

MEADOWBROOK INSURANCE GROUP INC

Form 424B5

July 19, 2007

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**Filed Pursuant to Rule 424(b)(5)
Registration No. 333-143244**

**PROSPECTUS SUPPLEMENT
(To Prospectus Dated June 12, 2007)**

6,250,000 Shares

Common Stock

We are offering 5,500,000 shares of common stock and our chairman, Merton J. Segal, his spouse Beverly Segal and a trust established for her benefit (collectively, Mr. Segal) are collectively offering 750,000 shares of common stock. We will not receive any proceeds from sales of our common stock by Mr. Segal.

Our common stock is traded on the New York Stock Exchange under the symbol MIG. On July 18, 2007, the closing price of our common stock as reported on the New York Stock Exchange was \$9.65 per share of common stock.

Investing in our common stock involves a high degree of risk. You should carefully consider the information under the heading Risk Factors beginning on page S-9 of this prospectus supplement and page 3 of the accompanying prospectus before buying shares of our common stock.

	Per Share	Total
Public offering price	\$ 9.65	\$ 60,312,500
Underwriting discounts and commissions*	\$ 0.4825	\$ 3,015,625
Proceeds, before expenses, to us	\$ 9.1675	\$ 50,421,250
Proceeds, before expenses, to the selling shareholder	\$ 9.1675	\$ 6,875,625

* See Underwriting on page S-74 for a description of the underwriters' compensation.

To the extent that the underwriters sell more than 6,250,000 shares of common stock, we have granted the underwriters an option for a period of 30 days to purchase up to 937,500 additional shares of our common stock at the public offering price, less the underwriting discount.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

We expect the shares of our common stock will be ready for delivery to purchasers on or about July 24, 2007.

KeyBanc Capital Markets

Friedman Billings Ramsey

**Ferris, Baker Watts
Incorporated**

The date of this prospectus supplement is July 19, 2007.

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ABOUT THIS PROSPECTUS SUPPLEMENT

This prospectus supplement is a supplement to the accompanying prospectus that is also a part of this document. This prospectus supplement and the accompanying prospectus are part of a Registration Statement on Form S-3 that we filed with the Securities and Exchange Commission, or the SEC, on May 24, 2007 using a shelf registration process (the Shelf Registration Statement). In this prospectus supplement, we provide you with specific information about the terms of this offering and certain other information. Both this prospectus supplement and the accompanying prospectus include important information about us, our common stock and other information you should know before investing in our common stock. This prospectus supplement and the accompanying prospectus also incorporate by reference important business and financial information about us that is not included in or delivered with these documents. You should read both this prospectus supplement and the accompanying prospectus, as well as the additional information described under the heading **Where You Can Find More Information** below and on page 3 of the accompanying prospectus before investing in our common stock. This prospectus supplement adds, updates and changes information contained in the accompanying prospectus and the information incorporated by reference. To the extent that any statement that we make or incorporate by reference in this prospectus supplement is inconsistent with the statements made in the accompanying prospectus or the information incorporated by reference herein or therein, the statements made or incorporated by reference in the accompanying prospectus are deemed modified or superseded by the statements made or incorporated by reference in this prospectus supplement.

You should rely only on the information contained in this prospectus supplement and the accompanying prospectus. We have not authorized any other person to provide you with information that is different from that contained in this prospectus supplement and the accompanying prospectus. If anyone provides you with different or inconsistent information, you should not rely on it. We are offering to sell and seeking offers to buy these securities only in jurisdictions where offers and sales are permitted. You should assume the information contained in this prospectus and any prospectus supplement is accurate only as of the date of this prospectus or such prospectus supplement relating to the offering, respectively, regardless of the time of delivery of this prospectus supplement or the accompanying prospectus or any sale of common stock. Our business, financial condition, results of operations and prospects may have changed since that date.

WHERE YOU CAN FIND MORE INFORMATION

We have filed the Shelf Registration Statement with the SEC with respect to the common stock offered for sale by us pursuant to this prospectus supplement and accompanying prospectus. This prospectus supplement and the accompanying prospectus, filed as part of the Shelf Registration Statement, do not contain all of the information set forth in the Shelf Registration Statement and its exhibits and schedules, portions of which have been omitted as permitted by the rules and regulations of the SEC. For further information about us and the common stock, we refer you to the Shelf Registration Statement and to its exhibits and schedules. Statements in this prospectus supplement and the accompanying prospectus about the contents of any contract, agreement or other document are not necessarily complete and, in each instance, we refer you to the copy of such contract, agreement or document filed or incorporated by reference as an exhibit to the Shelf Registration Statement, with each such statement being qualified in all respects by reference to the document to which it refers. Anyone may inspect the Shelf Registration Statement and its exhibits and schedules without charge at the public reference facilities maintained by the SEC in Washington, D.C. (100 F Street NE, Room 1580, Washington, D.C. 20549). Copies of such materials can be obtained from the SEC's public reference section at prescribed rates. You may obtain information on the operation of the public reference rooms by calling the SEC at (800) SEC-0330 or on the SEC website located at <http://www.sec.gov>.

Information about us is also available at our website at <http://www.meadowbrook.com>. However, the information on our website is not a part of this prospectus supplement or the accompanying prospectus.

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INCORPORATION OF INFORMATION BY REFERENCE

The SEC allows us to incorporate by reference the information we file with them. This means that we may disclose information to you by referring you to other documents we have filed with the SEC. The information that we incorporate by reference is an important part of this prospectus supplement and information that we later file with the SEC will automatically update and, where applicable, supersede the information in this prospectus supplement or incorporated by reference in this prospectus supplement.

We incorporate by reference in this prospectus supplement all the documents listed below and any filings Meadowbrook Insurance Group, Inc. makes with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus supplement and before all the shares of common stock offered by this prospectus supplement have been sold or de-registered:

the annual report on Form 10-K for the fiscal year ended December 31, 2006;

the proxy statement in connection with the 2007 Annual Meeting of Shareholders;

the quarterly report on Form 10-Q for the period ended March 31, 2007;

the current reports on Form 8-K filed on April 4, 2007, April 12, 2007, April 18, 2007, May 7, 2007 and May 11, 2007 and the current report on Form 8-K filed on July 9, 2007 (other than the portions furnished pursuant to Item 7.01 of Form 8-K);

the description of our common stock contained in a registration statement on Form 8-A dated September 14, 1995 filed under the Exchange Act and any amendments or reports filed with the SEC for the purpose of updating such description; and

the description of our preferred share purchase rights contained in a registration statement on Form 8-A dated October 12, 1999 filed under the Exchange Act and any amendments or reports filed with the SEC for the purpose of updating such description.

You may send a written request or call us to obtain without charge a copy of the documents incorporated by reference in this prospectus supplement. We will not send exhibits to these documents unless we specifically incorporated the exhibits by reference in this prospectus supplement. Make your request by calling or writing to:

Holly Moltane
Director of External Financial Reporting
Meadowbrook Insurance Group, Inc.
26255 American Drive
Southfield, Michigan 48034-5178
(248) 204-8590
hmoltane@meadowbrook.com

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PROSPECTUS SUPPLEMENT SUMMARY

This summary may not contain all of the information that may be important to you. You should read the entire prospectus supplement, including the financial statements and related notes and other financial data included or incorporated by reference in this prospectus supplement, before making an investment decision. Investors should carefully consider the information set forth under Risk Factors beginning on page S-9 of this prospectus supplement and page 3 of the accompanying prospectus. In addition, some statements include forward-looking statements that involve risk and uncertainties. See Special Note on Forward-Looking Statements on page S-16.

As used in this prospectus supplement, we, us, our and Meadowbrook Insurance Group, Inc. mean Meadowbrook Insurance Group, Inc. and our subsidiaries, unless the context indicates otherwise.

MEADOWBROOK INSURANCE GROUP, INC.

Overview

We are a specialty risk management organization offering a full range of insurance products and services, focused on niche and specialty program business, which we believe is under served by the standard insurance market. Program business refers to an aggregation of individually underwritten risks that have some unique characteristic and are distributed through a select group of focused general agencies, retail agencies and program administrators. We perform the majority of underwriting and claims services associated with these programs. We also provide property and casualty insurance coverage and services through programs and alternative risk management solutions for agents, professional and trade associations, public entities and small to medium-sized insureds.

We operate in the specialty insurance market, which differs significantly from the standard market. In the standard market, insurance rates and forms are highly regulated, with largely uniform products and coverages, and companies tend to compete for customers on the basis of price and distribute their products through a large number of independent agents. In contrast, our specialty market provides coverage for unique, homogenous or hard-to-place risks that may not easily fit the underwriting criteria of standard carriers. Our products and services are generally distributed through a select group of focused general agencies, retail agencies and program administrators. Policies or risks written in the specialty insurance market usually cover insureds engaged in similar, but highly specialized activities that are not often recognized as a program by standard insurers or involve insurance products or classes of insureds that are often overlooked by large admitted carriers.

We pursue niche-focused underwriting in areas that tend to exhibit a reduced level of competition. This focus has allowed us to improve underwriting results through controlled and disciplined growth with long-term program partners. Furthermore, our fee-based and commission income operations generate a stream of consistent revenue, which helps to offset the potential volatility generally associated with underwriting operations.

We have a disciplined management team and culture of accountability, which we believe has helped us to effectively manage our capital. Since our last public offering in 2002, we have established a strong track record of success in deploying capital. Since 2002, we have increased our revenues from \$197.8 million to \$318.2 million in 2006, representing a compound annual growth rate of 12.6%; earnings per share have grown from \$0.08 in 2002 to \$0.75 in 2006; and book value per share increased from \$4.98 at December 31, 2002 to \$6.93 at December 31, 2006. This financial performance was achieved, in part, by reducing our combined ratio from 108.6% in 2002 to 96.8% in 2006.

Recent Developments

In April 2007, A.M. Best Company (A.M. Best) upgraded the financial strength rating of our insurance subsidiaries to A- (Excellent) from B++ (Very Good). A.M. Best maintains a letter scale rating system ranging from A++ (Superior) to F (In Liquidation), and an A- rating is the fourth highest rating on a scale of sixteen used by A.M. Best. A.M. Best ratings are directed toward the concerns of policyholders and insurance agencies and are not intended for the protection of investors or as a recommendation to buy, hold or sell securities. However, ratings have become an increasingly important factor in establishing the competitive position of insurance

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companies. The rating reflects Meadowbrook's strong operating profitability generated through continued underwriting and operating improvements, solid capitalization, and Meadowbrook's recognized expertise in the specialty program business market and alternative risk market. With the upgrade, we believe we are well positioned to attract additional high quality underwriting prospects from new and existing insurance programs which we would not have been able to access with our previous B++ rating. With the addition of these new insurance clients, we should be able to further leverage fixed costs. In addition, we will be able to eliminate the use of a non-affiliated A rated insurance carrier to issue policies that require an A.M. Best rating of A. In 2006, the premium associated with these policies was \$72.6 million and the associated policy issuance fee (front fee) was \$4.0 million. We expect that elimination of these fees will produce approximately a 1.5 percentage point improvement in the combined ratio, which will be realized over a 12-24 month period as policies renew. As these policies renew, we will be able to issue the policies directly from one of our insurance company subsidiaries and eliminate the front fee as the premium is earned.

On April 16, 2007, we acquired the business of U.S. Specialty Underwriters, Inc. (USSU). Based in Cleveland, Ohio, USSU is a specialty program manager that produces fee-based income by underwriting excess workers' compensation coverage for a select group of insurance companies. In 2006, USSU produced \$54.0 million of premiums and \$8.5 million in net commissions through a nationwide network of agents who provide services to self-insured entities. USSU focuses on self-insureds within the healthcare industry, as well as universities and public schools in twenty-nine states. This acquisition provides growth to our fee-based operations and complements our existing public entity excess workers' compensation program.

Operations

For the year ending December 31, 2006, our revenue was derived from over \$700 million in annual gross premiums under management. For this period, nearly fifty percent of these premiums were underwritten within our insurance company operations; the remainder represents premiums under management within our fee-for-service and agency operations. Our specialty risk management operations and agency operations are supported by our full-service back office processing capabilities, which provide every function necessary to a risk management organization.

- (1) Figures are for the year ending December 31, 2006
- (2) Under GAAP, intercompany fees are fees paid by our insurance company subsidiaries for risk management services and are eliminated upon consolidation

Specialty Risk Management Operations

Our specialty risk management operations, which include insurance company specialty programs and fee-for-service specialty programs, focus on specialty or niche insurance business. We provide services and coverages tailored to meet specific requirements of defined client groups and their members. We generate business through

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independent program administrators, general agencies and wholesale and retail agents, collectively referred to as producers. We generate revenue from the services and coverages from our specialty risk management operations within seven categories: net earned premiums, management fees, claims fees, loss control fees, reinsurance placement fees, investment income and net realized gains (losses). Our specialty risk management operations generated total revenues of \$306.5 million, \$294.5 million and \$261.8 million for the years ending December 31, 2006, 2005 and 2004, respectively.

For over thirty years, we have specialized in providing risk management solutions for our clients. By forming risk-sharing partnerships, we align our financial objectives with our clients. Our products and services provide small to medium-sized client groups with access to more sophisticated risk management techniques previously available only to larger corporations. This enables our clients to control insurance costs and potentially turn risk management into a profit center. When our clients place their capital at risk, they are motivated to reduce exposure and share in the underwriting profits and investment income derived from their risk management plan. This commitment fosters a longer-term relationship.

Insurance Company Specialty Programs

Our insurance company specialty programs concentrate on underwriting specialty property and casualty insurance programs designed for niche classes of business such as trade/professional groups and associations. We provide various types of property and casualty insurance coverage, including workers' compensation, commercial multiple peril, general liability, professional liability, commercial auto liability and inland marine. While we have a focus on workers' compensation and commercial package policies, we seek to achieve a balance among our lines of business. Our program insureds are generally small to medium-sized businesses and professionals. Representative industries include public entities, retail, professional services, trucking, contractors, agricultural, manufacturing and high-tech. Typically, our insurance programs operate on a regional or state-specific basis, and our producers are local or regional insurance agents who possess expertise in their specialty areas of concentration. While these producers sell policies for us as well as for other insurance companies, we seek to be the producers' preferred source of coverage on the specific programs we have established, and in some cases we have an exclusive relationship or right of first refusal on the program. We seek to avoid geographic concentration of risks through our underwriting process that might unexpectedly create exposure to natural or man-made catastrophic events, and to mitigate such losses through the purchase of reinsurance.

Fee-For-Service Specialty Programs

Our fee-for-service specialty programs generate significant revenues. We provide risk management services for these programs in return for fees or commissions. These services include risk management consulting and administration, claims administration and handling, loss control and prevention, and reinsurance placement. The fees we receive are either a fixed amount or based on a percentage of premium or claim count. Representative fee-for-service specialty programs include self-insured workers' compensation funds and public entity pools and trusts. We also provide complete back office services for other insurance companies. We assume no underwriting risk from these programs and therefore do not need to allocate substantial capital to generate ongoing revenue. Our fee-for-service specialty programs generated net fee revenue of \$30.4 million, \$26.8 million and \$32.1 million for the years ending December 31, 2006, 2005 and 2004, respectively.

Agency Operations

Our agency operations specialize in commercial, group life/accident & health, as well as personal insurance product solutions and produce policies for more than fifty major regional, national and international unaffiliated insurance carriers. Our agency operations have grown to be one of the largest agencies in Michigan and, through acquisitions,

have expanded into California and Florida. Our Michigan-based retail insurance agency operations are consistently ranked as a leading business insurance agency in Michigan and the United States. Our agency operations generated net commissions of \$12.3 million, \$11.3 million and \$9.8 million for the years ending December 31, 2006, 2005 and 2004, respectively.

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As previously indicated, earnings per share have grown from \$0.08 per share in 2002 to \$0.75 per share in 2006 and book value per share has increased from \$4.98 at December 31, 2002 to \$6.93 at December 31, 2006. This financial performance was achieved, in part, by reducing our combined ratio from 108.6% in 2002 to 96.8% in 2006. Our return on beginning equity improved by ten percentage points over the same period.

	As of and for the Years Ending December 31,					As of and for the Quarters Ending March 31,	
	2002	2003	2004	2005	2006	2006	2007
	(In thousands, except per share and ratio data)						
Income Statement Data:							
Gross Written Premiums	\$ 183,637	\$ 253,280	\$ 313,493	\$ 332,209	\$ 330,872	\$ 89,010	\$ 89,504
Gross Commissions and Fees	63,180(1)	81,101(1)	88,585(1)(2)	86,670	91,167	23,564	23,998
Revenues							
Net Earned Premiums	145,383	151,205	214,493	249,959	254,920	63,124	65,204
Net Commissions and Fees	37,581(1)	45,291(1)	40,535(1)(2)	35,916	41,172	11,289	11,551
Net Investment Income	13,958	13,484	14,911	17,975	22,075	5,239	6,156
Total Revenues	197,787	210,803	270,278	304,017	318,236	79,645	82,905
Total Expenses	195,240	194,525	249,904	278,351	286,731	71,182	72,846
Net Income	1,650	10,099	14,061	17,910	22,034	5,625	6,923
Earnings per Share (Diluted)	\$ 0.08	\$ 0.35	\$ 0.48	\$ 0.60	\$ 0.75	\$ 0.19	\$ 0.23
Balance Sheet Data:							
Total Assets	674,839	692,266	801,696	901,344	969,000	925,518	1,009,352
Shareholders' Equity	147,395	155,113	167,510	177,365	201,693	180,947	207,379
Book Value per Share	\$ 4.98	\$ 5.34	\$ 5.76	\$ 6.19	\$ 6.93	\$ 6.28	\$ 7.02
Other Data:							
Combined Ratio	108.6%	104.4%	101.4%	98.7%	96.8%	96.2%	96.3%
Return on Beginning Equity	2.1%	6.9%	9.1%	10.7%	12.4%	12.7%	13.7%

(1) Both gross and net commissions and fees include fee revenue associated with two limited duration contracts with the state of Missouri. For the years 2002, 2003, and 2004, gross and net commissions and fees included \$748,000, \$14.5 million, and \$8.3 million, respectively, in fee revenue related to these contracts.

(2) In the third quarter of 2004, we accelerated the recognition of \$3.5 million in revenue from the two limited duration contracts with the state of Missouri.

Competitive Advantages

Flexible Business Model

We have the ability to selectively increase or decrease the underwriting exposure or amount of risk we retain based upon insurance market conditions and our own underwriting and capital management criteria. We offer a full spectrum of products and services to our clients for a fee. These services include risk management services, policy issuance, reinsurance placement and traditional insurance underwriting. This flexible model allows us to better manage underwriting cycles by offsetting lower premium volume with higher fee income when appropriate, or by reducing our reinsurance attachment point.

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Balanced Revenue Sources

Our diverse sources of revenue reduce earnings volatility and provide more flexibility to manage through the property and casualty insurance market cycles. Our revenues are derived from three principal sources:

Our targeted specialty programs generate insurance premiums and investment income. We focus on specific underwriting niches in smaller average premium accounts, which tend to be less subject to price competition.

Revenue generated from managed service fees allows us to provide our back office insurance service expertise to self-insured groups, public entity pools, trusts and other insurance companies, thus leveraging our resources over a larger customer base.

Agency commissions received from non-affiliated insurance carriers provide revenues which are not tied to the same geographic markets or class of business as those in our risk taking programs and create greater diversification.

These various revenue sources allow us to remain disciplined through the more competitive underwriting market cycles with the ability to leverage our infrastructure to generate fee and commission revenue, as well as target specific local or regional markets that are less competitive.

Specialty Niche Focus

We have expertise in insuring and providing risk management services to agents, professional and trade associations and small to medium-sized commercial businesses. We focus on specialty program business with unique characteristics in under served markets. These programs require specialized underwriting expertise and industry knowledge that we have accumulated since our inception over fifty years ago. We believe our range of products, specialized market knowledge and successful history serving these programs leads to enhanced client loyalty, program retention and increased shareholder value.

Comprehensive Program Controls

Unlike many other specialty insurers that work with program administrators, our organizational controls over our business enable us to monitor and identify further opportunities and quickly and efficiently react to any changes. To maintain these controls, we:

Perform the vast majority of our own underwriting which produces more consistent data and a better understanding of the risks we insure

Manage substantially all of our own claims which keeps us in tune with how losses develop and produces greater reliability and predictability in the reserving process, and an overall better result

Perform regular audits of our branch offices and program partners which allows us to ensure consistency in the application of our underwriting and claims handling standards

Maintain all data on our information systems which gives us more timely access to information in order to identify strengths and weaknesses in our programs and recognize and respond quickly to changes in the market

Perform monthly reviews of premium and losses on all programs which enables us to regularly evaluate pricing adequacy, reserve position and adherence to our underwriting guidelines

Execute a multi-disciplinary due diligence process which allows representatives from all significant disciplines within our company (e.g., actuarial, underwriting, claims, legal, finance and systems) to ensure that new programs are designed to meet our return on equity goals and are adequately structured to promote success

Utilize a web-based processing system which makes it easier for producers to do business with us and helps reduce costs and improve control over underwriting

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Our focus on underwriting controls as well as improved risk selection, adequate pricing, and expense initiatives have resulted in an improvement in our combined ratio from 108.6% in 2002 to 96.8% in 2006.

Successful Integration of Acquisitions

Part of our strategy is to pursue acquisitions that generate value significantly faster than we can create organically. Over the last ten years, we acquired six businesses which have contributed approximately \$12.2 million to our net income in 2006. Through these acquisitions, we have added a number of talented insurance professionals to our team and have realized synergies such as revenue growth, improved claims and loss control services and expansion of our geographic presence.

Long-Term Relationships

We serve our small and medium-sized agencies and insureds by providing specialized market knowledge, a diverse product offering and superior customer service. We believe our dedicated focus on these specialty products and markets has made us a preferred choice as risk manager or insurer among our potential client base. Our full range of products and services allow us to adapt to our clients' changing needs. Our customized solutions and risk sharing opportunities align the financial interests of our partners with ours and create partner loyalty as well as barriers to entry.

Experienced Management Team

Our senior management team has an average of 28 years of experience and broad industry expertise. Our management team has fostered a working environment that focuses on communicating current information and strategies with a strong commitment to integrity, training, innovation and respect. Since our 2002 offering, the senior management team has effectively deployed and managed the Company's capital, and achieved an A.M. Best rating increase from B+ to A-. The ratings upgrade was obtained while significantly growing revenues and increasing return on beginning equity from 2.1% in 2002 to 12.4% in 2006.

