

ASSURANCEAMERICA CORP  
Form 10-Q  
May 14, 2010  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

**FORM 10-Q**

(Mark one)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2010**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 0-06334**

**AssuranceAmerica Corporation**

(Exact name of smaller reporting company as specified in its charter)

Edgar Filing: ASSURANCEAMERICA CORP - Form 10-Q

**Nevada**  
(State of Incorporation)

**87-0281240**  
(IRS Employer ID Number)

**5500 Interstate North Parkway, Suite 600**  
(Address of principal executive offices)

**30328**  
(Zip Code)

**(770) 952-0200**

(Issuer's telephone number, including area code)

Check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
YES  NO

There were 65,494,357 shares of the Registrant's \$.01 par value Common Stock outstanding as of May 10, 2010.

**Table of Contents**

**ASSURANCEAMERICA CORPORATION**

**Index to Form 10-Q**

	<b>Page</b>
<b>PART I FINANCIAL INFORMATION</b>	
<b>Item 1 Financial Statements</b>	
<u>Consolidated Balance Sheets as of March 31, 2010 and December 31, 2009</u>	3
<u>Consolidated Statements of Operations For the Three Months Ended March 31, 2010 and March 31, 2009</u>	4
<u>Consolidated Statements of Comprehensive Income For the Three Months Ended March 31, 2010 and March 31, 2009</u>	5
<u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2010 and March 31, 2009</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
<b>Item 2 <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	16
<b>Item 3 <u>Quantitative and Qualitative Disclosures about Market Risk</u></b>	N/A
<b>Item 4 <u>Controls and Procedures</u></b>	23
<b>PART II OTHER INFORMATION</b>	
<b>Item 1A <u>Risk Factors</u></b>	24
<b>Item 2 <u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	29
<b>Item 3 <u>Defaults Upon Senior Securities</u></b>	29
<b>Item 4 <u>Removed and Reserved</u></b>	29
<b>Item 5 <u>Other Information</u></b>	29
<b>Item 6 <u>Exhibits</u></b>	29
<b><u>Signatures</u></b>	30

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

	(Unaudited)	
	March 31, 2010	December 31, 2009
<b>ASSETS</b>		
Cash and cash equivalents	\$ 6,305,051	\$ 6,253,643
Cash restricted	1,801,048	1,800,000
Short-term investments	366,134	365,717
Long-term investments, at fair value (amortized cost \$7,228,489 and \$7,745,142)	7,114,125	7,518,144
Long-term investments, held to maturity at amortized cost (fair value \$4,983,515 and \$4,981,850)	1,015,374	1,015,374
Marketable equity securities, at fair value (cost \$1,872,593 and \$1,888,334)	1,974,020	1,918,841
Other securities	155,000	155,000
Investment income due and accrued	102,755	180,719
Receivable from insureds	40,820,062	35,173,717
Reinsurance recoverable (including \$19,778,282 and \$14,099,266 on paid losses)	45,270,195	43,809,125
Prepaid reinsurance premiums	29,558,449	25,098,051
Deferred acquisition costs	2,908,125	2,457,647
Property and equipment (net of accumulated depreciation of \$4,532,829 and \$4,344,673)	2,005,948	2,012,963
Other receivables	1,276,891	1,766,762
Prepaid expenses	507,509	510,558
Intangibles (net of accumulated amortization of \$3,142,126 and \$3,051,877)	7,419,685	7,509,934
Security deposits	110,953	105,315
Prepaid income tax		249,452
Deferred tax assets	2,825,053	2,909,229
Other assets	332,289	335,526
<b>Total assets</b>	<b>\$ 151,868,666</b>	<b>\$ 141,145,717</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Accounts payable and accrued expenses	\$ 9,441,431	\$ 8,551,370
Unearned premium	42,298,260	35,916,156
Unpaid losses and loss adjustment expenses	35,966,420	41,972,983
Reinsurance payable	36,745,437	28,523,284
Provisional commission reserve	3,991,512	3,599,289
Funds withheld from reinsurers	1,875,000	1,875,000
Federal income taxes payable	292,295	
Revolving line of credit	1,200,000	1,500,000
Notes payable and related party debt	475,193	774,001
Junior subordinated debentures payable	4,983,515	4,981,850
<b>Total liabilities</b>	<b>137,269,063</b>	<b>127,693,933</b>
<b>Commitments and Contingencies</b>		
Common stock, \$.01 par value (authorized 120,000,000 and 80,000,000, outstanding 65,494,357 and 65,144,357)	654,943	651,442

Edgar Filing: ASSURANCEAMERICA CORP - Form 10-Q

Surplus-paid in	17,554,616	17,363,621
Accumulated deficit	(3,601,869)	(4,440,473)
Accumulated other comprehensive loss:		
Net unrealized losses on investment securities, net of taxes	(8,087)	(122,806)
<b>Total stockholders equity</b>	<b>14,599,603</b>	<b>13,451,784</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 151,868,666</b>	<b>\$ 141,145,717</b>

See accompanying notes to consolidated financial statements.

