The change was due to a $13.1 million decrease in unearned homeowners' insurance premiums, a $4.0 million decrease in unearned commercial general liability premiums, a $1.7 million increase in Federal Flood unearned premiums and a $0.4 million decrease in unearned automobile premiums. These changes are a result of our decreased premium volume during this period. See Gross Premiums Written.

Net Premiums Earned

Net premiums earned decreased $34.1 million, or 34.4%, to $65.1 million in 2008, compared with $99.2 million in 2007. The following table denotes net premiums earned by major product line.

	Years Ended December 31,			
	2008		2007	
	Amount	Percentage	Amount	Percentage
Homeowners'	$ 36,414,360	55.91%	$ 63,121,360	63.62%
Commercial General Liability	27,784,365	42.66%	32,738,178	32.99%
Federal Flood	-	0.00%	-	0.00%
Automobile	930,946	1.43%	3,364,583	3.39%
Net premiums earned	$ 65,129,671	100.00%	$ 99,224,121	100.00%

Commission Income

Commission income decreased $5.6 million, to $1.6 million in 2008, compared with $7.2 million in 2007. The 2008 commission income is primarily in connection with our reinsurance treaties.

The recurring components of our 2007 commission income totaled $1.4 million. Non-reoccurring components of our 2007 commission income totaled $5.8 million stemming from two separate events. First and pursuant to provisions contained in the three-year reinsurance treaties, we were afforded the right to cancel the remaining two years and be entitled to receive a no loss experience commission. In connection with this treaty, we reported approximately $2.8 million in 2007. The second non-reoccurring operating event was in connection with commission income totaling approximately $3.0 million in connection with our participation in a Citizens take out program which we began in 2004, wherein the commission was earned by us upon the successful retention of the policyholder for thirty-six months.

Finance Revenue

Finance revenue decreased $0.2 million, or 35.7%, to $0.4 million in 2008, compared with $0.5 million in 2007. The change is primarily due to the Company's decreased emphasis on automobile insurance and the finance revenue derived there-from.

Managing General Agent Fees

Managing general agent fees decreased $0.3 million, or 14.2%, to $1.7 million in 2008, compared with $2.0 million in 2007.

Net Investment Income

Net investment income decreased $1.6 million, or 20.2%, to $6.4 million in 2008, compared with $8.0 million in 2007. Net investment income on corporate bonds, which generally provide a higher yield than U.S. government bonds, increased $2.4 million, to $3.1 million in 2008, compared with $0.7 million in 2007. Net investment income on U.S. government bonds decreased $3.6 million, to $0.9 million in 2008, compared with $4.5 million in 2007.

Affecting our net investment income was a decrease in funds available for investment and a decrease in the overall yield to 4.11% in 2008 compared with a yield of 5.28% in 2007.

Net Realized Investment Losses

Net realized investment losses were $10.6 million in 2008, compared with $0.1 million in 2007. The table below depicts the net realized investment losses by investment category in 2008 as compared with the same period during 2007.

In 2008 we marked certain equity investments to market value pursuant to guidelines prescribed in SFAS No. 115. In reaching a conclusion that a security is either other than temporary or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as Standard and Poor's and Moody's, as well as information released via the general media channels. The pretax charge to operations was approximately $9.9 million in connection with our estimates of the net realizable value of these investments. A significant number of these investments were

subsequently sold in 2008, and we recognized an additional pretax charge to operations of $0.2 million.

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	Years Ended December 31,	
	2008	2007
Realized gains:		
Fixed securities	$ 769,738	$ 17,587
Equity securities	544,440	2,115,461
Total realized gains	1,314,178	2,133,048
Realized losses:		
Fixed securities	(854,004)	(384)
Equity securities	(11,052,944)	(2,278,083)
Total realized losses	(11,906,948)	(2,278,467)
Net realized (losses) on investments	$ (10,592,770)	$ (145,419)

Regulatory Assessments Recovered

Regulatory Assessments Recovered increased $0.4 million, or 27.2%, to $2.1 million in 2008, compared with $1.7 million in 2007.