Strategy

We plan to pursue profitable growth and favorable returns on equity through the following strategies:

Focus on Profitability

We intend to continue to focus on underwriting discipline and profitability. Specifically, we target a 95% combined ratio and annual growth in net income of 15-20%. We endeavor to select risks prudently, capitalize upon our A.M. Best rating upgrade to eliminate the majority of our policy issuance fees that we pay to unaffiliated carriers, use our flexible business model to manage through underwriting cycles, expand margins on fee based business, realize economies of scale and continue to seek opportunities to decrease expenses.

Grow Our Revenue Sources Organically

We plan to grow our revenues organically through the addition of new members to our existing programs, through implementing new insurance and managed programs and by adding new agency clients. Additionally, we act as underwriting managers for non-affiliated insurance companies on small workers' compensation and other lines of business. Where and when it is appropriate, we may have the opportunity to convert some premiums from managed programs to risk-bearing programs.

Leverage Our Diverse Distribution Channels

We generate business through a select number of independent program administrators, general agencies and wholesale and retail agents. These producers sell policies for us as well as for other insurance companies. However, we seek to be the preferred source of coverage on the specific programs we have established with the producer and in some cases we have an exclusive relationship or right of first refusal on the program. We intend to continue seeking producers with specialized knowledge of the programs they control and a history of profitable business. We

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also intend to continue distributing our products and services through a diversified array of producers to find the most attractive program opportunities and insulate our business from disruptions in any particular channel.

Continue Risk Sharing and Alignment with Our Partners

We plan on continuing to align our interests with those of our agents and customers through customized risk sharing arrangements including captives, rent-a-captives, profit-based commissions and dividend plans, among other things. We believe these arrangements enhance partner loyalty and create a stable, long term program.

Maintain Our Regional Program Focus

We plan to maintain our local and regional focus, as we believe it is a platform that allows us to grow our business and expand our margins. Our regional offices throughout the country perform underwriting, claims handling and loss control services, subject to comprehensive program controls. Our regional presence produces a higher level of service for the agents and customers with whom we do business and provides us with local market knowledge, which we believe provides an important advantage when developing market strategies, tailoring products to the needs of different regions and capitalizing on opportunities in each region.

Pursue Acquisitions on a Selective Basis

We plan to continue to pursue opportunities to acquire program managers, agencies and specialty books of business with a demonstrated history of profitable underwriting. We expect to continue targeting local and regional agencies or administrators that control profitable programs, with proven management teams that will continue to grow their business as part of our team. We expect acquisitions to be an important part of our strategy in the future.

Continue to Develop Scalable Technology

Our technology department has developed effective, customized analytical tools that we believe significantly enhance our ability to write profitable business and cost-effectively administer claims. In addition, these tools allow all internal systems to be connected. We intend to continue making investments in advanced and reliable technology infrastructure.

Challenges

Our business is subject to a number of risks discussed in the **Risk Factors** section and elsewhere in this prospectus supplement and the accompanying prospectus. In particular, the following considerations may offset our competitive advantages or have a negative effect on our business strategy and could cause a decrease in the price of our common stock and result in a loss of a portion or all of your investment:

If our estimates of reserves for losses and loss adjustment expenses are not adequate, we will have to increase our reserves, which would result in reductions in net income, retained earnings, statutory surplus and liquidity.

If our financial strength ratings are reduced, we may be adversely impacted.

Market conditions may cause our reinsurance to be more costly or unavailable, we may be required to bear increased risks or reduce the level of our underwriting commitments.

We are subject to credit risk with respect to the obligations of our reinsurers and risk-sharing partners. The inability of our reinsurers or risk-sharing partners to meet their obligations could adversely affect our

profitability.

We may face competitive pressures in our business that could adversely affect our profitability.

Our results may fluctuate due to many factors, including cyclical periods of price competition and excess capacity (known as a soft market) followed by periods of high premium rates and reduced underwriting capacity (known as a hard market).

For a further discussion of these and other risks, see Risk Factors.

Our principal executive offices are located at 26255 American Drive, Southfield, Michigan 48034-5178 and our telephone number is (248) 358-1100.

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THE OFFERING

Common stock we are offering	5,500,000 shares
Common stock offered by the selling shareholders	750,000 shares
Total	6,250,000 shares
Common stock outstanding after the offering	36,030,387 shares
Use of proceeds	<p>We estimate that our net proceeds from this offering, after payment of underwriting discounts and the expenses of the offering, will be approximately \$50.0 million, assuming no exercise of the underwriters option to acquire additional shares. We plan to use the net proceeds of the offering to temporarily reduce the outstanding balance of \$22.0 million on our bank line of credit, to support organic growth of our underwriting business, to fund potential select acquisitions, and for other general corporate purposes.</p> <p>We will not receive any of the proceeds from the sale of shares by the selling shareholders.</p>
Risk factors	See Risk Factors beginning on page S-9 of this prospectus supplement and page 3 of the accompanying prospectus and other information included in this prospectus supplement for a discussion of risks you should consider before deciding to invest in our common stock.
New York Stock Exchange Symbol	MIG

We calculated the outstanding shares after the offering assuming the underwriters do not exercise their option to purchase an additional 937,500 shares and based on the number of shares outstanding as of July 17, 2007, excluding:

174,200 shares reserved for issuance on the exercise of options granted under our existing stock option plan at an average option exercise price of \$11.53 per share; and

778,790 additional shares available for future issuance under our equity incentive plans.

Unless otherwise stated, all figures in this prospectus supplement assume no exercise of the underwriters option to acquire additional shares.

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RISK FACTORS

An investment in our common stock involves a number of risks. You should carefully consider the following information about these risks, together with the other information contained in this prospectus supplement and the accompanying prospectus as well as in our Annual Report on Form 10-K for the year ended December 31, 2006, which is incorporated herein by reference, before investing in our common stock. Additional risks not presently known to us, or that we currently deem immaterial, may also impair our business or results of operations. Any of the risks described could result in a significant or material adverse effect on our financial condition or results of operations, and a corresponding decline in the market price of our common stock. You could lose all or part of your investment.

This prospectus supplement and accompanying prospectus also contain forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of certain factors, including the risks described below and elsewhere in this prospectus supplement and the accompanying prospectus. See Special Note on Forward-Looking Statements.

If our estimates of reserves for losses and loss adjustment expenses are not adequate, we will have to increase our reserves, which would result in reductions in net income, retained earnings, statutory surplus, and liquidity.

We establish reserves for losses and expenses related to the adjustment of losses for the insurance policies we write. We determine the amount of these reserves based on our best estimate and judgment of the losses and costs we will incur on existing insurance policies. Star Insurance Company (Star), Savers Property and Casualty Insurance Company (Savers), Williamsburg National Insurance Company (Williamsburg) and Ameritrust Insurance Corporation (Ameritrust), and together with Star, Savers and Williamsburg, the Insurance Company Subsidiaries) obtain an annual statement of opinion from an independent actuarial firm on these reserves. While we believe our reserves are adequate, we base these reserves on assumptions about past and future events. The following factors could have a substantial impact on our future loss experience:

the amounts of claims settlements and awards

legislative activity

changes in inflation and economic conditions

Actual losses and the costs we incur related to the adjustment of losses under insurance policies could exceed, perhaps substantially, the amount of reserves we establish. When we increase reserves, our net income for the period will decrease by a corresponding amount. An increase in reserves may also require us to write off a portion of our deferred acquisition costs asset, which would cause a further reduction of net income in that period.

If our financial strength ratings are reduced, we may be adversely impacted.

Insurance companies are subject to financial strength ratings produced by external rating agencies. Higher ratings generally indicate greater financial stability and a stronger ability to pay claims. Ratings are assigned by rating agencies to insurers based upon factors they believe are important to policyholders. Ratings are not recommendations to buy, hold, or sell our securities.

Our ability to write business is most influenced by our rating from A.M. Best. A.M. Best ratings are designed to assess an insurer's financial strength and ability to meet continuing obligations to policyholders. Currently, our financial strength rating from A.M. Best is A- (Excellent) for our Insurance Company Subsidiaries. There can be no assurance that A.M. Best will not change its rating in the future. A rating downgrade from A.M. Best could materially adversely affect the business we write and our results of operations.

If market conditions cause our reinsurance to be more costly or unavailable, we may be required to bear increased risks or reduce the level of our underwriting commitments.

As part of our overall risk and capacity management strategy, we purchase reinsurance for significant amounts of risk underwritten by our Insurance Company Subsidiaries, especially for the excess-of-loss and severity risks. Market conditions beyond our control determine the availability and cost of the reinsurance we purchase, which

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may affect the level of our business and profitability. Our reinsurance facilities are generally subject to annual renewal. We may be unable to maintain our current reinsurance facilities or to obtain other reinsurance in adequate amounts and at favorable rates. Increases in the cost of reinsurance would adversely affect our profitability. In addition, if we are unable to renew our expiring facilities or to obtain new reinsurance on favorable terms, either our net exposure to risk would increase or, if we are unwilling to bear an increase in net risk exposures, we would have to reduce the amount of risk we underwrite.

We are subject to credit risk with respect to the obligations of our reinsurers and risk-sharing partners. The inability of our reinsurers or risk-sharing partners to meet their obligations could adversely affect our profitability.

Our Insurance Company Subsidiaries cede insurance to other insurers under pro rata and excess-of-loss contracts. These reinsurance arrangements diversify our business and reduce our exposure to large losses or from hazards of an unusual nature. We transfer some of the risk we have assumed to reinsurance companies in exchange for a portion of the premium we receive in connection with the risk. Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred, the ceding of insurance does not discharge us of our primary liability to our policyholder. If all or any of the reinsuring companies fail to pay or pay on a timely basis, we would be liable for such defaulted amounts. Therefore, we are subject to credit risk with respect to the obligations of our reinsurers. If our reinsurers fail to pay us or fail to pay on a timely basis, our financial results and financial condition could be adversely affected. In order to minimize our exposure to significant losses from reinsurer insolvencies, we evaluate the financial condition of our reinsurers and monitor the economic characteristics of the reinsurers on an ongoing basis. As of December 31, 2006, our reinsurance recoverables on paid and unpaid losses was \$202.7 million. (See Reinsurance Considerations that Impact Us on page S-61.)

In addition, with our risk-sharing programs, we are subject to credit risk with respect to the payment of claims by our clients' captive, rent-a-captive, large deductible programs and indemnification agreements, as well as on the portion of risk either ceded to captives or retained by our clients. The capitalization and creditworthiness of prospective risk-sharing partners is one of the factors we consider upon entering into and renewing risk-sharing programs. Generally, we collateralize balances due from our risk-sharing partners through funds withheld trusts or stand-by letters of credit issued by highly rated banks. No assurance can be given regarding the future ability of any of our risk-sharing partners to meet their obligations. The inability of our risk-sharing partners to meet their obligations could adversely affect our profitability.

We face competitive pressures in our business that could cause our revenues to decline and adversely affect our profitability.

We compete with a large number of other companies in our selected lines of business. We and our agents compete, and will continue to compete, with major United States, foreign and other regional insurers, as well as mutual companies, specialty insurance companies, underwriting agencies and diversified financial services companies. Many of our competitors have greater financial and marketing resources than we do. Our profitability could be adversely affected if we lose business or any of our agents to competitors offering similar or better products at or below our prices.

A number of new, proposed or potential legislative or industry developments could further increase competition in our industry. These developments include:

the formation of new insurers and an influx of new capital in the marketplace as existing companies attempt to expand their business as a result of better pricing and/or terms

programs in which state-sponsored entities provide property insurance in catastrophe-prone areas or other alternative market types of coverage

changing practices created by the internet, which has increased competition within the insurance business

These developments could make the property and casualty insurance marketplace more competitive by increasing the supply of insurance capacity. In that event, the current trend toward a softer market could be accelerated and may negatively influence our ability to maintain or increase rates. Accordingly, these developments could have an adverse effect on our business, financial condition and results of operations.

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Our results may fluctuate as a result of many factors, including cyclical changes in the insurance industry.

The results of companies in the property and casualty insurance industry historically have been subject to significant fluctuations and uncertainties. Our industry's profitability can be affected by:

rising levels of actual costs that are not known by companies at the time they price their products

volatile and unpredictable developments, including man-made, weather-related and other natural catastrophes or terrorist attacks

changes in loss reserves resulting from the general claims and legal environments as different types of claims arise and judicial interpretations relating to the scope of insurer's liability develop

fluctuations in interest rates, inflationary pressures and other changes in the investment environment, which affect returns on invested assets and may impact the ultimate payout of losses

increases in medical costs beyond historic or expected annual inflationary levels

The demand for property and casualty insurance can also vary significantly, rising as the overall level of economic activity increases and falling as that activity decreases. The property and casualty insurance industry historically is cyclical in nature, with periods of reduced underwriting capacity and favorable premium rates alternating with periods of excess underwriting capacity and flat or falling premium rates. These fluctuations in demand and supply could produce underwriting results that would have a negative impact on our financial condition and results of operations.

Negative developments within the workers' compensation insurance industry may adversely affect our financial condition and results of operations.

Although we engage in other businesses, approximately 34% of our premium was attributable to workers' compensation insurance for the trailing twelve months ended March 31, 2007. As a result, negative developments within the economic, competitive or regulatory conditions affecting the workers' compensation insurance industry may have an adverse effect on our financial condition and results of operations. For example, if legislators in one of our larger markets, such as Florida, Nevada, or Massachusetts, were to enact legislation to increase the scope or amount of benefits for employees under workers' compensation insurance policies without related premium increases or loss control measures, this could negatively affect the workers' compensation insurance industry. In some states, workers' compensation insurance premium rates are determined by regulation, and changes in mandated rates could reduce our profitability. Negative developments within the workers' compensation insurance industry could have a greater effect on us than on more diversified insurance companies with more diversified lines of insurance.

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

We seek to limit our loss exposure by writing a number of our insurance and reinsurance contracts on an excess-of-loss basis. Excess-of-loss insurance and reinsurance indemnifies the insured against losses in excess of a specified amount. In addition, we limit program size for each client and purchase third-party reinsurance for our own account. In the case of our assumed proportional reinsurance treaties, we seek per occurrence limitations or loss and loss expense ratio caps to limit the impact of losses ceded by the client. In proportional reinsurance, the reinsurer shares a proportional part of the premiums and losses of the reinsured. We also seek to limit our loss exposure by geographic diversification. Various provisions of our policies, such as limitations or exclusions from coverage or choice of forum negotiated to limit our risks, may not be enforceable in the manner we intend. As a result, one or

more catastrophic or other events could result in claims that substantially exceed our expectations, which could have an adverse effect on our results of operations or financial condition.

Because our investment portfolio consists primarily of fixed income securities, our investment income could suffer as a result of fluctuations in interest rates and market conditions.

We currently maintain and intend to continue to maintain an investment portfolio consisting primarily of fixed income securities. The fair value of these securities fluctuates depending on changes in interest rates. Generally, the

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fair market value of these investments increases or decreases in an inverse relationship with changes in interest rates, while net investment income earned by us from future investments in fixed income securities will generally increase or decrease with interest rates. Changes in interest rates may result in fluctuations in the income derived from, and the valuation of, our fixed income investments, which could have an adverse effect on our financial condition and results of operations.

In addition, our investment portfolio includes mortgage-backed securities. As of March 31, 2007, mortgage-backed securities constituted approximately 20.5% of our invested assets. As with other fixed income investments, the fair market value of these securities fluctuates depending on market and other general economic conditions and the interest rate environment. Changes in interest rates can expose us to prepayment risks on these investments. When interest rates fall, mortgage-backed securities are prepaid more quickly than expected and the holder must reinvest the proceeds at lower interest rates. Our mortgage-backed securities currently consist of securities with features that reduce the risk of prepayment, but there is no guarantee that we will not invest in other mortgage-backed securities that lack this protection. In periods of increasing interest rates, mortgage-backed securities are prepaid more slowly, which may require us to receive interest payments that are below the prevailing interest rates for longer than expected.

We could be forced to sell investments to meet our liquidity requirements.

We believe we maintain adequate amounts of cash and short-term investments to pay claims, and do not expect to have to sell securities prematurely for such purposes. We may, however, decide to sell securities as a result of changes in interest rates, credit quality, the rate or repayment or other similar factors. A significant increase in market interest rates could result in a situation in which we are required to sell securities at depressed prices to fund payments to our insureds. Since we carry debt securities at fair value, we expect these securities would be sold with no material impact on our net equity, although it could result in net realized losses. If these securities are sold, future net investment income may be reduced if we are unable to reinvest in securities with similar yields.

Because we are heavily regulated by the states in which we operate, we may be limited in the way we operate.

We are subject to extensive supervision and regulation in the states in which we operate. The supervision and regulation relate to numerous aspects of our business and financial condition. The primary purpose of the supervision and regulation is to maintain compliance with insurance regulations and to protect policyholders and not our shareholders. The extent of regulation varies, but generally is governed by state statutes. These statutes delegate regulatory, supervisory and administrative authority to state insurance departments. This system of regulation covers, among other things:

- standards of solvency, including risk-based capital measurements
- restrictions on the nature, quality and concentration of investments
- restrictions on the types of terms that we can include in the insurance policies we offer
- required methods of accounting
- required reserves for unearned premiums, losses and other purposes
- permissible underwriting and claims settlement practices
- potential assessments for the provision of funds necessary for the settlement of covered claims under certain insurance policies provided by impaired, insolvent or failed insurance companies

The regulations of the state insurance departments may affect the cost or demand for our products and may impede us from obtaining rate increases or taking other actions we might wish to take to increase our profitability. Furthermore, we may be unable to maintain all required licenses and approvals and our business may not fully comply with the wide variety of applicable laws and regulations or the relevant authority's interpretation of the laws and regulations. Also, regulatory authorities have relatively broad discretion to grant, renew or revoke licenses and approvals. If we do not have the requisite licenses and approvals or do not comply with applicable regulatory

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requirements, the insurance regulatory authorities could stop or temporarily suspend us from conducting some or all of our activities or monetarily penalize us.

Also, the insurance industry has recently become the focus of increased scrutiny by regulatory authorities relating to the placement of insurance, as well as claims handling by insurers in the wake of recent hurricane losses. Some states have adopted new disclosure requirements relating to the placement of insurance business, while other states are considering what additional regulatory oversight might be required with regard to claims handling activities of insurers. It is difficult to predict the outcome of these regulatory activities, whether they will expand into other areas of the business not yet contemplated, whether activities and practices currently thought of to be lawful will be characterized as unlawful and what form of additional or new regulations may be finally adopted and what impact, if any, such increase regulatory actions may have on our business. We have received general industry-wide requests for information from a few state insurance departments regarding compensation with insurance agents. We responded to these inquiries. Subsequent to our responses, we have not received any further inquiries or comments from the state insurance departments.

Our reliance on producers subjects us to their credit risk.

With respect to our agency billed premiums generated by our Insurance Company Subsidiaries, producers collect premiums from the policyholders and forward them to us. In certain jurisdictions, when the insured pays premium for these policies to producers for payment, the premium might be considered to have been paid under applicable insurance laws and the insured will no longer be liable to us for those amounts, whether or not we have actually received the premium from the producer. Consequently, we assume a degree of credit risk associated with producers. Although producers' failures to remit premiums to us have not caused a material adverse impact on us to date, there may be instances where producers collect premium but do not remit it to us and we may be required under applicable law to provide the coverage set forth in the policy despite the actual collection of the premium by us. Because the possibility of these events is dependent in large part upon the financial condition and internal operations of our producers, we may not be able to quantify any potential exposure presented by the risk. If we are unable to collect premium from our producers in the future, our financial condition and results of operations could be materially and adversely affected.

Provisions of the Michigan Business Corporation Act, our articles of incorporation and other corporate governing documents and the insurance laws of Michigan, Missouri, California and Florida may discourage takeover attempts.

The Michigan Business Corporation Act contains anti-takeover provisions. Chapters 7A (the Fair Price Act) and 7B (the Control Share Act) of the Business Corporation Act apply to us and may have an anti-takeover effect and may delay, defer or prevent a tender offer or takeover attempt that a shareholder might consider in their best interest, including those attempts that might result in shareholders receiving a premium over market price for their shares.

The Fair Price Act provides that a supermajority vote of 90 percent of the shareholders and no less than two-thirds of the votes of non interested shareholders must approve a business combination. The Fair Price Act defines a business combination to encompass any merger, consolidation, share exchange, sale of assets, stock issue, liquidation, or reclassification of securities involving an interested shareholder or certain affiliates. An interested shareholder is generally any person who owns ten percent or more of the outstanding voting shares of the company. An affiliate is a person who directly or indirectly controls, is controlled by, or is under common control with, a specified person. The supermajority vote required by the Fair Price Act does not apply to business combinations that satisfy certain conditions. These conditions include, among others: (i) the purchase price to be paid for the shares of the company in the business combination must be at least equal to the highest of either (a) the market value of the shares or (b) the highest per share price paid by the interested shareholder within the preceding two-year period or in the transaction in

which the shareholder became an interested shareholder, whichever is higher; and (ii) once becoming an interested shareholder, the person may not become the beneficial owner of any additional shares of the company except as part of the transaction which resulted in the interested shareholder becoming an interested shareholder or by virtue of proportionate stock splits or stock dividends.

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The Control Share Act establishes procedures governing control share acquisitions of large public Michigan corporations. A control share acquisition is defined as an acquisition of shares by an acquiror which, when combined with other shares held by that person or entity, would give the acquiror voting power, alone or as part of a group, at or above any of the following thresholds: 20 percent, 33 1/3 percent or 50 percent. Under the Control Share Act, an acquiror may not vote control shares unless the company's disinterested shareholders (defined to exclude the acquiring person, officers of the target company, and directors of the target company who are also employees of the company) vote to confer voting rights on the control shares. The Control Share Act does not affect the voting rights of shares owned by an acquiring person prior to the control share acquisition. The Control Share Act entitles corporations to redeem control shares from the acquiring person under certain circumstances. In other cases, the Control Share Act confers dissenters' right upon all of the corporation's shareholders except the acquiring person.