**Table of Contents****ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES****(Unaudited) CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Revenue:</b>		
Gross premiums written	\$ 32,379,713	\$ 33,599,969
Gross premiums ceded	(22,026,028)	(22,768,697)
<b>Net premiums written</b>	<b>10,353,685</b>	<b>10,831,272</b>
Increase in unearned premiums, net of prepaid reinsurance premiums	(1,921,706)	(2,543,761)
<b>Net premiums earned</b>	<b>8,431,979</b>	<b>8,287,511</b>
Commission income	6,479,576	6,680,972
Managing general agent fees	2,983,212	2,793,033
Net investment income	131,973	144,586
Net investment gains (losses) on securities	10,544	(239,887)
Other fee income	138,455	107,382
<b>Total revenue</b>	<b>18,175,739</b>	<b>17,773,597</b>
<b>Expenses:</b>		
Losses and loss adjustment expenses	5,957,458	5,759,991
Selling, general and administrative expenses	10,354,218	10,153,685
Stock option expense	89,495	78,895
Depreciation and amortization expense	278,406	300,244
Interest expense	97,481	134,357
<b>Total operating expenses</b>	<b>16,777,058</b>	<b>16,427,172</b>
<b>Income before provision for income tax expense</b>	<b>1,398,681</b>	<b>1,346,425</b>
Income tax provision	560,077	529,447
<b>Net income</b>	<b>\$ 838,604</b>	<b>\$ 816,978</b>
<b>Earnings per common share</b>		
Basic	\$ 0.013	\$ 0.013
Diluted	\$ 0.013	\$ 0.013
Weighted average shares outstanding-basic	65,385,468	65,047,708
Weighted average shares outstanding-diluted	65,948,319	65,147,708

See accompanying notes to consolidated financial statements.

**Table of Contents****ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES****(Unaudited) CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Net income</b>	<b>\$ 838,604</b>	<b>\$ 816,978</b>
<b>Other comprehensive gain (losses):</b>		
Change in unrealized gains (losses) of investments:		
Unrealized (gains) losses arising during the year	194,098	(114,239)
Reclassification adjustment for realized (gains) losses recognized during the year	(10,544)	239,887
Net change in unrealized gains	183,554	125,648
Deferred income taxes on above changes	(68,835)	(47,118)
Other comprehensive gains	114,719	78,530
<b>Comprehensive income</b>	<b>\$ 953,323</b>	<b>\$ 895,508</b>

See accompanying notes to consolidated financial statements.

**Table of Contents****ASSURANCEAMERICA COPORATION AND SUBSIDIARIES****(Unaudited) CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 838,604	\$ 816,978
<b>Adjustments to net income to net cash provided (used) by operating activities</b>		
Net investment (gains) losses on securities	(10,544)	239,887
Depreciation and amortization	297,227	299,384
Stock-based compensation	89,495	78,895
Deferred tax provision	15,345	136,287
<b>Changes in assets and liabilities:</b>		
Investment income due and accrued	77,964	(46,565)
Receivables	(5,156,474)	(8,210,857)
Prepaid expenses and other assets	648	17,410
Unearned premiums	6,382,104	8,641,167
Unpaid loss and loss adjustment expenses	(6,006,563)	307,415
Ceded reinsurance payable	8,222,153	3,573,017
Reinsurance recoverable	(1,461,070)	(1,212,494)
Prepaid reinsurance premiums	(4,460,398)	(6,097,405)
Accounts payable and accrued expenses	890,061	75,152
Prepaid income taxes/federal income taxes payable	541,747	385,395
Deferred acquisition costs	(450,478)	(490,047)
Provisional commission reserve	392,223	598,140
<b>Net cash provided (used) by operating activities</b>	<b>202,044</b>	<b>(888,241)</b>
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment, net	(181,142)	(82,090)
Change in short-investments	(417)	405
Proceeds from sales, call and maturities of investments	628,676	1,897,436
Purchases of investments	(102,897)	(2,306,455)
Transfer of cash to restricted cash	(1,048)	
Cash received on sale of book of business		30,000
Cash paid for acquisition of agencies, net of cash acquired		(28,800)
<b>Net cash provided (used) by investing activities</b>	<b>343,172</b>	<b>(489,504)</b>
<b>Cash flows from financing activities:</b>		
Repayment of notes payable	(298,808)	(247,388)
Net change in revolving line of credit	(300,000)	
Stock issued, net of expenses	105,000	120,000
<b>Net cash used by financing activities</b>	<b>(493,808)</b>	<b>(127,388)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>51,408</b>	<b>(1,505,133)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>6,253,643</b>	<b>8,287,149</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 6,305,051</b>	<b>\$ 6,782,016</b>

See accompanying notes to consolidated financial statements.