Other Income

Other income increased less than $0.1 million, or 2.1%, to $0.7 million in 2008, compared with $0.6 million in 2007. Major components of other income in 2008 included approximately $0.5 million in partial recognition of our gain on the sale of our Lauderdale Lakes property and $0.2 million of rental income, interest income and miscellaneous income.

Losses and LAE

Losses and LAE, our most significant expense, represent actual payments made and changes in estimated future payments to be made to or on behalf of our policyholders, including expenses required to settle claims and losses. We revise our estimates based on the results of analysis of estimated future payments to be made. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events.

Losses and LAE decreased by $5.8 million, or 12.1%, to $41.9 million in 2008, compared with $47.6 million in 2007. The overall change includes a $1.0 million decrease in our homeowners' program, a $2.2 million increase in our commercial general liability program and a $7.0 million decrease in connection with our automobile program.

We continue to revise our estimates of the ultimate financial impact of past storms. The revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and (iv) trends in general economic conditions, including the effects of inflation.

The composition of unpaid losses and LAE by product line is as follows:

December 31, 2008	December 31, 2007

	Case	Bulk	Total	Case	Bulk	Total
Homeowners'	$ 8,030,680	$ 19,687,271	$ 27,717,951	$ 7,775,769	$ 24,599,143	$ 32,374,912
Commercial General Liability	7,530,756	27,303,049	34,833,805	5,414,633	17,870,404	23,285,037
Automobile	666,921	1,563,809	2,230,730	530,308	3,494,533	4,024,841
Total	$ 16,228,357	$ 48,554,129	$ 64,782,486	$ 13,720,710	$ 45,964,080	$ 59,684,790

Factors that affect unpaid losses and LAE include the estimates made on a claim-by-claim basis known as "case reserves" coupled with bulk estimates known as IBNR. Periodic estimates by management of the ultimate costs required to settle all claim files are based on the Company's analysis of historical data and estimations of the impact of numerous factors such as (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation.

Management revises its estimates based on the results of its analysis. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors. Because of our process, reserves were increased by approximately $5.1 million in 2008.

In accordance with GAAP, our loss ratio is computed as losses and LAE divided by net premiums earned. A lower loss ratio generally results in higher operating income. Our loss ratio in 2008 was 64.3% compared with 48.0% for the same period in 2007. The table below reflects the loss ratios by product line.

	Years Ended December 31,	
	2008	2007
Homeowners'	56.2%	37.4%
Commercial General Liability	77.0%	58.9%
Automobile	1.8%	140.0%
All lines	64.3%	48.0%

For further discussion, see Footnote 7 to the Consolidated Financial Statements included under Part II, Item 8, of this Report.

Operating and Underwriting Expenses

Operating and underwriting expenses decreased $5.6 million, or 44.0%, to $7.1 million in 2008, compared with $12.7 million in 2007. The change is primarily due to a $2.9 million decrease in fees paid to boards, bureaus and associations, a $1.8 million decrease in premium taxes and a $1.2 million decrease in bad debts.

Salaries and Wages

Salaries and wages increased $0.7 million, or 10.3%, to $7.4 million in 2008, compared with $6.7 million in 2007. In 2008, we had a $0.3 million severance payment. The charge to operations for stock based compensation, in accordance with the provisions of SFAS No. 123R Share Based Payment ("SFAS No. 123R"), was approximately $0.5 million in 2008 compared with approximately $0.6 million in 2007.

Interest Expense

Interest expense decreased $0.2 million to nothing in 2008, compared with $0.2 million in 2007. The decrease results from the repayment of our subordinated debt on September 30, 2007.

Policy Acquisition Costs, Net of Amortization

Policy acquisition costs, net of amortization, decreased $4.7 million, or 24.0%, to $14.8 million in 2008, compared with $19.4 million in 2007. Policy acquisition costs, net of amortization, consists of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned. The recent decreased production volume for both the homeowners' and commercial general liability product lines is the reason for the decrease in this asset.

Provision for Income Tax (Benefit) Expense

The provision for income tax benefit was $1.3 million in 2008, compared with an income tax expense of $11.2 million in 2007. The effective rate for income taxes was 34.8% in 2008, compared with 34.5% in 2007.

Net (Loss) Income

As a result of the foregoing, the Company's net loss in 2008 was $2.5 million compared with net income of $21.3 million in 2007.