Our articles of incorporation allow our Board of Directors to issue one or more classes or series of preferred stock with voting rights, preferences and other privileges as the Board of Directors may determine. Also, we have adopted a shareholder rights plan which if triggered would significantly dilute the stock ownership percentage of anyone who acquires more than fifteen percent of our shares without the approval of our Board of Directors. The existence of our shareholder rights plan and the possible issuance of preferred shares could adversely affect the holders of our common stock and could prevent, delay or defer a change of control.

We are also subject to the laws of various states, such as Michigan, Missouri, California, and Florida, governing insurance holding companies. Under these laws, a person generally must obtain the applicable Insurance Department's approval to acquire, directly or indirectly, five to ten percent or more of the outstanding voting securities of our Insurance Company Subsidiaries. An Insurance Department's determination of whether to approve an acquisition would be based on a variety of factors, including an evaluation of the acquirer's financial stability, the competence of its management, and whether competition in that state would be reduced. These laws may prevent, delay or defer a change of control of us or our Insurance Company Subsidiaries.

Most states assess our Insurance Company Subsidiaries to provide funds for failing insurance companies and those assessments could be material.

Our Insurance Company Subsidiaries are subject to assessments in most states where we are licensed for the provision of funds necessary for the settlement of covered claims under certain policies provided by impaired, insolvent or failed insurance companies. Maximum contributions required by law in any one year vary by state, and have historically been less than one percent of annual premiums written. We cannot predict with certainty the amount of future assessments. Significant assessments could have a material adverse effect on our financial condition and results of operations.

We may require additional capital in the future, which may not be available or may only be 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. Based on our current operating plan, we believe our capital growth strategy, together with the proceeds of this offering, 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 or, may be on terms that are not favorable to us. In the case of equity financings, dilution to our shareholders could result, and in any case such securities may have rights, preferences and

privileges that are senior to those of the shares offered hereby. If we cannot obtain adequate capital on favorable terms or at all, our business, operating results and financial condition could be adversely affected.

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We have broad discretion in the use of the net proceeds from an offering and may not use them effectively.

Our management will have broad discretion in the application of the net proceeds from this offering and could spend the proceeds in ways that do not necessarily improve our results of operations or enhance the value of our common stock. The failure by our management to apply these proceeds effectively could result in financial losses that could have a material adverse effect on our business and cause the price of our common stock to decline.

Our performance is dependent on the continued services and performance of our senior management and other key personnel.

The success of our business is dependent on our ability to retain and motivate our senior management and key management personnel. The loss of the services of any of our executive officers or other key employees could have a material adverse effect on our business, financial condition, and results of operations. We have existing employment or severance agreements with Merton J. Segal, Robert S. Cubbin, Michael G. Costello, Karen M. Spaun, Stephen Belden, Robert C. Spring, Archie S. McIntyre, and Kenn R. Allen. We maintain a key person life insurance policy on Robert S. Cubbin, our President and CEO.

Our future success also will depend on our ability to attract, train, motivate and retain other highly skilled technical, managerial, marketing, and customer service personnel. Competition for these employees is intense and we may not be able to successfully attract, integrate or retain sufficiently qualified personnel. In addition, our future success depends on our ability to attract, retain and motivate our agents and other producers. Our failure to attract and retain the necessary personnel and producers could have a material adverse effect on our business, financial condition, and results of operations.

We rely on our information technology and telecommunications systems to conduct our business.

Our business is dependent upon the uninterrupted functioning of our information technology and telecommunication systems. We rely upon our systems, as well as the systems of our vendors, to underwrite and process our business, make claim payments, provide customer service, provide policy administration services, such as endorsements, cancellations and premium collections, comply with insurance regulatory requirements and perform actuarial and other analytical functions necessary for pricing and product development. Our operations are dependent upon our ability to timely and efficiently process our business and protect our information and telecommunications systems from physical loss, telecommunications failure or other similar catastrophic events, as well as from security breaches. While we have implemented business contingency plans and other reasonable and appropriate internal controls to protect our systems from interruption, loss or security breaches, a sustained business interruption or system failure could adversely impact our ability to process our business, provide customer service, pay claims in a timely manner or perform other necessary business functions. Likewise, a security breach of our computer systems could also interrupt or damage our operations or harm our reputation in the event confidential customer information is disclosed to third parties. Either of these circumstances could have a material adverse effect upon our financial condition, operations or reputation.

Managing technology initiatives and obtaining the efficiencies anticipated with technology implementation may present significant challenges.

While technological enhancements and initiatives can streamline several business processes and ultimately reduce the costs of operations, these initiatives can present short-term costs and implementation risks. Projections of associated costs, implementation timelines, and the benefits of those results may be inaccurate and such inaccuracies could increase over time. In addition, there are risks associated with not achieving the anticipated efficiencies from technology implementation that could impact our results of operations.

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SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

Some of the information in this prospectus supplement and the prospectus and the documents incorporated by reference in this prospectus supplement and the prospectus may contain forward-looking statements. These statements can be identified by the use of forward-looking phrases such as will, may, are expected to, is anticipated, estimate, target, forecast, plan, should, projected, intends to, or other similar words. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected, such as:

changes in the business environment in which we operate, including inflation and interest rates;

availability, terms and collectibility of reinsurance;

changes in taxes, laws and governmental regulations;

competitive product and pricing activity;

managing growth profitably;

catastrophe losses including those from future terrorist activity;

the cyclical nature of the property and casualty industry;

product demand;

claims development and the process of estimating reserves;

the ability of our reinsurers to pay reinsurance recoverables owed to us;

investment results;

changes in the ratings assigned to us by ratings agencies;

uncertainty as to reinsurance coverage for terrorist acts; and

availability of dividends from our insurance company subsidiaries.

We have described these and other risks under Risk Factors. You should keep in mind these risk factors and other cautionary statements in this prospectus supplement when considering forward-looking statements.

Except as required by law, we undertake no obligation to update or revise our forward-looking statements, whether as a result of new information, future events or otherwise.

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USE OF PROCEEDS

We will receive approximately \$50.0 million in net proceeds from this offering after deducting underwriting discounts and commissions and our estimated expenses for this offering of approximately \$3.0 million. If the underwriters option to purchase additional shares of common stock is exercised in full, we estimate that our net proceeds will be approximately \$58.6 million. We plan to use the net proceeds of the offering to temporarily reduce the outstanding balance of \$22.0 million on our bank line of credit, to support organic growth of our underwriting business, to fund potential select acquisitions, and for other general corporate purposes.

As of the date of this prospectus supplement, we cannot specify with certainty all of the particular uses for the net proceeds to us from this offering. Accordingly, we will retain broad discretion over the use of these proceeds. Pending the use of the net proceeds, we intend to invest the net proceeds in a variety of capital preservation investments, including short-term, interest-bearing, and investment-grade securities.

DIVIDEND POLICY

While we have paid dividends in the past, we have not in the past five years paid dividends on our common stock. Our Board of Directors considers whether or not a dividend will be declared based on a variety of factors, including but not limited to our cashflow, liquidity needs, results of operations and financial condition. As a holding company, we are dependent upon dividends and other permitted payments from our subsidiaries to pay any cash dividend. Our regulated subsidiaries ability to pay dividends to us is limited by government regulations. See Business Regulations that Impact Us on page S-66.

Table of Contents**CAPITALIZATION**

The following table shows our capitalization at March 31, 2007, and as adjusted to give effect to (i) our acquisition of the business of USSU on April 16, 2007 and (ii) the sale of the common stock offered by this prospectus supplement based upon the public offering price of \$9.65 per share and after deducting underwriting discounts and commissions and estimated offering expenses of approximately \$3.0 million.

		As Adjusted for Stock Issued in USSU Acquisition (In thousands)		As Adjusted for Stock Issued in this Offering
	Actual			
Revolving Debt	\$ 10,400	\$	23,060	\$ 0
Debentures	55,930		55,930	55,930
Total Debt	\$ 66,330	\$	78,990	\$ 55,930
Common stock, \$0.01 par value; authorized 75,000,000(1) shares, 29,539,236 (actual), 30,447,171 shares (as adjusted for the USSU acquisition) and 35,947,171 (as adjusted for this offering) issued and outstanding	295		304	359
Additional paid-in capital	125,265		135,256	185,227
Retained earnings	83,205		83,205	83,205
Note receivable from officer	(871)		(871)	(871)
Accumulated other comprehensive income	(515)		(515)	(515)
Total shareholders' equity	\$ 207,379	\$	217,379	\$ 267,405
Total Capitalization	\$ 273,709	\$	296,369	\$ 323,335

(1) We amended our Articles of Incorporation on May 14, 2007 to increase the number of authorized shares of common stock from 50,000,000 to 75,000,000.

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Our common stock is traded on the New York Stock Exchange under the symbol MIG. The following table shows the high and low prices of our common stock as reported by the NYSE and our dividends declared for each fiscal period shown.

	High	Low	Dividend
2005			
First quarter	\$ 5.89	\$ 4.98	
Second quarter	5.53	5.02	
Third quarter	5.72	5.05	
Fourth quarter	6.77	5.31	

	High	Low	Dividend
2006			
First quarter	\$ 7.00	\$ 5.63	
Second quarter	8.91	6.68	
Third quarter	11.83	8.32	
Fourth quarter	12.48	8.78	

	High	Low	Dividend
2007			
First quarter	\$ 11.68	\$ 9.10	
Second quarter	12.45	9.94	
Third quarter (through July 17, 2007)	11.57	9.30	

On July 18, 2007, the last reported sale price of our common stock on the New York Stock Exchange was \$9.65 per share. As of July 17, 2007, there were 246 holders of record of our common stock.

Table of Contents**SELECTED CONSOLIDATED FINANCIAL INFORMATION**

The following tables set forth our selected historical consolidated financial and operating information for the periods ended and as of the dates indicated. The selected consolidated income statement data for the years ended December 31, 2006 and 2005 and the balance sheet data as of December 31, 2006 and 2005 are derived from our audited financial statements included elsewhere in this prospectus supplement, which have been audited by Ernst & Young LLP, an independent registered public accounting firm. The selected consolidated income statement data for the year ended December 31, 2004 are derived from our audited financial statements included elsewhere in this prospectus supplement, which have been prepared in accordance with GAAP and have been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm. The selected consolidated income statement data for the years ended December 31, 2003 and 2002 and the balance sheet data as of December 31, 2004, 2003, and 2002 are derived for our audited financial statements, which have been prepared in accordance with GAAP and have been audited by PricewaterhouseCoopers LLP. The selected unaudited consolidated income statement data for the three months ended March 31, 2007 and 2006 and the balance sheet data as of March 31, 2007 and 2006 are derived from our unaudited financial statements included elsewhere in this prospectus supplement, which have been prepared in accordance with GAAP. The selected unaudited consolidated financial statements include all adjustments, other than normal recurring adjustments, which we consider necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods presented. These historical results are not necessarily indicative of results to be expected from any future period.

You should read the following selected consolidated financial information together with the other information contained in this prospectus supplement, including the section captioned Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes included elsewhere in this prospectus supplement.

	For the Years Ending December 31,					For the Quarters Ending March 31,	
	2002	2003	2004	2005	2006	2006	2007
	(In thousands, except per share and ratio data)					(Unaudited)	
Income Statement Data:							
Gross written premiums	\$ 83,637	\$ 253,280	\$ 313,493	\$ 332,209	\$ 330,872	\$ 89,010	\$ 89,504
Net written premiums	139,795	189,827	233,961	258,134	262,668	69,381	71,972
Net earned premiums	\$ 145,383	\$ 151,205	\$ 214,493	\$ 249,959	\$ 254,920	\$ 63,124	\$ 65,204
Net commissions and fees	37,581	45,291	40,535	35,916	41,172	11,289	11,551
Net investment income	13,958	13,484	14,911	17,975	22,075	5,239	6,156
	666	823	339	167	69	(7)	(6)

Net realized gains (losses)							
Gain on sale of subsidiary	199						
Total revenue	\$ 197,787	\$ 210,803	\$ 270,278	\$ 304,017	\$ 318,236	\$ 79,645	\$ 82,905
Net losses and loss adjustment expenses (LAE)	\$ 98,734	\$ 98,472	\$ 135,938	\$ 151,542	\$ 146,293	\$ 37,043	\$ 36,646
Policy acquisition and other underwriting expenses	33,573	23,606	33,424	44,439	50,479	11,424	13,643
Other administrative expenses	22,612	23,232	25,964	27,183	29,414	7,959	7,537
Salaries and employee benefits	37,659	48,238	52,297	51,331	54,569	13,368	13,532
Interest expense	3,021	977	2,281	3,856	5,976	1,388	1,488
Gain on debt reduction	(359)						
Income before income taxes and equity in earnings of affiliates	2,547	16,278	20,374	25,666	31,505	8,463	10,059
Equity in earnings of affiliates		3	39	1	128	9	13
Net income	\$ 1,650	\$ 10,099	\$ 14,061	\$ 17,910	\$ 22,034	\$ 5,625	\$ 6,923
Earnings per share Diluted	\$ 0.08	\$ 0.35	\$ 0.48	\$ 0.60	\$ 0.75	\$ 0.19	\$ 0.23

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	As of and for the Years Ending December 31,					As of and for the Quarters Ending March 31,	
	2002	2003	2004	2005	2006	2006	2007
	(In thousands, except per share and ratio data)					(Unaudited)	
Balance Sheet							
Data:							
Total investments and cash and cash equivalents	\$ 286,050	\$ 324,235	\$ 402,156	\$ 460,233	\$ 527,600	\$ 467,745	\$ 553,015
Total assets	674,839	692,266	801,696	901,344	969,000	925,518	1,009,352
Loss and LAE reserves	374,933	339,465	378,157	458,677	501,077	470,902	514,833
Revolving debt	32,497	17,506	12,144	7,000	7,000	8,312	10,400
Debentures		10,310	35,310	55,930	55,930	55,930	55,930
Shareholders' equity	147,395	155,113	167,510	177,365	201,693	180,947	207,379
Book value per share	\$ 4.98	\$ 5.34	\$ 5.76	\$ 6.19	\$ 6.93	\$ 6.28	\$ 7.02
Other Data:							
GAAP ratios							
(insurance companies only):							
Net loss and LAE ratio(1)	72.1%	70.1%	67.9%	65.2%	62.3%	63.7%	61.3%
Expense ratio(1)	36.5%	34.3%	33.5%	33.5%	34.5%	32.5%	35.0%
Combined ratio	108.6%	104.4%	101.4%	98.7%	96.8%	96.2%	96.3%

(1) Both the GAAP loss and loss adjustment expense ratio and the GAAP expense ratio are calculated based upon unconsolidated insurance company operations. The following table sets forth the intercompany fees, which are eliminated upon consolidation.

For the Years Ending December 31,						For the Quarters Ending March 31,	
2002	2003	2004	2005	2006	2006	2007	
(In thousands, except ratio data)						(Unaudited)	
Unconsolidated GAAP data							
Ratio Calculation Table:							
Net earned premiums	\$ 145,383	\$ 151,205	\$ 214,493	\$ 249,959	\$ 254,920	\$ 63,124	\$ 65,204
	\$ 98,734	\$ 98,472	\$ 135,938	\$ 151,542	\$ 146,293	\$ 37,043	\$ 36,646

Consolidated net losses and LAE							
Intercompany claim fees	6,154	7,514	9,691	11,523	12,553	3,158	3,295
Unconsolidated net losses and LAE	\$ 104,888	\$ 105,986	\$ 145,629	\$ 163,065	\$ 158,846	\$ 40,201	\$ 39,941
GAAP net loss and LAE ratio	72.1%	70.1%	67.9%	65.2%	62.3%	63.7%	61.3%
Consolidated policy acquisition and other underwriting expenses	\$ 33,573	\$ 23,606	\$ 33,424	\$ 44,439	\$ 50,479	\$ 11,424	\$ 13,643
Intercompany administrative and other underwriting fees	19,445	28,296	38,359	39,231	37,442	9,117	9,152
Unconsolidated policy acquisition and other underwriting expenses	\$ 53,018	\$ 51,902	\$ 71,783	\$ 83,670	\$ 87,921	\$ 20,541	\$ 22,795
GAAP expense ratio	36.5%	34.3%	33.5%	33.5%	34.5%	32.5%	35.0%
GAAP combined ratio	108.6%	104.4%	101.4%	98.7%	96.8%	96.2%	96.3%

Management uses the GAAP combined ratio and its components to assess and benchmark underwriting performance.

The GAAP combined ratio is the sum of the GAAP loss and loss adjustment expense ratio and the GAAP expense ratio. The GAAP loss and loss adjustment expense ratio is the unconsolidated net loss and loss adjustment expenses in relation to net earned premiums. The GAAP expense ratio is the unconsolidated policy acquisition and other underwriting expenses in relation to net earned premiums.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Overview

We are a specialty risk management organization offering a full range of insurance products and services, focused on niche and specialty program business, which we believe is under served by the standard insurance market. Program business refers to an aggregation of individually underwritten risks that have some unique characteristic and are distributed through a select group of focused general agencies, retail agencies and program administrators. We perform the majority of underwriting and claims services associated with these programs. We provide property and casualty insurance coverage and services through programs and alternative risk management solutions for agents, professional and trade associations and small to medium-sized insureds.

We operate in the specialty insurance market, which differs significantly from the standard market. In the standard market, insurance rates and forms are highly regulated, with largely uniform products and coverages, and companies tend to compete for customers on the basis of price and distribute their products through a large number of independent agents. In contrast, our specialty market provides coverage for unique, homogenous or hard-to-place risks that may not easily fit the underwriting criteria of standard carriers. Our products and services are generally distributed through a select group of more focused general agencies, retail agencies, and program administrators. Policies or risks written in the specialty insurance market usually cover insureds engaged in similar, but highly specialized activities that are not often recognized as a program by standard insurers or involve insurance products or classes of insureds that are often overlooked by large admitted carriers.

We pursue niche-focused underwriting in areas that tend to exhibit a reduced level of competition. This focus has allowed us to improve underwriting results through controlled and disciplined growth with long-term program partners. Furthermore, our fee-based and commission income operations generate a stream of consistent revenue, which helps to dampen the potential volatility generally associated with underwriting operations.

We have a disciplined management team and culture of accountability which we believe has helped us to effectively manage our capital. Since our last public offering in 2002, we have established a strong track record of success in deploying capital. Since 2002, we have increased our revenues from \$197.8 million to \$318.2 million in 2006, representing a compound annual growth rate of 12.6%; earnings per share have grown from \$0.08 in 2002 to \$0.75 in 2006; and book value per share increased from \$4.98 at December 31, 2002 to \$6.93 at December 31, 2006. This financial performance was achieved, in part, by reducing our combined ratio from 108.6% in 2002 to 96.8% in 2006.

A.M. Best Upgrade

In April 2007, we announced the upgrade of our financial strength rating by A.M. Best Company to A- (Excellent), from B++ (Very Good) for our Insurance Company Subsidiaries. With the upgrade, we believe we are well positioned to attract additional solid underwriting prospects from new and existing insurance programs and should realize significant cost savings in the future.

Critical Accounting Policies

In certain circumstances, we are required to make estimates and assumptions that affect amounts reported in our consolidated financial statements and related footnotes. We evaluate these estimates and assumptions on an on-going basis based on a variety of factors. There can be no assurance, however, that actual results will not be materially

different than our estimates and assumptions, and that reported results of operation will not be affected by accounting adjustments needed to reflect changes in these estimates and assumptions. We believe the following policies are the most sensitive to estimates and judgments.

Losses and Loss Adjustment Expenses

Significant periods of time can elapse between the occurrence of a loss, the reporting of the loss to the insurer, and the insurer's payment of that loss. To recognize liabilities for unpaid losses and loss adjustment expenses

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(LAE), insurers establish reserves as balance sheet liabilities representing estimates of amounts needed to pay reported and unreported net losses and LAE.

We establish a liability for losses and LAE, which represent case based estimates of reported unpaid losses and LAE and actuarial estimates of incurred but not reported losses (IBNR) and LAE. Such liabilities, by necessity, are based upon estimates and, while we believe the amount of our reserves is adequate, the ultimate liability may be greater or less than the estimate. As of December 31, 2006 and 2005, we have accrued \$501.1 million and \$458.7 million of gross loss and LAE reserves, respectively.

The following table sets forth our gross and net reserves for losses and LAE based upon an underlying source of data, at December 31, 2006 (in thousands):

	Case	IBNR	Total
Direct	\$ 181,884	\$ 227,864	\$ 409,748
Assumed-Directly Managed(1)	17,777	41,264	59,041
Assumed-Residual Markets(2)	9,242	16,855	26,097
Assumed-Retroceded	1,281	227	1,508
Assumed-Other	3,031	1,652	4,683
Gross	213,215	287,862	501,077
Less Ceded	90,038	108,384	198,422
Net	\$ 123,177	\$ 179,478	\$ 302,655

- (1) Directly managed represents business managed and processed by our underwriting, claims, and loss control departments, utilizing our internal systems and related controls.
- (2) Residual markets represent mandatory pooled workers compensation business based upon an individual company's market share by state.

In reference to the above table, the reserves related to our direct business and assumed business which we manage directly, are established through transactions processed through our internal systems and related controls. Accordingly, the case reserves are established on a current basis, therefore there is no backlog, and IBNR is determined utilizing various actuarial methods based upon historical data. Ultimate reserve estimates related to assumed business from residual markets are provided by individual states on a two quarter lag and include an estimated reserve based upon actuarial methods for this lag. Assumed business which is subsequently 100% retroceded to participating reinsurers relates to business previously discontinued and now is in run-off. Lastly, in relation to assumed business from other sources, we receive case and paid loss data within a forty-five day reporting period and develop our estimates for IBNR based on both current and historical data.

The completeness and accuracy of data received by cedants on assumed business that we do not manage directly is verified through monthly reconciliations to detailed statements, inception to date rollforwards of claim data, actuarial estimates of historical trends, field audits, and a series of management oversight reports on a program basis.