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RESULTS OF OPERATIONS
Year Ended December 31, 2007 Compared with Year Ended December 31, 2006

Gross Premiums Written

Gross premiums written decreased $19.1 million, or 12.5%, to $133.6 million for the year ended December 31, 2007 ("2007"), compared with $152.7 million for the year ended December 31, 2006 ("2006"). The following table denotes gross premiums written by major product line.

	Years Ended December 31,			
	2007		2006	
	Amount	Percentage	Amount	Percentage
Homeowners'	$ 99,502,479	74.48%	$ 114,388,069	74.93%
Commercial General Liability	32,221,551	24.12%	32,213,179	21.10%
Automobile	1,867,304	1.40%	6,063,645	3.97%
Gross written premiums	$ 133,591,334	100.00%	$ 152,664,893	100.00%

The following table sets forth the amounts and percentages of our gross premiums written in connection with our commercial general liability program by state:

	Years Ended December 31,			
	2007		2006	
	Amount	Percentage	Amount	Percentage
	(Dollars in Thousands)			
State				
Alabama	$ 26	0.08%	$ -	0.00%
Arkansas	-	0.00%	-	0.00%
California	23	0.07%	-	0.00%
Florida	21,192	65.79%	22,965	71.29%
Georgia	1,023	3.17%	1,805	5.60%
Kentucky	8	0.02%	9	0.03%
Louisiana	5,595	17.36%	5,743	17.83%
Maryland	-	0.00%	-	0.00%
South Carolina	182	0.56%	77	0.24%
Texas	4,127	12.81%	1,604	4.98%
Virginia	46	0.14%	10	0.03%
Total	$ 32,222	100.00%	$ 32,213	100.00%

The Company's sale of homeowners' policies decreased $14.9 million, or 13.0% to $99.5 million in 2007, compared with $114.4 million in 2006. The decrease is primarily due to the soft market conditions prevailing in the state of Florida. The soft market conditions are lead by Citizens, the state run insurance company. We believe that the competition in this market is based primarily on pricing insurance products at rates that do not reflect current economic conditions. We do not intend to compete with others solely on the basis of pricing mechanisms. Where our rates are competitive (and there are territories in Florida that so exist) we will continue to market our property insurance product.

The Company's sale of auto insurance policies decreased by $4.2 million, or 69.2%, to $1.9 million in 2007, compared with $6.1 million in 2006.

Gross Premiums Ceded

Gross premiums ceded decreased $23.0 million, or 34.0%, to $44.6 million in 2007, compared with $67.5 million in 2006.

(Decrease) Increase in Prepaid Reinsurance Premiums

The (decrease) increase in prepaid reinsurance premiums was ($11.3) million in 2007, compared with $20.2 million in 2006. The change in this account is primarily associated with the timing of our reinsurance payments measured against the term of the underling reinsurance policies.

Decrease (Increase) in Unearned Premiums

The decrease (increase) in unearned premiums was $21.4 million in 2007, compared with ($16.0) million in 2006. The change was due to a $19.4 million decrease in unearned homeowners' insurance premiums, a $0.5 million decrease in unearned commercial general liability premiums, and a $1.5 million decrease in unearned automobile premiums. These changes are a result of our decreased premium volume during this period. See Gross Premiums Written.

Net Premiums Earned

Net premiums earned increased $9.9 million, or 11.1%, to $99.2 million in 2007, compared with $89.3 million in 2006. The following table denotes net premiums earned by major product line.

	Years Ended December 31,			
	2007		2006	
	Amount	Percentage	Amount	Percentage
Homeowners'	$ 63,121,360	63.62%	$ 48,206,614	53.95%
Commercial General Liability	32,738,178	32.99%	27,658,007	30.96%
Automobile	3,364,583	3.39%	13,483,633	15.09%
Net premiums earned	$ 99,224,121	100.00%	$ 89,348,254	100.00%

As noted above, the Company's efforts to expand its commercial general liability lines of insurance products is coming to fruition, as reflected by increased net premiums earned of $5.1 million, or 18.4 % to $32.7 million in 2007, compared with $27.7 million in 2006.