The following table sets forth our net case and IBNR reserves for losses and LAE by line of business at December 31, 2006 (in thousands):

	Net Case	Net IBNR	Total
Workers Compensation	\$ 60,882	\$ 76,231	\$ 137,113
Residual Markets	9,242	16,856	26,098
Commercial Multiple Peril/General Liability	21,340	41,716	63,056
Commercial Automobile	24,555	30,087	54,642
Other	7,158	14,588	21,746
Total	\$ 123,177	\$ 179,478	\$ 302,655

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When a claim is reported to one of our Insurance Company Subsidiaries, for the majority of claims, our claims personnel within our risk management subsidiary will establish a case reserve for the estimated amount of the ultimate payment for a majority of our claims. The amount of the reserve is primarily based upon a case-by-case evaluation of the type of claim involved, the circumstances surrounding each claim, and the policy provisions relating to the type of losses. The estimate reflects the informed judgment of such personnel based on general insurance reserving practices, as well as the experience and knowledge of the claims person. Until the claim is resolved, these estimates are revised as deemed necessary by the responsible claims personnel based on subsequent developments, new information or periodic reviews of the claims.

In addition to case reserves and in accordance with industry practice, we maintain estimates of reserves for losses and LAE incurred but not yet reported. We project an estimate of ultimate losses and LAE at each reporting date. The difference between the projected ultimate loss and LAE reserves and the case loss reserves and LAE reserves, is carried as IBNR reserves. By using both estimates of reported claims and IBNR determined using generally accepted actuarial reserving techniques, we estimate the ultimate liability for losses and LAE, net of reinsurance recoverables.

Our reserves are reviewed by internal and independent actuaries for adequacy on a quarterly basis. When reviewing reserves, we analyze historical data and estimate the impact of various factors such as: (1) per claim information; (2) industry and our historical loss experience; (3) legislative enactments, judicial decisions, legal developments in the imposition of damages, and changes in political attitudes; and (4) trends in general economic conditions, including the effects of inflation. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events. There is no precise method, however, for subsequently evaluating the impact of any specific factor on the adequacy of reserves, because the eventual deficiency or redundancy is affected by multiple factors.

The key assumptions we use in our selection of ultimate reserves include underlying actuarial methodologies, a review of current pricing and underwriting initiatives, an evaluation of reinsurance costs and retention levels, and a detailed claims analysis with an emphasis on how aggressive claims handling may be impacting the paid and incurred loss data trends embedded in the traditional actuarial methods. With respect to the ultimate estimates for losses and LAE, the key assumptions remained consistent for the years ended December 31, 2006 and 2005.

Reinsurance Recoverables

Reinsurance recoverables represent (1) amounts currently due from reinsurers on paid losses and LAE, (2) amounts recoverable from reinsurers on case basis estimates of reported losses and LAE, and (3) amounts recoverable from reinsurers on actuarial estimates of IBNR losses and LAE. Such recoverables, by necessity, are based upon estimates. Reinsurance does not legally discharge us from our legal liability to our insureds, but it does make the assuming reinsurer liable to us to the extent of the reinsurance ceded. Instead of being netted against the appropriate liabilities, ceded unearned premiums and reinsurance recoverables on paid and unpaid losses and LAE are reported separately as assets in our consolidated balance sheets. Reinsurance recoverable balances are also subject to credit risk associated with the particular reinsurer. In our selection of reinsurers, we continually evaluate their financial stability. While we believe our reinsurance recoverables are collectible, the ultimate recoverable may be greater or less than the amount accrued. At December 31, 2006 and 2005, reinsurance recoverables on paid and unpaid losses were \$202.7 million and \$202.6 million, respectively.

In our risk-sharing programs, we are subject to credit risk with respect to the payment of claims by our clients' captive, rent-a-captive, large deductible programs, indemnification agreements, or on the portion of risk either ceded to the captives, or retained by the clients. The capitalization and credit worthiness of prospective risk-sharing partners is one of the factors we consider upon entering into and renewing risk-sharing programs. We collateralize balances due from our risk-sharing partners through funds withheld trusts or stand-by letters of credit issued by highly rated banks. We

have historically maintained an allowance for the potential uncollectibility of certain reinsurance balances due from some risk-sharing partners, some of which are in litigation. At the end of each quarter, an analysis of these exposures is conducted to determine the potential exposure to uncollectibility. At December 31, 2006, we believe this allowance is adequate. To date, we have not, in the aggregate, experienced

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material difficulties in collecting balances from our risk-sharing partners. No assurance can be given, however, regarding the future ability of any of our risk-sharing partners to meet their obligations.

Investments and Other Than Temporary Impairments of Securities and Unrealized Losses on Investments

Our investment securities are classified as available for sale. Investments classified as available for sale are available to be sold in the future in response to our liquidity needs, changes in market interest rates, tax strategies and asset-liability management strategies, among other reasons. Available for sale securities are reported at fair value, with unrealized gains and losses reported in the accumulated other comprehensive income component of shareholders equity, net of deferred taxes and, accordingly, have no effect on net income. However, if there is a decline in the fair value of an investment below its cost and the decline is considered other than temporary, the amount of decline below cost is charged to earnings.

Our investment portfolio is primarily invested in debt securities classified as available for sale, with a concentration in fixed income securities of a high quality. Our investment philosophy is to maximize after-tax earnings and maintain significant investments in tax-exempt bonds. Our policy for the valuation of temporarily impaired securities is to determine impairment based on analysis of, but not limited to, the following factors: (1) rating downgrade or other credit event (e.g., failure to pay interest when due); (2) financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology or discontinuance of a business segment; (3) prospects for the issuer's industry segment; and (4) intent and ability to retain the investment for a period of time sufficient to allow for anticipated recovery in market value. We evaluate our investments in securities to determine other than temporary impairment, no less than quarterly. Investments that are deemed other than temporarily impaired are written down to their estimated net fair value and the related losses recognized in income. There were no impaired investments written down in 2006, 2005, and 2004. There can be no assurance, however, that significant changes in the above factors in relation to our investment portfolio, will not result in future impairment charges.

At March 31, 2007, we had 289 securities that were in an unrealized loss position. These investments all had unrealized losses of less than ten percent. At March 31, 2007, 194 of those investments, with an aggregate \$192.3 million and \$3.8 million fair value and unrealized loss, respectively, have been in an unrealized loss position for more than eighteen months.

At December 31, 2006 and 2005, we had 293 and 267 securities that were in an unrealized loss position, respectively. These investments all had unrealized losses of less than ten percent. At December 31, 2006, 128 of those investments, with an aggregate \$127.3 million and \$3.1 million fair value and unrealized loss, respectively, have been in an unrealized loss position for more than eighteen months. At December 31, 2005, thirty-nine of those investments, with an aggregate \$29.9 million and \$1.2 million fair value and unrealized loss, respectively, have been in an unrealized loss position for more than eighteen months. As of December 31, 2006 and 2005, gross unrealized losses on available for sale securities were \$5.1 million and \$5.5 million, respectively.

Positive evidence considered in reaching our conclusion that the investments in an unrealized loss position are not other than temporarily impaired consisted of: 1) there were no specific events which caused concerns; 2) there were no past due interest payments; 3) there has been a rise in market prices; 4) our ability and intent to retain the investment for a sufficient amount of time to allow an anticipated recovery in value; and 5) changes in market value were considered normal in relation to overall fluctuations in interest rates.

Revenue Recognition

We recognize premiums written as earned on a pro rata basis over the life of the policy term. Unearned premiums represent the portion of premiums written that are applicable to the unexpired terms of an in force policy. Provisions for unearned premiums on reinsurance assumed from others are made on the basis of ceding reports when received and actuarial estimates.

For the year ending December 31, 2006, total assumed written premiums were \$83.9 million, of which \$72.6 million relates to assumed business we manage directly, and therefore, no estimation is involved. The remaining \$11.3 million of assumed written premiums includes \$10.1 million related to residual markets.

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Assumed premium estimates are specifically related to the mandatory assumed pool business from the National Council on Compensation Insurance (NCCI), or residual market business. The pools cede workers' compensation business to participating companies based upon the individual company's market share by state. The activity is reported from the NCCI to participating companies on a two quarter lag. To accommodate this lag, we estimate premium and loss activity based on historical and market based results. Historically, we have not experienced any material difficulties or disputes in collecting balances from NCCI; and therefore, no provision for doubtful accounts is recorded related to the assumed premium estimate.

In addition, certain premiums are subject to retrospective premium adjustments. Premium is recognized over the term of the insurance contract.

Fee income, which includes risk management consulting, loss control, and claims administration services, is recognized in the period the services are provided. Claims processing fees are recognized as revenue over the estimated life of the claims, or the estimated life of the contract. For those contracts that provide services beyond the contractually defined termination date of the related contracts, fees are deferred in an amount equal to an estimate of our obligation to continue to provide services.

Commission income, which includes reinsurance placement, is recorded on the later of the effective date or the billing date of the policies on which they were earned. Commission income is reported net of any sub-producer commission expense. Any commission adjustments that occur subsequent to the earnings process are recognized upon notification from the insurance companies. Profit sharing commissions from insurance companies are recognized when determinable, which is when such commissions are received.

We review, on an ongoing basis, the collectibility of our receivables and establish an allowance for estimated uncollectible accounts. As of December 31, 2006 and 2005, the allowance for uncollectibles on receivables was \$2.9 million and \$3.9 million, respectively.

Legal Contingencies

We are subject at times to various claims, lawsuits and proceedings relating principally to alleged errors or omissions in the placement of insurance, claims administration, consulting services and other business transactions arising in the ordinary course of business. Where appropriate, we vigorously defend such claims, lawsuits and proceedings. Some of these claims, lawsuits and proceedings seek damages, including consequential, exemplary or punitive damages, in amounts that could, if awarded, be significant. Most of the claims, lawsuits and proceedings arising in the ordinary course of business are covered by errors and omissions insurance or other appropriate insurance. In terms of deductibles associated with such insurance, we have established provisions against these items, which are believed to be adequate in light of current information and legal advice. In accordance with SFAS No. 5, Accounting for Contingencies, if it is probable that an asset has been impaired or a liability has been incurred as of the date of the financial statements and the amount of loss is estimable, an accrual is provided for the costs to resolve these claims in our consolidated financial statements. Period expenses related to the defense of such claims are included in other operating expenses in the accompanying consolidated statements of income. We, with the assistance of outside counsel, adjust such provisions according to new developments or changes in the strategy in dealing with such matters. On the basis of current information, we do not expect the outcome of the claims, lawsuits and proceedings to which we are subject to, either individually, or in the aggregate, will have a material adverse effect on our financial condition. However, it is possible that future results of operations or cash flows for any particular quarter or annual period could be materially affected by an unfavorable resolution of any such matters.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets of subsidiaries acquired. As required by SFAS No. 142 Goodwill and Other Intangible Assets, we no longer amortize goodwill and, at least annually, we test all existing goodwill for impairment using a fair value approach, on a reporting unit basis. Our annual assessment date for goodwill impairment testing is October 1st. We test for impairment more frequently if events or changes in circumstances indicate that there may be an impairment to goodwill. We carry goodwill on two reporting units within the agency operations segment in the amount of \$6.5 million and three reporting units within

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the specialty risk management operations segment in the amount of \$25.0 million. Based on our most recent evaluation of goodwill impairment, we determined that no impairment to goodwill exists.

Results of Operations

General Overview

For the first quarter of 2007, we continued to experience an improvement in our overall results in comparison to prior year. This improvement continues to reflect our selective growth, as well as our adherence to strict corporate underwriting guidelines and price adequacy. We continue to be committed to strong underwriting discipline and growth within our profitable programs. We continue to experience solid growth in our fee-based operations.

Overall underwriting results in 2006 continued to show improvement in comparison to 2005. Our results for 2006 demonstrated our commitment to strong underwriting discipline, as well as improved profitability within our specialty insurance and fee-for-service programs. Net income for 2006 in comparison to 2005 was indicative of our selective growth consistent with our corporate underwriting guidelines and controls over price adequacy. We continued to achieve operational efficiencies and enhancements in 2006.

Our generally accepted accounting principles (GAAP) combined ratio improved 1.9 percentage points to 96.8% in 2006 from 98.7% in 2005. For the first quarter of 2007, our combined ratio remained relatively consistent in comparison to 2006 at 96.3%.

Quarter ended March 31, 2007 versus March 31, 2006

Gross written premium was relatively flat for the first quarter of 2007 in comparison to 2006. Our existing underwritten business increased by \$4.5 million growth, or 5.4% over the first quarter of 2006. This growth included business from new programs implemented in 2006. The growth in existing business was slightly offset by a reduction in residual market premiums that are assigned to us as a result of a decrease in the estimate of the overall size of the residual market. We continue to follow pricing guidelines mandated by our corporate underwriting guidelines. Overall, our first quarter rate change was relatively flat. We anticipate rates to remain relatively stable in 2007. We continue to be selective on new program implementation by focusing only on those programs that meet our underwriting guidelines and have a proven history of profitability.

Our net income for the three months ended March 31, 2007, was \$6.9 million, or \$0.23 per dilutive share, compared to net income of \$5.6 million, or \$0.19 per dilutive share, for the comparable period of 2006. This improvement primarily reflects prior accident reserve redundancies, as well as our selective growth consistent with our corporate underwriting guidelines and our controls over price adequacy. This improvement was also attributable to an increase in net investment income in comparison to 2006 as a result of favorable prior year cash flows. These improvements were partially offset by an increase in our expense ratio, primarily associated with a decrease in ceding commissions.

Our revenues for the three months ended March 31, 2007, increased \$3.3 million, or 4.1%, to \$82.9 million, from \$79.6 million for the comparable period in 2006. This increase reflects a \$2.1 million, or 3.3%, increase in net earned premiums. The increase in net earned premiums is the result of selective growth consistent with our corporate underwriting guidelines and our controls over price adequacy, partially offset by a reduction in residual market premiums that are assigned to us as a result of a decrease in the estimate of the overall size of the residual market. We experienced slight revenue growth within our fee-for-service programs and agency operations, which increased \$262,000, or 2.3%, in comparison to the first quarter of 2006. In addition, the increase in revenue reflects a \$917,000 increase in investment income, primarily the result of an increase in average invested assets due to positive cash flow and a slight increase in yield.

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The following table sets forth the revenues and results from operations for specialty risk management operations (in thousands):

	For the Three Months Ended March 31,	
	2007	2006
Revenue:		
Net earned premiums	\$ 65,204	\$ 63,124
Management fees	4,875	4,531
Claims fees	2,204	2,100
Loss control fees	599	538
Reinsurance placement	333	418
Investment income	5,930	5,030
Net realized losses	(6)	(7)
Total revenue	\$ 79,139	\$ 75,734
Pre-tax income		
Specialty risk management operations	\$ 11,253	\$ 9,298

Our revenues from specialty risk management operations increased \$3.4 million, or 4.5%, to \$79.1 million for the three months ended March 31, 2007 from \$75.7 million for the comparable period in 2006.

Net earned premiums increased \$2.1 million, or 3.3%, to \$65.2 million for the three months ended March 31, 2007, from \$63.1 million in the comparable period in 2006. As previously indicated, this increase is the result of selective growth consistent with our corporate underwriting guidelines and our controls over price adequacy, partially offset by the previously mention reduction in residual market premiums.

Management fees increased \$344,000, or 7.6%, to \$4.9 million for the three months ended March 31, 2007, from \$4.5 million for the comparable period in 2006. This increase is primarily the result of the recognition of \$250,000 in profit sharing revenue received related to a specific managed program.

Claim fees increased \$104,000, or 5.0%, to \$2.2 million, from \$2.1 million for the comparable period in 2006. This increase is primarily the result of our 2006 entry into the self-insured workers compensation market in Nevada.

Net investment income increased \$900,000, or 17.9%, to \$5.9 million in 2007, from \$5.0 million in 2006. Average invested assets increased \$76.3 million, or 16.4%, to \$540.3 million in 2007, from \$464.0 million in 2006. The increase in average invested assets reflects cash flows from continued favorable underwriting results and an increase in the duration of our reserves. The increase in the duration of our reserves reflects the impact of growth in our excess liability business, which was implemented at the end of 2003. This type of business has a longer duration than the average reserves on our other programs and is now a larger proportion of reserves. The average investment yield for March 31, 2007, was 4.56%, compared to 4.52% for the comparable period in 2006. The current pre-tax book yield was 4.36%. The current after-tax book yield was 3.34%, compared to 3.15% in 2006. This increase is primarily the result of the shift in our investment portfolio to tax-exempt investments. The duration of the investment portfolio is 4.0 years.

Our specialty risk management operations generated pre-tax income of \$11.3 million for the three months ended March 31, 2007, compared to pre-tax income of \$9.3 million for the comparable period in 2006. This increase in pre-tax income demonstrates a continued improvement in underwriting results as a result of prior accident reserve redundancies, our selective growth in premium, adherence to our strict underwriting guidelines, and our continued focus on process improvements through technology and training. In addition, this improvement was also attributable to an increase in net investment income. These improvements were partially offset by an increase in our expense ratio. The GAAP combined ratio was 96.3% for the three months ended March 31, 2007, compared to 96.2% for the same period in 2006.

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Net loss and loss adjustment expenses (LAE) decreased \$397,000, to \$36.6 million for the three months ended March 31, 2007, from \$37.0 million for the same period in 2006. Our loss and LAE ratio improved 2.4 percentage points to 61.3% for the three months ended March 31, 2007, from 63.7% for the same period in 2006. This ratio is the unconsolidated net loss and LAE in relation to net earned premiums. The accident year loss ratio for the three months ended March 31, 2007 was 64.7%, compared to 63.9% for the same period in 2006. The increase in accident year loss and LAE ratio primarily reflects the anticipated impact of a slightly more competitive insurance market. The calendar year loss and LAE ratio of 61.3% includes favorable development of \$2.2 million, or 3.4 percentage points. This favorable development primarily reflects favorable claim settlements in the professional liability and workers compensation lines of business. Offsetting these improvements was unfavorable development within the general liability and auto liability lines of business. The unfavorable development within the general liability line of business reflects greater than expected claim activity within an excess liability program. The unfavorable development within the auto liability line of business was primarily the result of unexpected case reserve increases within our California-based energy program. Additional discussion of our reserve activity is described below within the *Other Items Reserves* section.

Our expense ratio increased 2.5 percentage points to 35.0% for the three months ended March 31, 2007, from 32.5% for the same period in 2006. This ratio is the unconsolidated policy acquisition and other underwriting expenses in relation to net earned premiums. This increase within our expense ratio is primarily the result of a decrease in ceding commissions. The decrease in ceding commissions is the result of a decrease in premiums and the consequent decrease in net fees received from one specific program in which we assume limited risk. For financial reporting purposes, these fees are included in a ceding commission and are treated as a reduction in underwriting expenses. In addition, the expense ratio for the first quarter of 2006 had reflected a reduction in certain insurance related assessments.

Agency Operations

The following table sets forth the revenues and results from operations from our agency operations (in thousands):

	For the Three Months Ended March 31,	
	2007	2006
Net commission	\$ 3,885	\$ 4,261
Pre-tax income(1)	\$ 1,294	\$ 1,651

- (1) Our agency operations include an allocation of corporate overhead, which includes expenses associated with accounting, information services, legal, and other corporate services. The corporate overhead allocation excludes those expenses specific to the holding company. For the three months ended March 31, 2007 and 2006, the allocation of corporate overhead to the agency operations segment was \$719,000 and \$825,000, respectively.

Our revenue from agency operations, which consists primarily of agency commission revenue, decreased \$376,000, or 8.8%, to \$3.9 million for the three months ended March 31, 2007, from \$4.3 million for the comparable period in 2006. This decrease is primarily the result of a reduction in premium on client renewals due to a more competitive pricing environment primarily on our larger Michigan accounts.

Our agency operations generated pre-tax income, after the allocation of corporate overhead, of \$1.3 million for the three months ended March 31, 2007, compared to \$1.7 million for the comparable period in 2006. The decrease in the

pre-tax income is primarily attributable to the decrease in agency commission revenue mentioned above.

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At March 31, 2007, our best estimate for the ultimate liability for loss and LAE reserves, net of reinsurance recoverables, was \$313.0 million. We established a reasonable range of reserves of approximately \$291.0 million to \$333.0 million. This range was established primarily by considering the various indications derived from standard actuarial techniques and other appropriate reserve considerations. The following table sets forth this range by line of business (in thousands):

Line of Business	Minimum Reserve Range	Maximum Reserve Range	Selected Reserves
Workers Compensation(1)	\$ 154,090	\$ 170,364	\$ 163,590
Commercial Multiple Peril/General Liability	62,837	76,526	69,032
Commercial Automobile	56,122	63,564	59,983
Other	17,992	22,506	20,349
Total Net Reserves	\$ 291,041	\$ 332,960	\$ 312,954

(1) Includes Residual Markets

Reserves are reviewed by internal and independent actuaries for adequacy on a quarterly basis. When reviewing reserves, we analyze historical data and estimate the impact of numerous factors such as (1) per claim information; (2) industry and our historical loss experience; (3) legislative enactments, judicial decisions, legal developments in the imposition of damages, and changes in political attitudes; and (4) trends in general economic conditions, including the effects of inflation. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of reserves, because the eventual deficiency or redundancy is affected by multiple factors.

The key assumptions used in our selection of ultimate reserves included the underlying actuarial methodologies, a review of current pricing and underwriting initiatives, an evaluation of reinsurance costs and retention levels, and a detailed claims analysis with an emphasis on how aggressive claims handling may be impacting the paid and incurred loss data trends embedded in the traditional actuarial methods. With respect to the ultimate estimates for losses and LAE, the key assumptions remained consistent for the three months ended March 31, 2007 and the years ended December 31, 2006 and 2005.

For the three months ended March 31, 2007, we reported a decrease in net ultimate loss estimates for accident years 2006 and prior of \$2.2 million, or 0.7% of \$302.7 million of net loss and LAE reserves at December 31, 2006. The decrease in net ultimate loss estimates reflected revisions in the estimated reserves as a result of actual claims activity in calendar year 2007 that differed from the projected activity. There were no significant changes in the key

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assumptions utilized in the analysis and calculations of our reserves during 2006 and for the three months ended March 31, 2007. The major components of this change in ultimate loss estimates are as follows (in thousands):

Line of Business	Reserves at December 31,	Incurred Losses			Paid Losses			Reserves at March 31,
	2006	Current Year	Prior Years	Total Incurred	Current Year	Prior Years	Total Paid	2007
Workers Compensation	\$ 137,113	\$ 14,200	\$ (2,759)	\$ 11,441	\$ (655)	\$ 11,162	\$ 10,507	\$ 138,047
Residual Markets	26,098	2,693	(1,515)	1,178	1,479	254	1,733	25,543
Commercial Multiple Peril/General Liability	63,056	6,662	3,103	9,765	(217)	4,006	3,789	69,032
Commercial Automobile	54,642	11,312	954	12,266	722	6,203	6,925	59,983
Other	21,746	4,009	(2,013)	1,996	243	3,150	3,393	20,349
Net Reserves	302,655	\$ 38,876	\$ (2,230)	\$ 36,646	\$ 1,572	\$ 24,775	\$ 26,347	312,954
Reinsurance Recoverable	198,422							201,879
Consolidated	\$ 501,077							\$ 514,833

Line of Business	Reserves at December 31, 2006	Re-Estimated Reserves at March 31, 2007 on Prior Years	Development as a Percentage of Prior Year Reserves
Workers Compensation	\$ 137,113	\$ 134,354	(2.0)%
Commercial Multiple Peril/General Liability	63,056	66,159	4.9%
Commercial Automobile	54,642	55,596	1.7%
Other	21,746	19,733	(9.3)%
Sub-total	276,557	275,842	(0.3)%
Residual Markets	26,098	24,583	(5.8)%
Total Net Reserves	\$ 302,655	\$ 300,425	(0.7)%

Workers Compensation Excluding Residual Markets The projected net ultimate loss estimate for the workers compensation line of business excluding residual markets decreased \$2.8 million, or 2.0% of net workers compensation reserves. This net overall decrease reflects decreases of \$1.0 million and \$691,000 in accident years 2005 and 2004, respectively. These decreases reflect better than expected experience for many of our workers compensation programs, including a Nevada, Florida, Tennessee, and Alabama program. Average severity on reported

claims did not increase as much as anticipated in the prior actuarial projections and, therefore, ultimate loss estimates were reduced. The change in ultimate loss estimates for all other accident years was insignificant.

Commercial Multiple Peril and General Liability The commercial multiple peril line and general liability line of business had an increase in net ultimate loss estimates of \$3.1 million, or 4.9% of net commercial multiple peril and general liability reserves. The net increase reflects increases of \$355,000, \$2.4 million, and \$229,000 in the ultimate loss estimates for accident years 2005, 2004 and 2000, which were primarily due to larger than expected claim emergence in a Florida-based program. This emergence reflects greater than expected claim activity within the excess liability program. The change in ultimate loss estimates for all other accident years was insignificant.

Commercial Automobile The projected net ultimate loss estimate for the commercial automobile line of business increased \$954,000, or 1.7% of net commercial automobile reserves. This net overall increase reflects increases of \$602,000 and \$1.4 million in accident years 2005 and 2004, respectively. These increases primarily reflect higher than expected emergence of claim activity in four California-based programs. These increases were

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offset by decreases of \$662,000 and \$231,000 in accident years 2006 and 2003, respectively. Three of the four California programs mentioned above contributed to these decreases. The change in ultimate loss estimates for all other accident years was insignificant.

Other The projected net ultimate loss estimate for the other lines of business decreased \$2.0 million, or 9.3% of net reserves. This net decrease reflects decreases of \$334,000, \$957,000, and \$425,000, in the net ultimate loss estimate for accident years 2006, 2005, and 2004, respectively. These decreases were due to better than expected case reserve development during the calendar year in a medical malpractice program. The change in ultimate loss estimates for all other accident years was insignificant.

Residual Markets The workers' compensation residual market line of business had a decrease in net ultimate loss estimates of \$1.5 million, or 5.8% of net reserves. This decrease reflects reductions of \$1.4 million and \$946,000 in accident years 2005 and 2004, respectively. Offsetting these decreases was an increase of \$803,000 in accident year 2006. We record loss reserves as reported by the National Council on Compensation Insurance (NCCI), plus a provision for the reserves incurred but not yet analyzed and reported to us due to a two quarter lag in reporting. These changes reflect a difference between our estimate of the lag incurred but not reported and the amounts reported by the NCCI in the quarter. The change in ultimate loss estimates for all other accident years was insignificant.

Salary and Employee Benefits and Other Administrative Expenses

Salary and employee benefits for the three months ended March 31, 2007, increased \$164,000, or 1.2%, to \$13.5 million, from \$13.4 million for the comparable period in 2006. This increase primarily reflects a slight increase in staffing levels in comparison to 2006, partially offset by a decrease in variable compensation. The decrease in variable compensation reflects the increase in our targeted return on equity.

Other administrative expenses decreased \$422,000, or 5.3%, to \$7.5 million, from \$7.9 million for the comparable period in 2006. This decrease in other administrative expenses is primarily related to a decrease in policyholder dividends. In addition, there were various decreases in other general operating expenses in comparison to 2006.

Salary and employee benefits and other administrative expenses include both corporate overhead and the holding company expenses included in the non-allocated expenses of our segment information.

Interest Expense

Our interest expense increased slightly in comparison to 2006. Interest expense for the three months ended March 31, 2007, increased \$100,000, or 7.2%, to \$1.5 million, from \$1.4 million for the comparable period in 2006. Interest expense is primarily attributable to our debentures, which are described within the *Liquidity and Capital Resources* section of Management's Discussion and Analysis, as well as our line of credit. The average outstanding balance on our line of credit during the three months ending March 31, 2007, was \$9.6 million, compared to \$8.3 million for the same period in 2006. The average interest rate, excluding the debentures, was approximately 6.7% in 2007, compared to 6.2% in 2006.

Income Taxes

Our income tax expense, which includes both federal and state taxes, for the three months ended March 31, 2007, was \$3.1 million, or 31.3% of income before taxes. For the same period last year, we reflected an income tax expense of \$2.8 million, or 33.6% of income before taxes. The decrease in our tax rate from 2006 to 2007 primarily reflects a higher level of tax exempt securities in our investment portfolio, slightly offset by a higher level of income within our fee-based operations, which are taxed at a 35% Federal tax rate. Our tax exempt securities as a percentage of total

invested assets were 45.3% and 36.8% at March 31, 2007 and 2006, respectively.

Years ended December 31, 2006 and 2005

Our gross written premium was down slightly in comparison to 2005. This slight decrease was primarily the result of exiting a limited number of small programs that no longer met our pricing standards, therefore reducing

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premium volume in certain limited programs in which pricing competition dictates that we write less volume and maintaining pricing discipline throughout the organization. In addition, this decrease was the result of a reduction in audit related premiums. We continue to follow pricing guidelines mandated by our corporate underwriting guidelines. Overall, our year-to-date rate change was relatively flat. In 2006, there were anticipated mandatory rate decreases in workers' compensation in some states, but for the most part those were offset by benefit changes that should lower incurred losses. We implemented several new programs in 2006 and continue to be selective on new program implementation by focusing on those that meet our underwriting guidelines and have a history of profitability.

Our net income improved \$4.1 million, or 23.0%, to \$22.0 million, or \$0.75 per diluted share, in 2006, from net income of \$17.9 million, or \$0.60 per diluted share, in 2005. As previously indicated, this improvement is primarily the result of our selective growth consistent with our corporate underwriting guidelines and our controls over price adequacy. In addition, during 2005 we increased our retention levels on certain reinsurance treaties, which favorably impacted net earned premiums and net income for 2006, compared to 2005. Growth in our fee-for-service programs also contributed to the overall improvement in net income in comparison to 2005.

Our revenues increased \$14.2 million, or 4.7%, to \$318.2 million for the year ended December 31, 2006, from \$304.0 million for the comparable period in 2005. This increase reflects a \$4.9 million, or 2.0%, increase in net earned premiums. The increase in net earned premiums is the result of our selective growth consistent with our corporate underwriting guidelines and our controls over price adequacy, as well as the favorable impact from an increase in our retention levels on certain reinsurance treaties effective in 2005. Offsetting the overall increase in net earned premiums for the year ended December 31, 2006, was a reduction in audit related premiums in comparison to 2005. The increase in revenue was also the result of an overall increase in fee-for-service revenue, primarily as a result of new managed programs. In addition, the increase in revenue reflects a \$4.1 million increase in investment income, primarily due to an increase in average invested assets as a result of improved cashflow from favorable underwriting results, an increase in the duration of our reserves, and proceeds from the junior subordinated debentures issued in the third quarter of 2005. The increase in investment income is also the result of a slight increase in yield.

Years ended December 31, 2005 and 2004

Our net income improved \$3.8 million, or 27.4%, to \$17.9 million, or \$0.60 per diluted share, in 2005, from net income of \$14.1 million, or \$0.48 per diluted share, in 2004. This improvement was primarily the result of our controlled growth of premiums written, the impact from rate increases in 2004 and 2005, overall expense initiatives, and the continued leveraging of fixed costs. In addition, we increased our retention levels on certain reinsurance treaties, which favorably impacted net earned premiums and net income. These improvements manifested, despite the favorable effect in the third quarter of 2004, from the acceleration of \$3.5 million in deferred revenue, less approximately \$500,000 in expenses and \$1.0 million in taxes, relating to the early termination of a specific multi-state claims run-off contract. Net income was also favorably impacted by approximately \$814,000 from profit-sharing commissions received in 2005, partially offset by continuing expenses primarily related to implementation and compliance with Section 404 of the Sarbanes-Oxley Act. In addition, net income was favorably impacted as a result of a \$386,000 increase in the deferred tax asset relating to the increase in the statutory federal tax rate from 34% to 35%.

Our revenues increased \$33.7 million, or 12.5%, to \$304.0 million for the year ended December 31, 2005, from \$270.3 million for the comparable period in 2004. This increase reflected a \$35.5 million, or 16.5%, increase in net earned premiums. The increase in net earned premiums was the result of our controlled growth in written premiums from various existing programs and new programs implemented in 2004, a higher retention on certain reinsurance treaties effective in 2005, and the impact of an overall 8.4% rate increase in 2004. Partially offsetting these increases in revenue was an approximate \$5.5 million decrease in managed fee revenue, which was primarily the result of an acceleration of \$3.5 million in deferred claim fee revenue recognized in the third quarter of 2004. This comparative

decrease in managed fee revenue in 2005 was due to the acceleration of deferred claim fee revenue in 2004, as the result of an earlier than anticipated termination of two limited duration administrative services and multi-state claims run-off contracts. These contracts had been terminated by the liquidator for the companies during the third quarter of 2004. Therefore, the revenues that we anticipated earning in the first nine months of 2005 were

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accelerated into the third quarter of 2004. In addition, the increase in revenue reflected a \$3.1 million increase in investment income, primarily the result of an increase in average invested assets and a slight increase in yield.

Specialty Risk Management Operations

The following table sets forth the revenues and results from operations for our specialty risk management operations (in thousands):

	For the Years Ended December 31,		
	2006	2005	2004
Revenue:			
Net earned premiums	\$ 254,920	\$ 249,959	\$ 214,493
Management fees	18,714	16,741	16,253
Claims fees(1)	8,776	7,113	13,207
Loss control fees	2,216	2,260	2,174
Reinsurance placement	735	660	420
Investment income	21,115	17,692	14,887
Net realized gains	69	85	339
Total revenue	\$ 306,545	\$ 294,510	\$ 261,773
Pre-tax income			
Specialty risk management operations	\$ 37,950	\$ 29,444	\$ 23,205

- (1) During 2004, we accelerated the recognition of \$3.5 million in deferred claim revenue, as a result of an earlier than anticipated termination of two limited duration administrative services and multi-state claims run-off contracts. These contracts had been terminated by the liquidator for the companies during the third quarter of 2004. Had the contract not been terminated, we would have received additional claims fee revenue for continued claims handling services.

Years ended December 31, 2006 and 2005. Our revenues from specialty risk management operations increased \$12.0 million, or 4.1%, to \$306.5 million for the year ended December 31, 2006, from \$294.5 million for the comparable period in 2005.

Net earned premiums increased \$4.9 million, or 2.0%, to \$254.9 million for the year ended December 31, 2006, from \$250.0 million in the comparable period in 2005. This increase is primarily the result of selective growth consistent with our corporate underwriting guidelines and our controls over price adequacy, as well as the favorable impact from an increase in our retention levels on certain reinsurance treaties. Offsetting these increases was an overall decrease in audit related premiums in comparison to 2005, reflecting improvements in the estimation of exposures during the underwriting cycle.

Management fees increased \$2.0 million, or 11.8%, to \$18.7 million, for the year ended December 31, 2006, from \$16.7 million for the comparable period in 2005. This increase is primarily the result of a Florida-based program implemented in the second quarter of 2005. In addition, this increase is the result of growth in a specific New England-based program. Also contributing to the overall increase in management fees was the recognition of \$250,000 from a profit-based revenue sharing payment related to a specific managed program.

Claim fees increased \$1.7 million, or 23.4%, to \$8.8 million, from \$7.1 million for the comparable period in 2005. This increase is primarily the result of our 2006 entry into the self-insured workers' compensation market in Nevada. In addition, this increase is the result of increases in revenue related to a specific Minnesota-based program, as well as a Florida-based program, which was implemented in the second quarter of 2005.

Net investment income increased \$4.1 million, or 22.8%, to \$22.1 million in 2006, from \$18.0 million in 2005. Average invested assets increased \$69.6 million, or 16.4%, to \$493.9 million in 2006, from \$424.3 million in 2005. The increase in average invested assets reflects cash flows from underwriting activities primarily from favorable underwriting results and an increase in the duration of our reserves. The increase in the duration of our reserves reflects the impact of our public entity excess program, which was implemented at the end of 2003. This program

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has a longer duration than the average reserves on our remaining programs and is a larger proportion of reserves. In addition, the \$19.4 million in net proceeds received from capital raised in 2005 through the issuances of debentures increased average invested assets. The average investment yield for 2006 was 4.47%, compared to 4.24% in 2005. The current pre-tax book yield was 4.35%. The current after-tax book yield was 3.28%, compared to 3.06% in 2005. This increase is primarily the result of the shift in our investment portfolio to tax-exempt investments. The duration of the investment portfolio is 3.9 years.

Our specialty risk management operations generated pre-tax income of \$38.0 million for the year ended December 31, 2006, compared to pre-tax income of \$29.4 million for the year ended December 31, 2005. This increase in pre-tax income demonstrates a continued improvement in underwriting results as a result of our controlled growth in premium volume and our continued focus on leveraging of fixed costs. The GAAP combined ratio was 96.8% for the year ended December 31, 2006, compared to 98.7% for the comparable period in 2005.

Net losses and loss adjustment expenses (LAE) decreased \$5.2 million, or 3.5%, to \$146.3 million for the year ended December 31, 2006, from \$151.5 million for the same period in 2005. Our loss and LAE ratio improved 2.9 percentage points to 62.3% for the year ended December 31, 2006, from 65.2% for the same period in 2005. This ratio is the unconsolidated net loss and LAE in relation to net earned premiums. The accident year loss ratio remained flat at 63.4% for 2006, compared to 63.3% in 2005. The favorable development in our loss ratio was primarily the result of improvement in frequency and claim settlements within the professional liability line of business. In addition, workers' compensation residual market experience improved as a result of lower market share assessments and lower loss reserves on the industry pooled experience. Both 2006 and 2005, were adversely impacted by a single large workers' compensation claim. The increase was \$1.5 million and \$900,000 in 2006 and 2005, respectively. Excluding the adverse impact of this claim, overall workers' compensation reflected improvement in claim settlements relative to their collective case reserves. The experience within the general liability line of business also improved due to favorable case reserve settlements in 2006, in comparison to 2005. These improvements were partially offset by a single property claim of \$1.9 million within a California-based agricultural program. Allowances within other reserve categories, collectively, did not contribute to the development in 2006, compared to 2005 where we experienced approximately \$1.3 million in adverse development related to allowances on reinsurance recoverables. Additional discussion of our reserve activity is described below within the Other Items Reserves section.

Our expense ratio for the year ended December 31, 2006 was 34.5%, compared to 33.5% in 2005. This ratio is the unconsolidated policy acquisition and other underwriting expenses in relation to net earned premiums. The increase in our expense ratio in comparison to 2005 reflects a reduction in an accrual for estimated profit-based ceding commissions on an excess reinsurance treaty for a specific commercial transportation program. This decrease was the result of unfavorable loss development on a limited number of excess of loss claims from prior accident years and added \$1.6 million to our expenses, or 0.6 percentage points to our expense ratio for the year, as compared to a favorable impact on the 2005 expense ratio of \$1.1 million, or 0.5 percentage points. As of December 31, 2006, the remaining accrual was less than \$150,000; therefore, we do not anticipate any further unfavorable adjustments. Offsetting this increase in the expense ratio was a reduction in insurance related assessments primarily related to the guaranty fund in Florida and Nevada.

Years ended December 31, 2005 and 2004. Our revenues from specialty risk management operations increased \$32.7 million, or 12.5%, to \$294.5 million for the year ended December 31, 2005, from \$261.8 million for the comparable period in 2004.

Net earned premiums increased \$35.5 million, or 16.5%, to \$250.0 million for the year ended December 31, 2005, from \$214.5 million in the comparable period in 2004. This increase primarily reflected our controlled growth of premiums written, as well as a favorable impact from an increase in our retention levels on certain reinsurance treaties.

Management fees increased \$488,000, or 3.0%, to \$16.8 million, for the year ended December 31, 2005, from \$16.3 million for the comparable period in 2004. Management fees were impacted by an anticipated shift in fee-for-service revenue previously generated from a third party contract to internally generated fee revenue from a specific renewal rights agreement that is eliminated upon consolidation. Due to the earlier than anticipated termination of this third party contract, the revenues we anticipated earning in 2005 were accelerated into the third quarter of 2004.

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Excluding revenue generated from this third party contract, management fee revenue increased approximately \$1.7 million, or 11.1%, in comparison to 2004. This increase was primarily the result of a new Florida-based program implemented in the second quarter of 2005, as well as growth in a specific existing New England-based program.

Claim fees decreased \$6.1 million, or 46.1%, to \$7.1 million, from \$13.2 million for the comparable period in 2004. This decrease reflected a similar anticipated shifting of revenue previously generated from a multi-state claims run-off service contract, to internally generated fee revenue from a specific renewal rights agreement that is eliminated upon consolidation. Also impacting this comparison was the effect of the earlier than anticipated termination of the third party contract, which caused the revenues we anticipated earning in 2005 to be accelerated into the third quarter of 2004. Excluding revenue generated from this third party contract, claim fee revenue would have remained relatively consistent in comparison to 2004.

Net investment income increased \$3.1 million, or 20.5%, to \$18.0 million in 2005, from \$14.9 million in 2004. Average invested assets increased \$65.6 million, or 18.3%, to \$424.3 million in 2005, from \$358.7 million in 2004. The increase in average invested assets reflected cash flows from underwriting activities and growth in gross written premiums during 2004 and 2005, as well as net proceeds from capital raised in 2004 and 2005 through the issuances of debentures. The average investment yield for 2005 was 4.24%, compared to 4.16% in 2004. The current pre-tax book yield was 4.17%. The current after-tax book yield was 3.06%, compared to 2.85% in 2004.

Our specialty risk management operations generated pre-tax income of \$29.4 million for the year ended December 31, 2005, compared to pre-tax income of \$23.2 million for the year ended December 31, 2004. This increase in pre-tax income demonstrated a continued improvement in underwriting results as a result of our controlled growth in premium volume and our continued focus on leveraging of fixed costs. Offsetting a portion of this improvement, was a \$3.0 million pre-tax benefit, recognized in the third quarter of 2004, from the previously mentioned acceleration of revenue recognition, net of expenses, relating to the termination of a specific multi-state claims run-off contract. The GAAP combined ratio was 98.7% for the year ended December 31, 2005, compared to 101.4% for the comparable period in 2004.

Net losses and loss adjustment expenses increased \$15.6 million, or 11.5%, to \$151.5 million for the year ended December 31, 2005, from \$135.9 million for the same period in 2004. Our loss and LAE ratio improved 2.7 percentage points to 65.2% for the year ended December 31, 2005, from 67.9% for the same period in 2004. This ratio is the unconsolidated net loss and LAE in relation to net earned premiums. The accident year loss ratio improved 2.5 percentage points to 63.3% for the year ended December 31, 2005, from 65.8% for the same period in 2004. This overall improvement in the loss ratio reflects the impact of earned premiums from the controlled growth of profitable programs which had favorable underwriting experience, as well as our intended shift in our mix of business between workers compensation and general liability. Historically, the general liability line of business has a lower loss ratio and a higher external producer commission. In addition, the loss ratio was favorably impacted as a result of efficiencies realized in our claims handling activities. These improvements were partially offset by a single large workers compensation claim of \$900,000, as well as an increase to an exposure allowance of \$1.5 million, specific to reinsurance recoverables for a discontinued surety program and a discontinued workers compensation program. Although we increased our allowance for these specific exposures, the actual exposures did not increase.

Our expense ratio for the years ended December 31, 2005 and 2004 was 33.5%. This ratio is the unconsolidated policy acquisition and other underwriting expenses in relation to net earned premiums. Our expense ratio was impacted by an anticipated increase in gross external commissions, due to the shift in our mix of business between workers compensation and general liability. The general liability line of business has a higher external producer commission rate and, as previously indicated, a lower loss ratio. Offsetting these increases to the expense ratio was the impact of the leveraging of fixed costs.

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The following table sets forth the revenues and results from operations from our agency operations (in thousands):

	For the Years Ended December 31,		
	2006	2005	2004
Net commission	\$ 12,285	\$ 11,304	\$ 9,805
Pre-tax income(1)	\$ 2,951	\$ 3,343	\$ 2,257

- (1) Our agency operations include an allocation of corporate overhead, which includes expenses associated with accounting, information services, legal, and other corporate services. The corporate overhead allocation excludes those expenses specific to the holding company. For the years ended December 31, 2006, 2005, and 2004, the allocation of corporate overhead to the agency operations segment was \$2.9 million, \$3.1 million, and \$3.5 million, respectively.

Years ended December 31, 2006 and 2005. Our revenue from agency operations, which consists primarily of agency commission revenue, increased \$1.0 million, or 8.7%, to \$12.3 million for the year ended December 31, 2006, from \$11.3 million for the comparable period in 2005. This increase is primarily the result of the November 2005 acquisition of a Florida-based retail agency and an increase in profit sharing commissions in comparison to 2005. Offsetting these increases was a decrease in commission revenue as a result of a reduction in premium on client renewals.