Commission Income

Commission income increased $5.5 million, to $7.2 million in 2007, compared with $1.7 million in 2006. Recurring components of our commission income totaled $1.4 million. Non-reoccurring components of our commission income totaled $5.8 million stemming from two separate events. First and pursuant to provisions contained in the three-year reinsurance treaties, we were afforded the right to cancel the remaining two years and be entitled to receive a no loss experience commission. In connection with this treaty, we reported approximately $2.8 million in 2007. The second non-reoccurring operating event was in connection with commission income totaling approximately $3.0 million in connection with our participation in a Citizens take out program in 2004, wherein the commission was earned by us upon the successful retention of the policyholder for thirty-six months.

Finance Revenue

Finance revenue decreased $1.1 million, or 67.7%, to $0.5 million in 2007, compared with $1.7 million in 2006. The change is primarily due to the Company's decreased emphasis on automobile insurance and the finance revenue derived there-from.

Managing General Agent Fees

Managing general agent fees decreased $0.6 million, or 22.5%, to $2.0 million in 2007, compared with $2.6 million in 2006.

Net Investment Income

Net investment income increased $2.0 million, or 34.2%, to $8.0 million in 2007, compared with $5.9 million in 2006. The increase in investment income is primarily a result of the additional amounts of invested assets. Also affecting our net investment income was an increase in overall yield to 6.10 % in 2007 compared with a yield of 5.28 % in 2006.

Net Realized Investment (Losses) Gains

Net realized investment (losses) gains were ($0.1) million in 2007, compared with $1.1 in 2006. The table below depicts (losses) gains by investment category.

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	Years Ended December 31, 2007	2006
Realized gains:		
Fixed income securities	$ 17,587	$ 151
Equity securities	2,115,461	1,471,307
Total realized gains	2,133,048	1,471,458
Realized losses:		
Fixed income securities	(384)	(66,722)
Equity securities	(2,278,083)	(341,874)
Total realized losses	(2,278,467)	(408,596)
Net realized (losses) gains on investments	$ (145,419)	$ 1,062,862

Regulatory Assessments Recovered

Regulatory assessments recovered increased $1.5 million to $1.7 million in 2007, compared with $0.1 million in 2006.

Other Income

Other income decreased $0.8 million, or 55.7%, to $0.6 million in 2007, compared with $1.4 million in 2006. Major components of other income in 2007 included approximately $0.5 million in partial recognition of our gain on the sale of our Lauderdale Lakes property and $0.1 million of rental income, interest income and miscellaneous income.

Loss and LAE

Loss and LAE, our most significant expense, represent actual payments made and changes in estimated future payments to be made to or on behalf of our policyholders, including expenses required to settle claims and losses. We revise our estimates based on the results of analysis of estimated future payments to be made. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events.

Loss and LAE increased by $3.2 million, or 7.3%, to $47.6 million in 2007, compared with $44.4 million in 2006. The increase includes $1.2 million adverse development associated with the 2004 hurricanes.

We continue to revise our estimates of the ultimate financial impact of past storms. The revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors.

The table below reflects no impact to operations in 2007 from the four hurricanes that occurred in July, August, September and October of 2005.

2005 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
			(Dollars in millions)	
Dennis (July 10)	-	$ -	$ -	$ -
Katrina (August 25)	4	0.1	0.1	-
Rita (September 20)	-	-	-	-
Wilma (October 24)	205	20.5	20.5	-
Total Loss Estimate	209	$ 20.6	$ 20.6	$ -

The following table reflects the changes in 2007 in connection with the four hurricanes that occurred in August and September of 2004. A charge of $1.2 million occurred in 2007 in connection with these storms.

2004 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
			(Dollars in millions)	
Charley (August 13)	1	$ 2.2	$ 2.2	$ -
Frances (September 3)	-	0.8	0.8	-
Ivan (September 14)	-	1.0	-	1.0
Jeanne (September 25)	1	0.2	-	0.2
Total Loss Estimate	2	$ 4.2	$ 3.0	$ 1.2

Our loss ratio, as determined in accordance with GAAP, in 2007 was 48.0%, compared with 49.7% in 2006. The table below reflects the loss ratios by product line.