Our agency operations generated pre-tax income, after the allocation of corporate overhead, of \$3.0 million for the year ended December 31, 2006, compared to \$3.3 million for the comparable period in 2005. This decrease in pre-tax income in comparison to 2005 is primarily the result of a slight increase in operating expenses coupled with the decrease in commission revenue noted above as a result of the reduction in premium on client renewals, offset by the favorable impact from the Florida-based retail agency acquisition.

Years ended December 31, 2005 and 2004. Our revenue from agency operations, which consists primarily of agency commission revenue, increased \$1.5 million, or 15.3%, to \$11.3 million for the year ended December 31, 2005, from \$9.8 million for the comparable period in 2004. This increase was primarily the result of profit sharing commissions received in the first and third quarter of 2005. In addition, the agency operations experienced an increase in new business and renewal retentions in comparison to 2004, which was partially offset by a reduction in renewal rates.

Our agency operations generated pre-tax income, after the allocation of corporate overhead, of \$3.3 million for the year ended December 31, 2005, compared to \$2.3 million for the comparable period in 2004. The improvement in the pre-tax margin was primarily attributable to the overall increase in commissions and leveraging of fixed costs. Excluding fixed costs and the allocation of corporate overhead, all other expenses remained relatively consistent.

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At December 31, 2006, our best estimate for the ultimate liability for loss and LAE reserves, net of reinsurance recoverables, was \$302.7 million. We established a reasonable range of reserves of approximately \$280.3 million to \$318.1 million. This range was established primarily by considering the various indications derived from standard actuarial techniques and other appropriate reserve considerations. The following table sets forth this range by line of business (in thousands):

Line of Business	Minimum Reserve Range	Maximum Reserve Range	Selected Reserves
Workers Compensation(1)	\$ 154,145	\$ 170,385	\$ 163,211
Commercial Multiple Peril/General Liability	57,250	68,729	63,056
Commercial Automobile	49,718	56,049	54,642
Other	19,174	22,940	21,746
Total Net Reserves	\$ 280,287	\$ 318,103	\$ 302,655

(1) Includes Residual Markets

For the year ended December 31, 2006, we reported a decrease in net ultimate loss estimates for accident years 2005 and prior of \$2.7 million, or 1.0% of \$271.4 million of net loss and LAE reserves at December 31, 2005. The decrease in net ultimate loss estimates reflected revisions in the estimated reserves as a result of actual claims activity in calendar year 2006 that differed from the projected activity. There were no significant changes in the key assumptions utilized in the analysis and calculations of our reserves during 2006 and 2005. The major components of this change in ultimate loss estimates are as follows (in thousands):

Line of Business	Reserves at December 31, 2005	Current Year	Inurred Losses Prior Years	Total Incurred	Current Year	Paid Losses Prior Years	Total Paid	Reserves at December 31, 2006
Workers Compensation	\$ 128,802	\$ 58,687	\$ (920)	\$ 57,767	\$ 8,850	\$ 40,606	\$ 49,456	\$ 137,113
Residual Markets	24,440	10,920	(848)	10,072	4,248	4,166	8,414	26,098
Commercial Multiple Peril/General Liability	52,506	24,985	284	25,269	2,545	12,174	14,719	63,056
Commercial Automobile	44,382	37,305	596	37,901	9,202	18,439	27,641	54,642
Other	21,293	17,115	(1,831)	15,284	6,945	7,886	14,831	21,746
Net Reserves	271,423	\$ 149,012	\$ (2,719)	\$ 146,293	\$ 31,790	\$ 83,271	\$ 115,061	302,655
Reinsurance Recoverable	187,254							198,422
Consolidated	\$ 458,677							\$ 501,077

Line of Business	Reserves at December 31, 2005	Re-Estimated Reserves at December 31, 2006 on Prior Years	Development as a Percentage of Prior Year Reserves
Workers Compensation	\$ 128,802	\$ 127,882	(0.7)%
Commercial Multiple Peril/General Liability	52,506	52,790	0.5%
Commercial Automobile	44,382	44,978	1.3%
Other	21,293	19,462	(8.6)%
Sub-total	246,983	245,112	(0.8)%
Residual Markets	24,440	23,592	(3.5)%
Total Net Reserves	\$ 271,423	\$ 268,704	(1.0)%

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Workers Compensation Excluding Residual Markets The projected net ultimate loss estimate for the workers compensation line of business, excluding residual markets, decreased \$920,000, or 0.7% of net workers compensation reserves. This net overall decrease reflects decreases of \$837,000, \$1.7 million, and \$592,000 in the ultimate loss estimates for accident years 2005, 2004, and 2001, respectively. These decreases reflect better than expected experience for many of our workers compensation programs, including a Nevada program, a Florida program, a Tennessee program, and an Alabama program. Average severity on reported claims did not increase as much as anticipated in the prior actuarial projections so ultimate loss estimates were reduced. These decreases were offset by increases of \$1.6 million, \$631,000, and \$766,000 in the ultimate loss estimate for accident years 2003, 2000, and 1998, respectively. These increases reflect some large claim activity and case reserve strengthening primarily related to a Massachusetts program and a large claim in a Florida program. The change in ultimate loss estimates for all other accident years was insignificant.

Commercial Multiple Peril and General Liability The commercial multiple peril line and general liability line of business had an increase in net ultimate loss estimates of \$284,000, or 0.5% of net commercial multiple peril and general liability reserves. The net increase reflects increases of \$239,000, \$439,000, and \$260,000 in the ultimate loss estimates for accident years 2002, 2000, and 1995, respectively. These increases reflect greater than expected claim activity within a California program and a Missouri program. These increases also reflect a large settlement in an inactive national program. These increases were offset by decreases of \$907,000 and \$350,000 in accident years 2005 and 2003, respectively. These decreases reflect better than expected claim emergence in a California program and the aforementioned Missouri program. The change in ultimate loss estimates for all other accident years was insignificant.

Commercial Automobile The projected net ultimate loss estimate for the commercial automobile line of business increased \$596,000, or 1.3% of net commercial automobile reserves. This net overall increase reflects increases of \$1.5 million and \$596,000 in accident years 2005 and 2003, respectively. These increases reflect higher than expected emergence of claim activity in two California-based programs. These increases were offset by decreases of \$1.6 million and \$352,000 in accident years 2004 and 2001, respectively. These decreases reflect better than expected claim emergence within a California-based program. The change in ultimate loss estimates for all other accident years was insignificant.

Other The projected net ultimate loss estimate for the other lines of business decreased \$1.8 million, or 8.6% of net reserves. This net decrease reflects a reduction of \$1.7 million in accident year 2004. This decrease is due to better than expected case reserve development in a medical malpractice program, offset by an increase of \$254,000 in accident year 2005. This increase in accident year 2005 is the result of a claim within a specific California-based program. The change in ultimate loss estimates for all other accident years was insignificant.

Residual Markets The workers compensation residual market line of business had a decrease in net ultimate loss estimates of \$848,000, or 3.5% of net reserves. This decrease reflects reductions of \$1.2 million, \$618,000, and \$294,000 in accident years 2004, 2003, and 2002, respectively. Offsetting these decreases was an increase of \$1.2 million in accident year 2005. We record loss reserves as reported by the National Council on Compensation Insurance (NCCI), plus a provision for the reserves incurred but not yet analyzed and reported to us due to a two quarter lag in reporting. These changes reflect a difference between our estimate of the lag incurred but not reported and the amounts reported by the NCCI in the quarter. The change in ultimate loss estimates for all other accident years was insignificant.

Salary and Employee Benefits and Other Administrative Expenses

Years ended December 31, 2006 and 2005. Salary and employee benefits increased \$3.3 million, or 6.3%, to \$54.6 million in 2006, from \$51.3 million for the comparable period in 2005. This increase primarily reflects an increase in variable compensation. In addition, this increase is the result of an increase in staffing levels, primarily as a

result of the recent additions of our Florida-based retail agency and our entry into the self-insured workers compensation market in Nevada. Excluding those additions, overall staffing levels for 2006 were slightly higher in comparison to 2005.

Other administrative expenses increased \$2.2 million, or 8.2%, to \$29.4 million in 2006, from \$27.2 million in 2005. A portion of this increase is the result of the expenses associated with the additions of our Florida-based

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agency and our entry into the self-insured workers' compensation market in Nevada. As revenues increase in these two locations we expect to see margins improve. In addition, the increase in other administrative expenses is the result of information technology enhancements and various increases in other general operating expenses in comparison to 2005.

Years ended December 31, 2005 and 2004. Salary and employee benefits decreased \$966,000, or 1.8%, to \$51.3 million in 2005, from \$52.3 million for the comparable period in 2004. This decrease primarily reflected a decrease in variable compensation, as a result of raising the performance targets for achievement. This decrease was partially offset by merit increases for associates. In addition, this decrease was partially due to a slight reduction in staffing levels in comparison to 2004 as a result of our expense control initiatives.

Other administrative expenses increased \$1.2 million, or 4.7%, to \$27.2 million in 2005, from \$26.0 million in 2004. This increase was primarily attributable to consulting and audit expenses associated with Section 404 of the Sarbanes-Oxley Act, as well as increases in expenses as the result of information technology enhancements. Offsetting these increases was a decrease in bad debt expense as a result of overall refinements in our estimation for allowances on bad debt. The increase in other administrative expenses was also offset by our overall expense control initiatives.

Interest Expense

Interest expense for 2006, 2005, and 2004 was \$6.0 million, \$3.9 million, and \$2.3 million, respectively. Interest expense is primarily attributable to our debentures and current lines of credit, which are described within the Liquidity and Capital Resources section of Management's Discussion and Analysis. The increase in interest expense was related to the issuance of the senior debentures issued in the second quarter of 2004 and the junior subordinated debentures issued in the third quarter of 2005, as well as an overall increase in the average interest rates. The average outstanding balance on our lines of credit was \$10.6 million, \$9.0 million, and \$14.8 million in 2006, 2005, and 2004, respectively. The average interest rate, excluding our debentures, was approximately 6.5%, 4.8%, and 5.2%, in 2006, 2005, and 2004, respectively, primarily as a result of increases in the underlying eurocurrency based rate.

Income Taxes

Income tax expense, which includes both federal and state taxes, for 2006, 2005 and 2004, was \$9.6 million, \$7.8 million, and \$6.4 million, or 30.5%, 30.2% and 31.2% of income before taxes, respectively. Our effective tax rate differs from the 35% statutory rate primarily due to a shift towards increasing investments in tax-exempt securities in an effort to maximize after-tax investment yields. Our current and deferred taxes are calculated using a 35% statutory rate.

Liquidity and Capital Resources

Our principal sources of funds, which include both regulated and non-regulated cash flows, are insurance premiums, investment income, proceeds from the maturity and sale of invested assets, risk management fees, and agency commissions. Funds are primarily available for the payment of claims, commissions, salaries and employee benefits, other operating expenses, shareholders' dividends, share repurchases, and debt service. Our regulated sources of funds are insurance premiums, investment income, and proceeds from the maturity and sale of invested assets. These regulated funds are used for the payment of claims, policy acquisition and other underwriting expenses, and taxes relating to the regulated portion of net income. Our non-regulated sources of funds are in the form of commission revenue, outside management fees, and intercompany management fees. Our internal capital resources include both non-regulated cash flow and excess capital in our Insurance Company Subsidiaries, which is defined as the dividend Star may issue without prior approval from our regulators. We review the excess capital in aggregate to determine the use of such capital. The general uses have historically included the following: contributions to our Insurance Company

Subsidiaries to support premium growth, select acquisitions, debt service, shareholders' dividends, share repurchases, investments in technology, and other expenses of the holding company.

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The following table illustrates net income, excluding interest, depreciation, and amortization, between our regulated and non-regulated subsidiaries, which reconciles to our consolidated statement of income and statement of cash flows (in thousands):

	For the Three Months Ended March 31, 2007 2006	
Net income	\$ 6,923	\$ 5,625
Insurance company subsidiaries:		
Net income, excluding interest, depreciation, and amortization	\$ 5,616	\$ 4,583
Adjustments to reconcile net income to net cash provided by operating activities	441	334
Changes in operating assets and liabilities	11,283	7,956
Total adjustments	11,724	8,290
Net cash provided by operating activities	\$ 17,340	\$ 12,873
Fee-based subsidiaries:		
Net income	\$ 1,307	\$ 1,042
Depreciation	737	543
Amortization	144	165
Interest	1,488	1,388
Net income, excluding interest, depreciation, and amortization	3,676	3,138
Adjustments to reconcile net income to net cash (used in) provided by operating activities	1,573	577
Changes in operating assets and liabilities	(3,068)	(1,420)
Total adjustments	(1,495)	(843)
Depreciation	(737)	(543)
Amortization	(144)	(165)
Interest	(1,488)	(1,388)
Net cash (used in) provided by operating activities	\$ (188)	\$ 199
Consolidated total adjustments	10,229	7,447
Consolidated net cash provided by operating activities	\$ 17,152	\$ 13,072

Consolidated cash flow provided by operations for the three months ended March 31, 2007 was \$17.2 million, compared to consolidated cash flow provided by operations of \$13.1 million for the comparable period in 2006.

Regulated subsidiaries cash flow provided by operations for the three months ended March 31, 2007 was \$17.3 million, compared to \$12.9 million for the comparable period in 2006. This increase is primarily the result of growth in our underwritten business, a reduction in paid losses as a result of improved claim activity, and an increase in investment income as a result of growth in our investment portfolio. Partially offsetting these improvements was an increase in payments related to policy acquisition costs.

Non-regulated subsidiaries cash flow used in operations for the three months ended March 31, 2007 was \$188,000, compared to cash flow provided by operations of \$199,000 for the comparable period in 2006. The decrease in cash flow from operations is primarily the result of variable compensation payments related to our long-term incentive plan, which were made in the first quarter of 2007 and related to 2006 performance and profitability. This decrease was partially offset by a slight increase in fee-based revenues.

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We continue to anticipate a temporary increase in cash outflows related to our investments in technology as we enhance our operating systems and controls. We believe these temporary increases will not affect our liquidity, debt covenants, or other key financial measures.

Years ended December 31, 2006, 2005, and 2004

	For the Years Ended December 31,		
	2006	2005	2004
Net income	\$ 22,034	\$ 17,910	\$ 14,061
Insurance Company Subsidiaries:			
Net income, excluding interest, depreciation, and amortization	\$ 19,712	\$ 13,508	\$ 6,973
Adjustments to reconcile net income to net cash provided by operating activities	3,033	3,003	6,866
Changes in operating assets and liabilities	46,915	59,784	48,270
Total adjustments	49,948	62,787	55,136
Net cash provided by operating activities	\$ 69,660	\$ 76,295	\$ 62,109
Fee-based Subsidiaries:			
Net income	\$ 2,322	\$ 4,402	\$ 7,088
Depreciation	2,553	2,452	1,591
Amortization	590	198	376
Interest	5,976	3,856	2,535
Net income, excluding interest, depreciation, and amortization	11,441	10,908	11,590
Adjustments to reconcile net income to net cash provided by (used in) operating activities	3,161	4,444	(1,063)
Changes in operating assets and liabilities	(852)	(3,194)	2,540
Total adjustments	2,309	1,250	1,477
Depreciation	(2,553)	(2,452)	(1,591)
Amortization	(590)	(198)	(376)
Interest	(5,976)	(3,856)	(2,535)
Net cash provided by operating activities	\$ 4,631	\$ 5,652	\$ 8,565
Consolidated total adjustments	52,257	64,037	56,613
Consolidated net cash provided by operating activities	\$ 74,291	\$ 81,947	\$ 70,674

Cash flow provided by operations was \$74.3 million in 2006, compared to \$81.9 million in 2005. Cash flow provided by operations in 2004 was \$70.7 million.

Years ended December 31, 2006 and 2005

Regulated subsidiaries cash flow provided by operations for the year ended December 31, 2006 was \$69.7 million, compared to \$76.3 million for the comparable period in 2005. This decrease was primarily the result of timing in relation to reinsurance payments. This decrease was slightly offset by improved underwriting results, lower paid losses in proportion to incurred losses, and an increase in investment income.

Non-regulated subsidiaries cash flow provided by operations for the year ended December 31, 2006 was \$4.6 million, compared to \$5.7 million for the comparable period in 2005. This decrease in cash flow in comparison to 2005 was primarily the result of a decrease in net income. The decrease in net income was primarily attributable to an increase in interest expense related to the issuance of the junior subordinated debentures issued in the third

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quarter of 2005 and an overall increase in average interest rates. In addition, the decrease in net income was the result of an increase in administrative costs related to the additions of our Florida-based agency and our entry into the self-insured workers' compensation market in Nevada, as well as an increase due to information technology enhancements. These increases were offset by an overall increase in fee-for-service and agency commission revenue.

Years ended December 31, 2005 and 2004

Regulated subsidiaries' cash flow provided by operations for the year ended December 31, 2005 was \$76.3 million, compared to \$62.1 million for the comparable period in 2004. This increase was the result of improved underwriting results and an increase in investment income, offset by a tax benefit reduction from the utilization of the net operating loss carryforward in 2004.

Non-regulated subsidiaries' cash flow provided by operations for the year ended December 31, 2005 was \$5.7 million, compared to \$8.6 million for the comparable period in 2004. The decrease in non-regulated cash flow from operations reflected the decrease in net income, which was primarily the result of the previously mentioned acceleration of revenue, recognized in the third quarter of 2004. In addition, the decrease in net income was the result of an increase in administrative costs related to compliance with Section 404 of the Sarbanes-Oxley Act, offset by an increase in revenue associated with profit-sharing commissions. In addition, the decrease in cash flow from operations was the result of variable compensation payments made in the first quarter of 2005, related to 2004 performance and profitability and a decrease in cash as a result of tax payments.

Other Items***Long-term Debt***

The following table summarizes the principal amounts and variables associated with our long-term debt (in thousands):

Year of Issuance	Description	Year		Interest Rate Terms	Interest Rate at	Principal
		Callable	Year Due		March 31, 2007	
2003	Junior subordinated debentures	2008	2033	Three-month LIBOR, plus 4.05%	9.41%	\$ 10,310
2004	Senior debentures	2009	2034	Three-month LIBOR, plus 4.00%	9.36%	13,000
2004	Senior debentures	2009	2034	Three-month LIBOR, plus 4.20%	9.56%	12,000
2005	Junior subordinated debentures	2010	2035	Three-month LIBOR, plus 3.58%	8.93%	20,620
					Total	\$ 55,930

We received a total of \$53.3 million in net proceeds from the issuances of the above long-term debt, of which \$26.2 was contributed to the surplus of our Insurance Company Subsidiaries and the remaining balance was used for general

corporate purposes. Associated with the issuance of the above long-term debt, we incurred approximately \$1.7 million in issuance costs for commissions paid to the placement agents in the transactions. These issuance costs have been capitalized and are included in other assets on the balance sheet, which are being amortized over seven years as a component of interest expense. The seven year amortization period represents our best estimate of the estimated useful life of both the senior debentures and junior subordinated debentures.

The junior subordinated debentures issued in 2003 and 2005, were issued in conjunction with the issuance of \$10.0 million and \$20.0 million, respectively, in mandatory redeemable trust preferred securities by unconsolidated subsidiary trusts.

With the expiration of the five year non-call period approaching in 2008 for the junior subordinated debentures issued in 2003, we will be reviewing the capital strategy associated with refinancing at lower costs through debentures or equity.

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Interest Rate Swaps

In October 2005, we entered into two interest rate swap transactions to mitigate our interest rate risk on \$5.0 million and \$20.0 million of our senior debentures and trust preferred securities, respectively. In accordance with Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, these interest rate swap transactions were recorded at fair value on the balance sheet and any changes in their fair value are accounted for within other comprehensive income. The interest differential to be paid or received is accrued and is recognized as an adjustment to interest expense.

The first interest rate swap transaction, which relates to \$5.0 million of our \$12.0 million issuance of senior debentures, has an effective date of October 6, 2005 and ending date of May 24, 2009. We are required to make certain quarterly fixed rate payments calculated on a notional amount of \$5.0 million, non-amortizing, based on a fixed annual interest rate of 8.925%. The counterparty is obligated to make quarterly floating rate payments to us referencing the same notional amount, based on the three-month LIBOR, plus 4.20%.

The second interest rate swap transaction, which relates to \$20.0 million of our \$20.0 million issuance of trust preferred securities, has an effective date of October 6, 2005 and ending date of September 16, 2010. We are required to make quarterly fixed rate payments calculated on a notional amount of \$20.0 million, non-amortizing, based on a fixed annual interest rate of 8.34%. The counterparty is obligated to make quarterly floating rate payments to us referencing the same notional amount, based on the three-month LIBOR, plus 3.58%.

In relation to the above interest rate swaps, the net interest income received for the year ended December 31, 2006, was approximately \$67,000. For the year ended December 31, 2005, the net interest expense incurred was approximately \$4,000. The total fair value of the interest rate swaps as of December 31, 2006 and 2005 was approximately \$200,000 and \$14,000, respectively. Accumulated other comprehensive income at December 31, 2006 and 2005 included accumulated income on the cash flow hedge, net of taxes, of approximately \$130,000 and \$9,000, respectively.

The net interest income received for the three months ended March 31, 2007, was approximately \$38,000. The net interest expense incurred for the three months ended March 31, 2006, was approximately \$18,000. The total fair value of the interest rate swaps as of March 31, 2007, was approximately \$83,000. Accumulated other comprehensive income at March 31, 2007 included the accumulated income on the cash flow hedge, net of taxes, of \$54,000.

Revolving Line of Credit

In November 2004, we entered into a revolving line of credit for up to \$25.0 million. We recently increased the limit of this facility to \$35.0 million and extended the term to September 30, 2010. (See Subsequent Events). We use the revolving line of credit to meet short-term working capital needs. Under the revolving line of credit, we and certain of our non-regulated subsidiaries pledged security interests in certain property and assets of named subsidiaries.

At December 31, 2006 and 2005, we had an outstanding balance of \$7.0 million and \$5.0 million, respectively, on the revolving line of credit. At March 31, 2007, we had an outstanding balance of \$10.4 million.