	Years Ended December 31,	
	2007	2006
Homeowners'	37.4%	46.70%
Commercial General Liability	58.9%	38.20%
Automobile	140.0%	84.40%
All lines	48.0%	49.70%

For further discussion, see Footnote 7 to the Consolidated Financial Statements included under Part II, Item 8, of this Report.

Operating and Underwriting Expenses

Operating and underwriting expenses decreased $0.5 million, or 3.6%, to $12.7 million in 2007, compared with $13.2 million in 2006. The change is primarily due to a $2.3 million aggregate decrease in fees paid to boards, bureaus and associations, bad debts, real estate taxes, motor vehicle reports, telephone, temporary employment, postage and bank fees, offset by a $1.8 million aggregate increase in legal fees, building rent, premium taxes, consulting fees, licensing,

accounting fees and a one time settlement payment to State National.

Salaries and Wages

Salaries and wages decreased $0.3 million, or 4.0%, to $6.7 million in 2007, compared with $7.0 million in 2006.

Interest Expense

Interest expense decreased $0.5 million, or 73.6%, to $0.2 million in 2007, compared with $0.7 million in 2006. The decrease results from our subordinated debt retirement on September 30, 2007.

Policy Acquisition Costs, Net of Amortization

Policy acquisition costs, net of amortization, increased $2.0 million, or 11.6%, to $19.4 million in 2007, compared with $17.4 million in 2006. The increase is primarily in connection with a more generous commission structure during 2007. Policy acquisition costs, net of amortization, consists of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned.

Provision for Income Tax Expense

The provision for income tax expense increased $3.8 million, or 51.8%, to $11.2 million in 2007, compared with $7.4 million in 2006. The effective rate for income tax expense is 34.5% in 2007, compared with 34.7% in 2006.

Net Income

As a result of the foregoing, the Company's net income in 2007 was $21.3 million compared with net income of $13.9 million in 2006.

CONTRACTUAL OBLIGATIONS

A summary of long-term contractual obligations as of December 31, 2008 follows. The amounts represent estimates of gross undiscounted amounts payable over time.

(Dollars in Thousands)

Contractual Obligations	Total	2009	2010	2011	2012	Thereafter
Unpaid Losses and LAE	$ 64,782	$ 38,455	$ 15,489	$ 7,126	$ 2,488	$ 1,224
Operating leases	1,913	625	638	650	-	-
Total	$ 66,696	$ 39,080	$ 16,127	$ 7,776	$ 2,488	$ 1,224

LIQUIDITY AND CAPITAL RESOURCES

In 2008, our primary sources of capital were revenues generated from operations, including decreased reinsurance recoverable, net, increased unpaid losses and LAE, decreased prepaid reinsurance premiums, decreased policy acquisition costs, net of amortization, non-cash compensation, depreciation and amortization, decreased premiums receivable, decreased premium finance contracts receivable, provision for uncollectible premiums receivable and decreased other assets. Also contributing to our liquidity were proceeds from the sale of investment securities and exercised employee stock options. Because we are a holding company, we are largely dependent upon fees and commissions from our subsidiaries for cash flow.

In 2008, operations used net operating cash flow of $22.3 million, as compared with provided $32.8 million and $27.5 million in 2007 and 2006, respectively.

In 2008, operations generated $18.0 million of gross cash flow, due to a $6.1 million decrease in reinsurance recoverable, net, a $5.1 million increase in unpaid losses and LAE, a $2.9 million decrease in prepaid reinsurance premiums, a $2.4 million decrease in policy acquisition costs, net of amortization, $0.4 million of non-cash compensation, $0.3 million of depreciation and amortization, a $0.3 million decrease in premiums receivable, a $0.2 million decrease in premium finance contracts receivable, $0.2 million in the provision for uncollectible premiums receivable and a $0.1 million decrease in other assets.

In 2008, operations used $40.3 million of gross cash flow primarily due to a $15.9 million decrease in unearned premiums, $10.6 million of net realized investment losses, a $4.2 million decrease in income taxes payable and a $2.9 million increase in deferred income tax expense. Additional operational uses of cash include a $2.3 million increase in income taxes recoverable, a $1.1 million decrease in premium deposits and customer credit balances, a $0.6 million decrease in accounts payable and accrued expenses, $0.2 million of amortization of investment discount, all in conjunction with a net loss of $2.5 million.

In 2008, net investing activities provided $128.7 million, as compared with used $19.0 million and $19.7 million in 2007 and 2006, respectively. Our available for sale investment portfolio is highly liquid as it consists entirely of readily marketable securities. In 2008, investing activities generated $156.7 million and used $28.0 million from the maturity several times over of our very short municipal portfolio.

In 2008, net financing activities used $4.3 million, as compared with used $9.2 million and provided $4.1 million in 2007 and 2006, respectively. In 2008, the sources of cash in connection with financing activities included $1.3 million of exercised stock options and a $0.2 million tax benefit related to non-cash compensation. The uses of cash in connection with financing activities included $5.7 million in dividends paid and $0.1 million for the purchase of treasury stock.

We offer direct billing in connection with our automobile and homeowner programs. Direct billing is an agreement in which the insurance company accepts from the insured, as a receivable, a promise to pay the premium, as opposed to requiring the full amount of the policy at policy inception, either directly from the insured or from a premium finance company. The advantage of direct billing a policyholder by the insurance company is that we are not reliant on a credit facility, but remain able to charge and collect interest from the policyholder.

We believe that our current capital resources will be sufficient to meet currently anticipated working capital requirements. There can be no assurances, however, that such will be the case.

Federated National's and American Vehicle's statutory capital surplus levels as of December 31, 2008 were approximately $31.5 million and $25.1 million, respectively, and their statutory net losses in 2008 were $2.2 million and $2.4 million, respectively.

As of December 31, 2008, 2007, and 2006, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as "structured finance" or "special purpose" entities, which were established for the purpose of facilitating off-balance-sheet arrangements or other contractually narrow or limited purposes. As such, management believes that we currently are not exposed to any financing, liquidity, market or credit risks that could arise if we had engaged in transactions of that type requiring disclosure herein.

IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements and related data presented herein have been prepared in accordance with GAAP, which requires the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. Our primary assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the inflationary effect on the cost of paying losses and LAE.

Insurance premiums are established before we know the amount of losses and LAE and the extent to which inflation may affect such expenses. Consequently, we attempt to anticipate the future impact of inflation when establishing rate levels. While we attempt to charge adequate premiums, we may be limited in raising premium levels for competitive and regulatory reasons. Inflation also affects the market value of our investment portfolio and the investment rate of return. Any future economic changes that result in prolonged and increasing levels of inflation could cause increases in the dollar amount of incurred losses and LAE and thereby materially adversely affect future liability requirements.

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SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

	Year Ended December 31, 2008			
	(Dollars in Thousands except EPS)			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue:				
Net premiums earned	$ 18,606	$ 15,459	$ 16,249	$ 14,816
Other revenue	1,436	(32)	(283)	1,106
Total revenue	20,042	15,427	15,966	15,922
Expenses:				
Losses and LAE	7,874	12,493	9,888	11,613
Other expenses	7,150	7,024	7,927	7,189
Total expenses	15,024	19,517	17,815	18,803
Income (loss) before provision for income tax expense (benefit)	5,018	(4,090)	(1,849)	(2,881)
Provision for income tax expense (benefit)	709	(1,590)	(336)	(107)
Net income (loss)	$ 4,309	$ (2,500)	$ (1,513)	$ (2,774)
Basic net income (loss) per share	$ 0.54	$ (0.31)	$ (0.19)	$ (0.35)
Fully diluted net income (loss) per share	$ 0.54	$ (0.31)	$ (0.19)	$ (0.35)
Weighted average number of common shares outstanding	7,913	7,974	8,014	8,014
Weighted average number of common shares outstanding (assuming dilution)	7,960	7,974	8,014	8,014

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	Year Ended December 31, 2007 (Dollars in Thousands except EPS)			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue:				
Net premiums earned	$ 22,373	$ 24,814	$ 27,181	$ 24,856
Other revenue	3,212	9,679	2,390	4,627
Total revenue	25,585	34,493	29,571	29,483
Expenses:				
Losses and LAE	14,103	9,658	14,850	9,009
Other expenses	10,215	9,802	11,066	7,925