The revolving line of credit provides for interest at a variable rate based, at our option, upon either a prime based rate or LIBOR-based rate. In addition, the revolving line of credit also provides for an unused facility fee. On prime based borrowings, the applicable margin ranges from 75 to 25 basis points below prime. On LIBOR-based borrowings, the applicable margin ranges from 125 to 175 basis points above LIBOR. These margin ranges were reduced to a range between 75 to 175 basis points above LIBOR with the recent increase in this facility. The margin for all loans is dependent on the sum of non-regulated earnings before interest, taxes, depreciation, amortization, and non-cash

impairment charges related to intangible assets for the preceding four quarters, plus dividends paid or payable to us from subsidiaries during such period (Adjusted EBITDA). As of March 31, 2007, the weighted average interest rate for LIBOR-based borrowings was 6.6%.

Debt covenants include maintenance of: (1) the ratio of Adjusted EBITDA to interest expense of at least 2.0 to 1.0, (2) minimum net worth of \$130.0 million and increasing annually, commencing June 30, 2005, by fifty percent

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of the prior year's positive net income, (3) minimum A.M. Best rating of B, and (4) on an annual basis, a minimum Risk Based Capital Ratio for Star of 1.75 to 1.00. As of March 31, 2007, we were in compliance with these covenants.

This line of credit expires November 2007. We plan to seek to renew the line of credit upon its expiration and will be evaluating the renewal terms based upon our overall capital strategy.

Investment Portfolio

As of December 31, 2006 and 2005, the recorded values of our investment portfolio, including cash and cash equivalents, were \$527.6 million and \$460.2 million, respectively. The debt securities in the investment portfolio, at December 31, 2006, were 97.2% investment grade A- or above bonds as defined by Standard and Poor's.

Shareholders' Equity

At March 31, 2007, shareholders' equity was \$207.4 million, or \$7.02 per common share. Shareholders' equity was \$201.7 million, or \$6.93 per common share, at December 31, 2006, compared to \$177.4 million, or \$6.19 per common share at December 31, 2005. The increase in shareholders' equity during 2006 primarily reflects year-to-date earnings. At March 31, 2007, return on beginning equity was 13.7%. Return on beginning equity was 12.4% at December 31, 2006, compared to 10.7% at December 31, 2005.

On October 28, 2005, our Board of Directors authorized management to purchase up to 1,000,000 shares of our common stock in market transactions for a period not to exceed twenty-four months. For the year ended December 31, 2006 and the three months ended March 31, 2007, we did not repurchase any common stock. For the year ended December 31, 2005, we purchased and retired a total of 772,900 shares of common stock for a total cost of approximately \$4.2 million. Of these shares, 63,000 shares for a total cost of approximately \$372,000 related to the current share repurchase plan. As of March 31, 2007, the cumulative amount we repurchased and retired under our current share repurchase plan was 63,000 shares of common stock for a total cost of approximately \$372,000. As of March 31, 2007, we have available up to 937,000 shares remaining to be purchased.

On February 8, 2007, our Board of Directors and the Compensation Committee of the Board of Directors approved the distribution of our LTIP award for the 2004-2006 plan years, which included both a cash and stock award. The stock portion of the LTIP award was valued at \$2.5 million, which resulted in the issuance of 579,496 shares of our common stock. Of the 579,496 shares issued, 191,570 shares were retired for payment of the participant's associated withholding taxes related to the compensation recognized by the participant. The retirement of the shares for the associated withholding taxes reduced our paid in capital by \$1.8 million.

Our Board of Directors did not declare a dividend in 2006 or 2005. When evaluating the declaration of a dividend, our Board of Directors considers a variety of factors, including but not limited to, our cash flow, liquidity needs, results of operations and our overall financial condition. As a holding company, the ability to pay cash dividends is partially dependent on dividends and other permitted payments from our subsidiaries. We did not receive any dividends from our Insurance Company Subsidiaries in 2006 or 2005.

Regulatory

A significant portion of our consolidated assets represent assets of our Insurance Company Subsidiaries. The State of Michigan Office of Financial and Insurance Services (OFIS) restricts the amount of funds that may be transferred to us in the form of dividends, loans or advances. These restrictions, in general, are as follows: the maximum discretionary dividend that may be declared, based on data from the preceding calendar year, is the greater of each insurance company's net income (excluding realized capital gains) or ten percent of the insurance company's surplus.

(excluding unrealized gains). These dividends are further limited by a clause in the Michigan law that prohibits an insurer from declaring dividends except out of surplus earnings of the company. Earned surplus balances are calculated on a quarterly basis. Since Star is the parent insurance company, its maximum dividend calculation represents the combined Insurance Company Subsidiaries' surplus. At March 31, 2007, Star's earned surplus position was positive \$22.7 million. At December 31, 2006, Star had positive earned surplus of

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\$13.2 million. As of March 31, 2007, Star may pay a dividend of up to \$16.5 million without the prior approval of OFIS, which is ten percent of statutory surplus as of year end 2006. No statutory dividends were paid during 2006 or 2005.

Our Insurance Company Subsidiaries are required to maintain certain deposits with regulatory authorities, which totaled \$148.8 million and \$128.7 million at December 31, 2006 and 2005, respectively.

Contractual Obligations and Commitments

The following table is a summary of our contractual obligations and commitments as of December 31, 2006 (in thousands):

		Payments Due by Period			
		Less than	One to	Three to	More than
	Total	One Year	Three Years	Five Years	Five Years
Non-regulated companies:					
Lines of credit(1)	\$ 7,000	\$ 7,000	\$	\$	\$
Senior debentures, excluding interest(2)	25,000				25,000
Junior subordinated debentures, excluding interest(2)	30,930				30,930
Operating lease obligations(3)	14,069	2,749	4,757	3,474	3,089
Regulated companies:					
Losses and loss adjustment expenses(4)	501,077	140,670	179,453	73,886	107,068
Total	\$ 578,076	\$ 150,419	\$ 184,210	\$ 77,360	\$ 166,087

(1) Relates to our revolving line of credit (excludes interest).

(2) Five year call feature associated with debentures, estimated seven year repayment.

(3) Consists of rental obligations under real estate leases related to branch offices. In addition, includes amounts related to equipment leases.

(4) The loss and loss adjustment expense payments do not have contractual maturity dates and the exact timing of payments cannot be predicted with certainty. However, based upon historical payment patterns, we have included an estimate of our gross losses and loss adjustment expenses. In addition, we have anticipated cash receipts on reinsurance recoverables on unpaid losses and loss adjustment expenses of \$198.4 million, of which we estimate that these payments to be paid for losses and loss adjustment expenses for the periods less than one year, one to three years, three to five years, and more than five years, to be \$33.7 million, \$64.5 million, \$34.9 million, and \$65.3 million, respectively, resulting in net losses and loss adjustment expenses of \$107.0 million, \$115.0 million, \$39.0 million, and \$41.7 million, respectively.

We maintain an investment portfolio with varying maturities that we believe will provide adequate cash for the payment of claims.

Variable Compensation

We have established two variable compensation plans as an incentive for performance of our management team. They consist of an Annual Bonus Plan (Bonus Plan) and a Long-Term Incentive Plan (LTIP). The Bonus Plan is a discretionary cash bonus plan premised upon a targeted growth in net after-tax earnings on a year over year basis. Each year, the Compensation Committee and our Board of Directors establish a new target based upon prior year performance and the forecasted performance levels anticipated for the following year. If the minimum threshold is met, the Bonus Plan is funded from 0% up to a maximum of 120% of the targeted bonus pool. The amount of the bonus pool is established by aggregating the individual targets for each participant, which is a percentage of salary. At the end of the year, the Compensation Committee and the Board of Directors review the

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Company's performance in relation to performance targets and then establish the total bonus pool to be utilized to pay cash bonuses to the management team based upon overall corporate and individual participant goals.

The LTIP is intended to provide an incentive to management to improve the performance of the Company over a three year period, thereby increasing shareholder value. The LTIP is not discretionary and is based upon a target for an average three year return on beginning equity. If the targets are met and all other terms and conditions are satisfied, the LTIP awards are paid. The LTIP can be funded from 0% to 160% of target, based upon the three year performance of the Company. The LTIP is paid 50% in cash and 50% in stock. A participant's percentage is established by the Compensation Committee and the Board of Directors in advance of any new three year LTIP award. The stock component of the LTIP is paid based upon the closing stock price at the beginning of the three year LTIP performance period, in accordance with the terms and conditions of the LTIP.

Both the Bonus Plan and the LTIP are administered by the Compensation Committee and all awards are reviewed and approved by the Board of Directors at both inception and at distribution.

Regulatory and Rating Issues

The National Association of Insurance Commissioners (NAIC) has adopted a risk-based capital (RBC) formula to be applied to all property and casualty insurance companies. The formula measures required capital and surplus based on an insurance company's products and investment portfolio and is used as a tool to evaluate the capital of regulated companies. The RBC formula is used by state insurance regulators to monitor trends in statutory capital and surplus for the purpose of initiating regulatory action. In general, an insurance company must submit a calculation of its RBC formula to the insurance department of its state of domicile as of the end of the previous calendar year. These laws require increasing degrees of regulatory oversight and intervention as an insurance company's RBC declines. The level of regulatory oversight ranges from requiring the insurance company to inform and obtain approval from the domiciliary insurance commissioner of a comprehensive financial plan for increasing its RBC to mandatory regulatory intervention requiring an insurance company to be placed under regulatory control in a rehabilitation or liquidation proceeding.

At December 31, 2006, each of our Insurance Company Subsidiaries was in excess of any minimum threshold at which corrective action would be required.

Reinsurance

Intercompany pooling agreements are commonly entered into between affiliated insurance companies, so as to allow the companies to utilize the capital and surplus of all of the companies, rather than each individual company. Under pooling arrangements, companies share in the insurance business that is underwritten and allocate the combined premium, losses and related expenses between the companies within the pooling arrangement. The Insurance Company Subsidiaries entered into an Inter-Company Reinsurance Agreement (the Pooling Agreement). This Pooling Agreement includes Star, Ameritrust Insurance Corporation (Ameritrust), Savers Property and Casualty Insurance Company (Savers) and Williamsburg National Insurance Company (Williamsburg). Pursuant to the Pooling Agreement, Savers, Ameritrust and Williamsburg have agreed to cede to Star and Star has agreed to reinsure 100% of the liabilities and expenses of Savers, Ameritrust and Williamsburg, relating to all insurance and reinsurance policies issued by them. In return, Star agrees to cede and Savers, Ameritrust and Williamsburg have agreed to reinsure Star for their respective percentages of the liabilities and expenses of Star. Annually, we examine the Pooling Agreement for any changes to the ceded percentage for the liabilities and expenses. Any changes to the Pooling Agreement must be submitted to the applicable regulatory authorities for approval.

Convertible Note

In July 2005, we made a \$2.5 million loan, at an effective interest rate equal to the three-month LIBOR, plus 5.2%, to an unaffiliated insurance agency. In December 2005, we loaned an additional \$3.5 million to the same agency. The original \$2.5 million demand note was replaced with a \$6.0 million convertible note. The effective interest rate of the convertible note is equal to the three-month LIBOR plus 5.2% and the note is due December 20, 2010. This agency has been a producer for us for over ten years. As security for the loan, the borrower granted us a

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security interest in its accounts, cash, general intangibles, and other intangible property. Also, the shareholder then pledged 100% of the common shares of three insurance agencies and the common shares owned by the shareholder in another agency, and has executed a personal guaranty. This note is convertible upon our option based upon a pre-determined formula, beginning in 2008. The conversion feature of this note is considered an embedded derivative pursuant to SFAS No. 133, and therefore is accounted for separately from the note. At March 31, 2007, the estimated fair value of the derivative was not material to the financial statements.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, which becomes effective for fiscal years beginning after November 15, 2007. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. We will evaluate the impact of SFAS No. 157, but believe the adoption of SFAS No. 157 will not have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. SFAS No. 159 will permit entities the option to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis as of specified election dates. This election is irrevocable. The objective of SFAS No. 159 is to improve financial reporting and reduce the volatility in reported earnings caused by measuring related assets and liabilities differently. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We will evaluate the potential impact SFAS No. 159 will have on our consolidated financial statements.

Subsequent Events

As previously indicated, in April 2007, we announced an upgrade of the financial strength rating by A.M. Best Company to A- (Excellent), from B++ (Very Good) for our Insurance Company Subsidiaries.

On April 10, 2007, we executed an amendment to our current revolving credit agreement with our bank. The amendments included an extension of the term to September 30, 2010, an increase to the available borrowings up to \$35.0 million, and a reduction of the variable interest rate basis to a range between 75 to 175 basis points above LIBOR.

On April 16, 2007, we entered into an Asset Purchase Agreement (Agreement) to acquire the business of U.S. Specialty Underwriters, Inc. (USSU) for a purchase price of \$23.0 million. We simultaneously closed on the acquisition on the same date. The purchase price was comprised of \$13.0 million in cash and \$10.0 million in our common stock. The total shares issued for the \$10.0 million portion of the purchase price was 907,935 shares. Under the terms of the Agreement, we acquired the excess workers' compensation business and other related assets of USSU. In addition, we entered into a Management Agreement with the shareholder of USSU. Under the terms and conditions of the Management Agreement, the shareholder is responsible for the day to day administration and management of the acquired business. The shareholder's consideration for the performance of its duties shall be in the form of a Management Fee payable by us based on a share of net income before interest, taxes, depreciation, and amortization. In addition, we can terminate the Management Agreement in the future, at our discretion, based on a multiple of the Management Fee calculated for the trailing twelve months and subject to the terms and conditions of the Agreement. USSU is based in Cleveland, Ohio, and is a specialty program manager that produces fee based income by underwriting excess workers' compensation coverage for a select group of insurance companies.

Qualitative and Quantitative Disclosures about Market Risk

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates as well as other relevant market rate or price changes. The volatility and liquidity in the markets in which the underlying assets are traded directly influence market risk. The following is a discussion of our primary risk exposures and how those exposures are currently managed as of December 31, 2006. Our market risk sensitive instruments are primarily fixed income securities, which are available for sale and not held for trading purposes.

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Interest rate risk is managed within the context of an asset and liability management strategy where the target duration for the fixed income portfolio is based on the estimate of the liability duration and takes into consideration our surplus. The investment policy guidelines provide for a fixed income portfolio duration of between three and a half and five and a half years. At December 31, 2006, our fixed income portfolio had a modified duration of 3.93, compared to 3.38 at December 31, 2005.

At December 31, 2006, the fair value of our investment portfolio was \$484.7 million. Our market risk to the investment portfolio is interest rate risk associated with debt securities. Our exposure to equity price risk is not significant. Our investment philosophy is one of maximizing after-tax earnings and has historically included significant investments in tax-exempt bonds. During 2005 and 2006, we continued to increase our holdings of tax-exempt securities based on our return to profitability and our desire to maximize after-tax investment income. For our investment portfolio, there were no significant changes in our primary market risk exposures or in how those exposures are managed compared to the year ended December 31, 2005. We do not anticipate significant changes in our primary market risk exposures or in how those exposures are managed in future reporting periods based upon what is known or expected to be in effect.

A sensitivity analysis is defined as the measurement of potential loss in future earnings, fair values, or cash flows of market sensitive instruments resulting from one or more selected hypothetical changes in interest rates and other market rates or prices over a selected period. In our sensitivity analysis model, a hypothetical change in market rates is selected that is expected to reflect reasonable possible near-term changes in those rates. Near term means a period of up to one year from the date of the consolidated financial statements. In our sensitivity model, we measure the hypothetical change in fair values on debt securities assuming an upward or downward parallel shift in interest rates. The table below presents our model's estimate of changes in fair values given a change in interest rates. Dollar values are rounded and in thousands.

	Rates Down 100bps	Rates Unchanged	Rates Up 100bps
Market Value	\$ 504,727	\$ 484,724	\$ 464,642
Yield to Maturity or Call	3.62%	4.62%	5.62%
Effective Duration	3.94	4.09	4.24

The other financial instruments, which include cash and cash equivalents, equity securities, premium receivables, reinsurance recoverables, line of credit and other assets and liabilities, when included in the sensitivity model, do not produce a material loss in fair values.

Our debentures are subject to variable interest rates. Thus, our interest expense on these debentures is directly correlated to market interest rates. At December 31, 2006 and 2005, we had debentures of \$55.9 million. At this level, a 100 basis point (1%) change in market rates would change annual interest expense by \$559,000.

In October 2005, we entered into two interest rate swap transactions to mitigate our interest rate risk on \$5.0 million and \$20.0 million of our senior debentures and trust preferred securities, respectively. We accrue for these transactions in accordance with SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities*, as subsequently amended. These interest rate swap transactions have been designated as a cash flow hedges and are deemed highly effective hedges under SFAS No. 133. In accordance with SFAS No. 133, these interest rate swap transactions are recorded at fair value on the balance sheet and the effective portion of any changes in fair value are accounted for within other comprehensive income. The interest differential to be paid or received is being accrued and is being recognized as an adjustment to interest expense.

In addition, our revolving line of credit under which we can borrow up to \$35.0 million is subject to variable interest rates. We recently increased the limit of this facility from \$25.0 million to \$35.0 million and extended the term to September 30, 2010. (See Subsequent Events). Thus, our interest expense on the revolving line of credit is directly correlated to market interest rates. At December 31, 2006, we had \$7.0 million outstanding on this revolving line of credit. At this level, a 100 basis point (1%) change in market rates would have changed interest expense by \$70,000. At December 31, 2005, we had \$5.0 million outstanding on this revolving line of credit. At this level, a 100 basis point (1%) change in market rates would have changed interest expense by \$50,000.

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BUSINESS

Overview

We are a full-service risk management organization which focuses on niche or specialty program business and risk management solutions for agents, professional and trade associations, pools, trusts, and small to medium-sized insureds. Our programs are primarily on a regional basis with a single line of business within a program. Within the workers' compensation line of business we have a regional focus in New England, Florida, and Nevada. Within the commercial auto and commercial multiple peril we have a regional focus in California. Our fee-for-service business is also on a regional basis with an emphasis in the Midwest and southeastern regions, as well as the self-insured market in Nevada. Our corporate strategy emphasizes a regional focus and diverse sources of revenue between underwritten premiums, service fee revenue, and commissions. This allows us to leverage fixed costs without sacrificing pricing of our insurance premiums. Currently, we manage over \$700 million in gross written premiums.

We were founded in 1955 as a retail insurance agency. We earn commission revenue through the operation of our retail property and casualty insurance agencies, located in Michigan, California, and Florida. Our Michigan-based retail insurance agency operations are consistently ranked as a leading business insurance agency in Michigan and the United States.

For over 30 years, we have specialized in providing risk management solutions for our clients. By forming risk-sharing partnerships, we align our financial objectives with our clients. By utilizing our products and services, small to medium-sized client groups gain access to more sophisticated risk management techniques previously available only to larger corporations. This enables our clients to control insurance costs and potentially turn risk management into a profit center. By having their capital at risk, our clients are motivated to reduce exposure and share in the underwriting profits and investment income derived from their risk management plan.

Based upon the particular risk management goals of our clients and our assessment of the opportunity for operating profit, we offer solutions on a managed basis, a risk-sharing basis, or a fully-insured basis, in response to a specific market opportunity. In a managed program, we earn service fee revenue by providing management and other services to a client's risk-bearing entity, but generally do not share in the operating results. In a risk-sharing program, we share the operating results with the client through a reinsurance agreement with a captive or rent-a-captive. The captive and rent-a-captive structures are licensed reinsurance companies and are accounted for under the provisions of Statement of Financial Accounting Standards (SFAS) No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*. In risk-sharing programs, we derive revenue from net earned premiums, fee-for-service revenue and commissions, and investment income. In addition, we may benefit from the fees our risk management subsidiary earns for services we perform on behalf of our Insurance Company Subsidiaries. These fees are eliminated upon consolidation. However, the fees associated with the captive's portion of the program are reimbursed through a ceding commission. In a fully-insured program, we provide insurance products without a risk-bearing mechanism and derive revenue from net earned premiums and investment income.

We have developed a broad range of capabilities and services in the design, management, and servicing of our clients' risk management needs. These capabilities and services include:

program and product design;

underwriting, risk selection, and policy issuance;

sales, marketing, and public relations to members of groups;

administration of risk-bearing entities, such as mutual insurance companies, captives, rent-a-captives, public entity pools, and risk retention and risk purchasing groups;

claims handling and administration;

loss prevention and control;

reinsurance placement;

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risk analysis and identification;

actuarial and loss reserve analysis;

information technology and processing;

feasibility studies;

litigation management;

accounting and financial statement preparation;

regulatory compliance; and

audit support.

Recent Acquisitions

On April 16, 2007, we acquired the business of U.S. Specialty Underwriters, Inc. (USSU) for a purchase price of \$23.0 million. The purchase price was comprised of \$13.0 million in cash and \$10.0 million in our common stock. Under the terms of the transaction, we acquired the excess workers' compensation business and other related assets. USSU is a specialty program manager that produces fee based income by underwriting excess workers' compensation coverage for a select group of insurance companies.

Our Agency Operations

We earn commission revenue through the operation of our retail property and casualty insurance agencies, located in Michigan, California, and Florida. Our agency operations produce commercial, personal lines, life, and accident and health insurance, with more than fifty unaffiliated insurance carriers. The agency produces an immaterial amount of business for our affiliated Insurance Company Subsidiaries.

In total, our agency operations generated commissions of \$12.3 million, \$11.3 million, and \$9.8 million, for the years ending December 31, 2006, 2005, and 2004, respectively.

Our Specialty Risk Management Operations

Our specialty risk management operations segment focuses on specialty or niche insurance business in which we provide various services and coverages tailored to meet specific requirements of defined client groups and their members. These services include risk management consulting, claims administration and handling, loss control and prevention, and reinsurance placement, along with various types of property and casualty insurance coverage, including workers' compensation, commercial multiple peril, general liability, professional liability, commercial auto liability, and inland marine. Insurance coverage is provided primarily to associations or similar groups of members and to specified classes of business of our agent-partners. We recognize revenue related to the services and coverages from our specialty risk management operations within seven categories: net earned premiums, management fees, claims fees, loss control fees, reinsurance placement, investment income, and net realized gains (losses).

Net earned premiums include the following lines of business:

Workers Compensation

Commercial Multiple Peril

General Liability

Errors and Omissions

Automobile

Owners, Landlord and Tenant

Employment Practices Liability

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Professional Liability

Medical

Real Estate Appraisers

Pharmacists

Inland Marine

Product Liability

Excess Reinsurance

Commercial Property

Description of Specialty Risk Management Programs

Fee-for-Service Specialty Programs:

With a managed program, we earn fee-for-service revenue by providing management and other services to a client's risk-bearing entity, but generally do not share in the operating results of the program. We believe our managed programs provide a consistent source of revenue, as well as opportunities for revenue growth without a proportionate increase in capital. Revenue growth may occur through the sale of existing products to additional members of the group, the expansion of coverages and services provided to existing programs and the creation of programs for new client groups.

Services for which we receive fee revenue from managed programs include:

program design and development;

underwriting;

reinsurance placement;

policy administration;

loss prevention and control;

claims administration and handling;

litigation management;

information technology and processing;

accounting functions; and

general management and oversight of the program.

The fees we receive from our managed programs are generally either a fixed amount or based on a percentage of premium serviced or claim count.

We provide insurance management services to public entity associations and currently manage public entity pools and other insurance entities, which provide insurance coverage for approximately 1,700 participants, including city, county, township, and village governments in three states, as well as other diverse industry groups.

Insurance Company Programs:

We provide three broad types of insurance company programs, including fully insured, captives and client risk-sharing programs. With a client risk-sharing program, our Insurance Company Subsidiaries underwrite individual primary insurance policies for members of a group or association, or a specific industry and then share the operating results with the client or client group through a reinsurance agreement with a captive or rent-a-captive. In some instances, a captive owned by a client or client group reinsures a portion of the risk on a quota-share basis. A captive is an insurance company or reinsurance company, which is formed for the purpose of insuring or reinsuring risks

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related to the businesses of its shareholders or members. A rent-a-captive allows organizations to obtain the benefits of a captive insurance company, without the initial costs and capital investment required to form their own captive. This is often an interim step utilized by groups and associations prior to forming their own captive. As part of its participation in a rent-a-captive, the client group purchases redeemable preferred stock of our unconsolidated subsidiary. These shares entitle the client group to participate in profits and losses of the program through a dividend or additional capital contribution. Dividends or additional capital contributions are determined and accrued on the basis of underwriting profits or losses plus investment income on trust accounts less costs. The captive and rent-a-captive structures are licensed reinsurance companies, which have a self-sustaining integrated set of activities and assets, and are in the reinsurance business for the purpose of providing a return to their investors, who are the shareholders (primary beneficiaries) of the captive company. The primary beneficiaries have their own equity at risk, decision making authority, and the ability to absorb losses. Therefore, the transactions associated with the captive and rent-a-captive structures are accounted for under the provisions of SFAS No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*.

In addition to premium revenue and investment income from our net retained portion of the operating results, we may also be compensated through the receipt of fees for policy issuance services and acquisition costs, captive administration, reinsurance placement, loss prevention services, and claims administrative and handling services. In addition, we may benefit from the fees our risk management subsidiary earns for services we perform on behalf of our Insurance Company Subsidiaries. These fees are eliminated upon consolidation. However, the fees associated with the captive's portion of the program are reimbursed through a ceding commission. For financial reporting purposes, ceding commissions are treated as a reduction in underwriting expenses.

Our experience has been that the number of claims and the cost of losses tend to be lower in risk-sharing programs than with traditional forms of insurance. We believe that client risk-sharing motivates participants to focus on loss prevention, risk control measures and adherence to stricter underwriting guidelines.

The following schematic illustrates the basic elements in many of our client risk-sharing programs.

CAPTIVE RISK-SHARING STRUCTURE

- (1) We account for transactions with these risk-sharing clients as reinsurance under the provisions of SFAS No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Clients*.

The captive's shareholders, which may or may not include the insured, and its board of directors make the decision to form the captive or terminate the captive, based upon either their own analysis or the analysis performed by an independent third party consultant they hire. The shareholders of the captive make the decision whether to invest and how much to invest in the captive. This decision may be based upon advice from third party consultants.

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The agent of the business will make the decision to submit the risk to the insurance company for underwriting and the policyholders make the decision to purchase the quoted policy.

The captive administrator provides administrative services to the captive in exchange for a fee. This fee is usually a fixed amount, but can be a variable amount based upon premium volume, and is negotiated on an annual basis with the captive's board of directors. Such services may include bookkeeping, providing regulatory information, and other administrative services. We do not provide loss prevention, claims handling, underwriting, and other insurance services directly to the captive. However, our risk management services subsidiary provides these services to our Insurance Company Subsidiaries for a fee, which is eliminated upon consolidation. The costs associated with these services are included within the premium quoted to the policyholder.

In applying FIN 46(R)'s provisions to the captive risk-sharing structure, our variable interest in the captive is limited to administrative fees based upon a fixed amount or a percentage of premiums and the credit risk associated with any reinsurance recoverables recognized.

The captives are generally capitalized with common stock and may use preferred stock in isolated instances. The captive's variability is: (1) created based upon the experience of their portion of business directly written through our Insurance Company Subsidiaries and ceded to the captive on a quota share basis; and (2) absorbed by the captive's shareholders.

In general, the captive's common and/or preferred shareholders are either the agents or producers of the business, a sponsoring group or association, a group of policyholders, a policyholder, or a general agent. The captive's shareholders are not related parties of ours pursuant to either SFAS No. 57, *Related Party Disclosures*, or paragraph 16 of FIN 46(R).

By design, the capital base of the captive is structured to absorb the projected losses of the program, and the captive's shareholders bear the risk of loss. We protect ourselves from potential credit risk related to reinsurance recoverables from the captive by a collateral requirement included within a trust agreement up to 110% of the estimated reserves for losses and unearned premiums. In addition, we monitor the capital adequacy and financial leverage ratios of the captive to mitigate future credit risk.

In another variation of client risk-sharing, we establish retrospectively rated programs for individual accounts. With this type of program, we work with the client to develop the appropriate self-insured retention and loss fund amount and then help arrange for excess-of-loss reinsurance. The client reimburses us for all claim payments within the client's retention. We generally earn a management fee (which includes claims and loss control fees). In most of these programs, we also share in the operating results with the client and receive a ceding commission in the client risk-sharing reinsurance contract to reimburse us for expenses and our fee for services.

In another version of client risk-sharing, the agent accepts an up-front commission that is adjusted up or down based on operating results of the program produced.

With a fully-insured program, we provide our insurance products without a risk-sharing mechanism and derive revenue from net earned premiums and investment income. Fully-insured programs are generally developed only in response to specific market opportunities and when we believe there is potential to evolve into a risk-sharing mechanism.

Description of Our Fee-for-Service Capabilities

Our risk management subsidiary provides the following services to our fee-for-service clients and to our Insurance Company Subsidiaries for a fee. The fees associated with services provided to our Insurance Company Subsidiaries are eliminated upon consolidation. The costs associated with these services are charged to our insureds in the form of premiums.

Program and Product Design. Before implementing a new program, we generally review: (1) financial projections for the contemplated program, (2) historical loss experience, (3) actuarial studies of the underlying risks, (4) the credit worthiness of the potential client, and (5) the availability of reinsurance. Our senior management team and associates representing each of the risk-management disciplines work together to design, market, and implement new programs. Our due diligence process is structured to provide a risk assessment of the program and how the program fits within our entity wide business plan and risk profile.

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Underwriting Risk Selection and Policy Issuance. Through our risk management subsidiary, we perform underwriting services for our Insurance Company Subsidiaries that meet our corporate underwriting guidelines. We maintain substantially all ultimate underwriting authority and monitor compliance with our corporate underwriting guidelines through a periodic underwriting audit process and with a system of internal control procedures. Our underwriting personnel help develop the proper criteria for selecting risks, while actuarial and reinsurance personnel evaluate and recommend the appropriate levels of rate and risk retention. The program is then tailored according to the requirements and qualifications of each client. With managed programs, we may perform underwriting services based upon the profile of the specific program for a fee.

Claims Administration and Handling. Through our risk management subsidiary, we provide substantially all claims management and handling services for workers' compensation and most other lines, such as property, professional liability, and general liability. Our claims handling standards are set by our corporate claims department and are monitored through self-audits, corporate claim audits, internal controls, and other executive oversight reports. We handle substantially all claims functions for the majority of the programs we manage. Our involvement in claims administration and handling provides feedback to program managers in assessing the client's risk environment and the overall structure of the program.

Loss Prevention and Control. Through our risk management subsidiary, we provide loss control services, which are designed to help clients prevent or limit the impact of certain loss events. Through an evaluation of the client's workplace environment, our loss control specialists assist the client in planning and implementing a loss prevention program and, in certain cases, provide educational and training programs. With our managed programs, we provide these same services for a fee based upon the profile of the specific program.

Administration of Risk-Bearing Entities. We generate fee revenue by assisting in the formation and administration of risk-bearing entities for clients and agents. We currently provide administrative services for over fourteen captives and/or rent-a-captives and hold an insignificant minority interest in two of these captives. These services are provided by our subsidiaries in Bermuda and Barbados.

Reinsurance Placement. Through our reinsurance intermediary subsidiary, Meadowbrook Intermediaries, Inc., we earn commissions by placing excess-of-loss reinsurance and insurance coverage with high deductibles for insurance companies, captives, and self-insured programs we manage. Reinsurance is also placed for clients who do not have other business relationships with us.

Sales, Marketing, and Public Relations. We market our programs and services to associations, professional and trade groups, local, regional and national insurance agents, and insurance consultants. Sales and marketing efforts include personal contact through independent agents, direct mail, telemarketing, association publications/newsletters, advertising, internet-based marketing including our corporate website (www.meadowbrook.com), and subsidiary branch/division websites. We access or manage a range of distribution systems and regional agency networks on a program-specific basis.

We also participate in seminars, trade and industry conventions such as Target Markets Program Administrators Association, American Association of Managing General Agents, American Society of Association Executives, Self Insurance Institute of America, National Association of Professional Surplus Lines Offices, Public Risk Management Association, and various individual state independent agent associations.

In 2000, we launched our Advantage System (Advantage). Advantage is an internet-based business processing system for quoting and binding workers' compensation insurance policies. In addition to reducing our internal administrative processing costs, Advantage enhances underwriting practices by automating risk selection criteria.

Our Insurance Company Subsidiaries and Their Performance

Our Insurance Company Subsidiaries issue insurance policies. Through our Insurance Company Subsidiaries, we engage in specialty risk management programs where we assume underwriting risks in exchange for premium. Our Insurance Company Subsidiaries primarily focus on specialty programs designed specifically for trade groups and associations, whose members are homogeneous in nature. Members are typically small-to-medium sized businesses. Our programs focus on select classes of property and casualty business which, through our due diligence

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process, we believe have demonstrated a fundamentally sound prospect for generating underwriting profits. We occasionally do offer our programs on a multi-state basis; but more generally, our programs operate on a regional or state-specific basis. We maintain underwriting authority through our regional offices based upon underwriting guidelines set forth by our corporate underwriting department, which we monitor through underwriting audits and a series of executive underwriting and rate monitor reports. We seek to avoid geographic concentration of risks that might lead to aggregation of exposure to losses from natural or intentionally caused catastrophic events. We also handle the majority of our claims through our regional offices based upon standards set forth by our corporate claims office and monitored through a series of self-audits and corporate claims audit, internal control audits, and executive claims monitoring reports. American Indemnity Insurance Company, Ltd. (American Indemnity) and Preferred Insurance Company, Ltd. (PICL), which offer clients captive or rent-a-captive options, complement our Insurance Company Subsidiaries.

Star, Savers, Williamsburg and Ameritrust are domiciled in Michigan, Missouri, California, and Florida, respectively. American Indemnity and PICL are Bermuda-based insurance companies.

We may at times place risks directly with third party insurance carriers and participate in the risk as a reinsurance partner. Such arrangements typically generate management fee revenue and provide a means to manage premium leverage ratios.

Our insurance operations are subject to various leverage tests (e.g. premium to statutory surplus ratios), which are evaluated by regulators and rating agencies. Our targets for gross and net written premium to statutory surplus are 2.8 to 1.0 and 2.25 to 1.0, respectively. As of December 31, 2006, on a statutory consolidated basis, gross and net premium leverage ratios were 2.0 to 1.0 and 1.6 to 1.0, respectively.

Our Insurance Company Subsidiaries are authorized to write business, on either an admitted or surplus lines basis, in all 50 states. Star is admitted in all 50 states. Williamsburg is admitted in 37 states, and is authorized to write business on a surplus lines basis in one state. Savers is admitted in 5 states and is authorized to write business on a surplus lines basis in 46 states. Ameritrust is admitted in seven states. Our Insurance Company Subsidiaries primarily offer workers compensation, commercial multiple peril, general liability, inland marine, and other liability coverages. For the year ended December 31, 2006, the workers compensation line of business accounted for 35.9%, 39.9%, and 42.4% of gross written premiums, net written premiums, and net earned premiums, respectively.

In 2001, 2000, and 1999, we eliminated a limited group of unprofitable programs that were not aligned with our historic and present business strategy. The uncertainty of future reserve development on these discontinued programs has been reduced as a result of aggressive claims handling and reserve strengthening. However, while we believe we have adequate reserves, there can be no assurances that there will not be additional losses in the future relating to these programs. Outstanding reserves related to these discontinued programs as of December 31, 2006 and 2005 were \$5.6 million and \$7.4 million, respectively.

The following table summarizes gross written premiums, net written premiums, and net earned premiums for the three month periods ending March 31, 2007 and March 31, 2006 and for the years ending December 31, 2006, 2005, 2004, 2003, and 2002 (in thousands):

Three Months Ending March 31,						Years Ending December 31,				
	%	2006	%	2006	%	2005	%	2004	%	2003
6	36.6%	\$ 38,049	42.7%	\$ 118,794	35.9%	\$ 133,732	40.3%	\$ 146,982	46.9%	\$ 141,456
4	32.2%	27,627	31.0%	94,355	28.5%	85,978	25.9%	71,715	22.9%	48,091

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0	2.3%	3,788	4.3%	12,837	3.9%	12,467	3.8%	10,925	3.5%	9,758
1	6.5%	2,943	3.3%	20,001	6.0%	16,167	4.9%	15,248	4.9%	10,473
4	14.9%	10,492	11.8%	59,308	17.9%	59,144	17.8%	48,070	15.3%	26,902
9	7.6%	6,111	6.9%	25,577	7.7%	24,720	7.4%	20,553	6.6%	16,600
4	100.0%	\$ 89,010	100.0%	\$ 330,872	100.0%	\$ 332,209	100.0%	\$ 313,493	100.0%	\$ 253,280

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Three Months Ending March 31,					Years Ending December 31,				
%	2006	%	2006	%	2005	%	2004	%	2003
39.4%	\$ 27,450	43.5%	\$ 108,085	42.4%	\$ 119,423	47.8%	\$ 117,914	55.0%	\$ 93,324
26.0%	15,484	24.5%	63,138	24.8%	54,829	21.9%	43,701	20.4%	26,075
0.3%	491	0.8%	1,528	0.6%	1,727	0.7%	1,628	0.8%	1,556
5.0%	2,140	3.4%	10,433	4.1%	8,072	3.2%	6,416	3.0%	4,849
20.1%	12,229	19.4%	49,341	19.4%	45,373	18.2%	29,274	13.6%	12,940
9.2%	5,330	8.4%	22,395	8.8%	20,534	8.2%	15,560	7.3%	12,461
100.0%	\$ 63,124	100.0%	\$ 254,920	100.0%	\$ 249,959	100.0%	\$ 214,493	100.0%	\$ 151,205

Three Months Ending March 31,					Years Ending December 31,				
%	2006	%	2006	%	2005	%	2004	%	2003
39.3%	\$ 32,886	47.4%	\$ 104,846	39.9%	\$ 117,287	45.4%	\$ 122,896	52.5%	\$ 111,572
30.5%	20,332	29.3%	67,504	25.7%	59,870	23.2%	46,351	19.8%	36,628
0.4%	453	0.7%	1,271	0.5%	1,690	0.7%	1,630	0.7%	1,500
5.8%	1,517	2.2%	12,384	4.7%	8,004	3.1%	7,568	3.2%	6,278
15.5%	8,954	12.9%	52,950	20.2%	49,122	19.0%	37,762	16.1%	19,599
8.5%	5,239	7.6%	23,713	9.0%	22,162	8.6%	17,754	7.6%	14,250
100.0%	\$ 69,381	100.0%	\$ 262,668	100.0%	\$ 258,134	100.0%	\$ 233,961	100.0%	\$ 189,827

From 2004 through 2006, there has been a shift in our mix of business, which has been calculated to diversify our product line and produce more predictable, stable results. The mix of business has impacted our expense ratio, as the percentage of workers' compensation premium being written in relation to the overall total has declined from a high of 57.1% in 2002 to approximately 35.9% in 2006. The decline in workers' compensation premium from 2004 to 2006 is primarily due to our decision to exit a limited number of small programs that were no longer meeting our pricing standards, an overall reduction in audit-related premiums, and a decline in the amount of residual market assignments we received relative to workers' compensation premiums. The residual market assignments are a form of a tax whereby any workers' compensation risk that cannot be written in the voluntary market is assigned to carriers participating in the workers' compensation business in that state.

In addition, workers' compensation has declined as a result of our reduction of premium writings in the state of Florida as pricing competition has intensified and due to mandatory rate decreases in Florida, Massachusetts and Nevada. We do believe the benefit changes and other actions we have taken in those states have allowed us to maintain underwriting profitability even in these more competitive environments. The increase in premium volume in lines other than workers' compensation has been driven by new programs we have implemented with both existing and new programs partners, all of which have proven track records of profitability and for which we believe we are receiving adequate pricing to produce our targeted return on equity. Overall, both net written premium and net earned premium have increased over the same time frame, largely as a result of the increase in the amount of premium we retain versus premium ceded to excess of loss reinsurers.

Our Loss and Loss Adjustment Expense Reserves

We establish a liability for losses and loss adjustment expenses (LAE), which represent case base estimates of reported unpaid losses and LAE and actuarial estimates of incurred but not reported losses (IBNR) and LAE. In addition, the liability for losses and loss adjustment expenses represents estimates received from ceding reinsurers on assumed business. We project an estimate of ultimate losses and LAE expenses at each reporting date. The difference between the projected ultimate loss and LAE reserves and the case loss and LAE reserves, is carried as IBNR reserves. By using both estimates of reported claims and IBNR determined using generally accepted actuarial reserving techniques, we estimate the ultimate liability for losses and LAE, net of reinsurance recoverables. While we believe the amount of our reserves is adequate, the ultimate liability may be greater or less than the estimate.

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Reinsurance recoverables represent (1) amounts currently due from reinsurers on paid losses and LAE, (2) amounts recoverable from reinsurers on case basis estimates of reported losses and LAE, and (3) amounts recoverable from reinsurers on actuarial estimates of incurred but not reported losses and LAE. Such recoverables, by necessity, are also based upon estimates and, while management believes that the amount accrued is collectible, the ultimate recoverable may be greater or less than the amount accrued.

Reserves related to our direct business and assumed business we manage directly are established through transactions processed through our internal systems and related controls. Accordingly, case reserves are established on a current basis, and regularly reviewed and updated as additional information becomes available. IBNR is determined utilizing various actuarial methods based upon historical data. Ultimate reserve estimates related to assumed business from residual markets are provided by individual states on a two quarter lag and include an estimated reserve based upon actuarial methods for this lag. Assumed business which is subsequently 100% retroceded to participating reinsurers relates to business previously discontinued and now is in run-off. Finally, in relation to assumed business from other sources, we receive case and paid loss data within a forty-five day reporting period and develop estimates for IBNR based on current and historical data.

The completeness and accuracy of data received by cedants on assumed business that we do not manage directly is verified through monthly reconciliations to detailed statements, inception to date rollforwards of claim data, actuarial estimates of historical trends, field audits, and a series of management oversight reports on a program basis.

Significant periods of time can elapse between the occurrence of a loss, the reporting of the loss to the insurer, and the insurer's payment of that loss. To recognize liabilities for unpaid losses and LAE, insurers establish reserves as balance sheet liabilities representing estimates of amounts needed to pay reported and unreported net losses and LAE.

The key assumptions we use in our selection of ultimate reserves include underlying actuarial methodologies, a review of current pricing and underwriting initiatives, an evaluation of reinsurance costs and retention levels, and a detailed claims analysis with an emphasis on how aggressive claims handling may be impacting the paid and incurred loss data trends embedded in the traditional actuarial methods. With respect to the ultimate estimates for losses and LAE, the key assumptions remained consistent for the years ended December 31, 2006, 2005, and 2004.

The following table sets forth our gross and net reserves for losses and LAE based upon the underlying source of data, at December 31, 2006 (in thousands):

	Case	IBNR	Total
Direct	\$ 181,884	\$ 227,864	\$ 409,748
Assumed-Directly Managed(1)	17,777	41,264	59,041
Assumed-Residual Markets(2)	9,242	16,855	26,097
Assumed-Retroceded	1,281	227	1,508
Assumed-Other	3,031	1,652	4,683
Gross	213,215	287,862	501,077
Less Ceded	90,038	108,384	198,422
Net	\$ 123,177	\$ 179,478	\$ 302,655

- (1) Directly managed represents business managed and processed by our underwriting, claims, and loss control departments, utilizing our internal systems and related controls.
- (2) Residual markets represent mandatory pooled workers' compensation business based upon an individual company's market share by state.

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The following table sets forth our net case and IBNR reserves for losses and LAE by line of business at December 31, 2006 (in thousands):

	Net Case	Net IBNR	Total
Workers Compensation	\$ 60,882	\$ 76,231	\$ 137,113
Residual Markets	9,242	16,856	26,098
Commercial Multiple Peril/General Liability	21,340	41,716	63,056
Commercial Automobile	24,555	30,087	54,642
Other	7,158	14,588	21,746
Total	\$ 123,177	\$ 179,478	\$ 302,655

The following table provides a reconciliation of gross and net reserves on a generally accepted accounting principles (GAAP) basis, for the specified periods, reflecting changes in losses incurred and paid losses (in thousands):

	For the Years Ended December 31,		
	2006	2005	2004
Balance, beginning of year	\$ 458,677	\$ 378,157	\$ 339,465
Adjustment for deconsolidation of subsidiary(1)			(2,989)
Less reinsurance recoverables	187,254	151,161	147,446
Net balance, beginning of year	271,423	226,996	189,030
Incurred related to:			
Current year	149,012	146,658	131,409
Prior years	(2,719)	4,884	4,529
Total incurred	146,293	151,542	