**Table of Contents**

**ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**March 31, 2010 and 2009**

**(1) Description of Business**

AssuranceAmerica Corporation, a Nevada corporation (the Company) is an insurance holding company whose business is comprised of AssuranceAmerica Insurance Company (AAIC), AssuranceAmerica Managing General Agency, LLC (MGA) and TrustWay Insurance Agencies, LLC (TrustWay), each wholly-owned. The Company solicits and underwrites non-standard private passenger automobile insurance. The Company is headquartered in Atlanta, Georgia.

**(2) Summary of Significant Accounting Policies**

**Basis of Consolidation and Presentation**

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. In our opinion, the financial statements reflect all adjustments (consisting solely of normal recurring accruals) necessary for a fair presentation of the financial position, results of operations and cash flows for the interim period. Certain items in prior period financial statements have been reclassified to conform to the current presentation. For further information, please refer to our audited consolidated financial statements appearing in the Form 10-K for the year ended December 31, 2009.

**Valuation of available-for-sale investments.** Our available for sale investment portfolio are recorded at fair value, which is typically based on publicly-available quoted prices. From time to time, the carrying value of our investments may be temporarily impaired because of the inherent volatility of publicly-traded investments. We do not adjust the carrying value of any investment unless management determines that the impairment of an investment's value is other than temporary.

We conduct regular reviews to assess whether our investments are impaired and if any impairment is other than temporary. Factors considered by us in assessing whether an impairment is other than temporary include the credit quality of the investment, the duration of the impairment, our ability and intent to hold the investment until recovery or maturity and overall economic conditions. If we determine that the value of any investment is other-than-temporarily impaired, we record a charge against earnings in the amount of the impairment.

Gains and losses realized on the disposition of available for sale investment securities are determined on the specific identification basis and credited or charged to income. Premium and discount on available for sale investment securities are amortized and accreted using the interest method and charged or credited to investment income.

**Valuation of held to maturity investments.** Our held to maturity investments consists of Redeemable Preferred securities, which are carried at amortized cost with realized gains and losses reported in the current period's earnings. Premium and discount on these securities are amortized and accreted using the interest method and charged or credited to investment income.

**Valuation of trading investments.** Our trading investment portfolio consists of equity securities, which are carried at fair value with realized gains and losses reported in the current period's earnings.

**Estimates**

A discussion of our significant accounting policies and the use of estimates is included in the notes to the consolidated financial statements included in the Company's Financial Statements for the year ended December 31, 2009 as filed with the Securities and Exchange Commission in the 2009 Form 10-K.

## **Table of Contents**

### **Disclosures about Fair Value Measurements**

In January 2010, the FASB issued Accounting Standards Update ( ASU ) No. 2010-06, Fair Value Measurements and Disclosures (Topic 820), the FASB issued new accounting guidance which expands disclosure requirements relating to fair value measurements. The guidance adds requirements for disclosing amounts of and reasons for significant transfers into and out of Levels 1 and 2 and requires gross rather than net disclosures about purchases, sales, issuances and settlements relating to Level 3 measurements. The guidance also provides clarification that fair value measurement disclosures are required for each class of assets and liabilities. Disclosures about the valuation techniques and inputs used to measure fair value for measurements that fall in either Level 2 or Level 3 are also required. The Company adopted the provisions of the new guidance as of March 31, 2010, except for disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements, which are required for fiscal years beginning after December 15, 2010. Disclosures are not required for earlier periods presented for comparative purposes. The new guidance affects disclosures only; and therefore, the adoption had no impact on the Company's results of operations or financial position.

### **Subsequent Events**

On February 24, 2010, the FASB issued ASU 2010-09 to amend ASC 855, Subsequent Events. As a result of the ASU, SEC registrants will not disclose the date through which management evaluated subsequent events in the financial statements either in originally issued financial statements or in reissued financial statement.

### **Consolidation of Variable Interest Entities**

In June 2009, the FASB issued ASU 2009-17, Consolidations (Topic 810), the FASB issued new accounting guidance which requires an entity to perform a qualitative analysis to determine whether it holds a controlling financial interest (i.e., is a primary beneficiary) in a variable interest entity ( VIE ). The analysis identifies the primary beneficiary of a VIE as the entity that has both the power to direct the activities of the VIE that most significantly impact the economic performance of the VIE and the obligation to absorb losses, or the right to receive benefits, that could potentially be significant to the VIE. The Company adopted the new guidance as of January 1, 2010. The adoption had no impact on the Company's results of operations or financial position.

### **(3) Investments**

All of the Company's marketable equity and long-term investment securities have been classified as available-for-sale, except for the redeemable trust preferred, which is carried at amortized cost. The Company's long-term securities are available to be sold in response to the Company's liquidity needs, changes in market interest rates, asset-liability management strategies, and other economic factors. Investments available-for-sale are stated at fair value on the balance sheet. Unrealized gains and losses are excluded from earnings and are reported as a component of other comprehensive income within shareholders' equity, net of related deferred income taxes.

A decline in the fair value of an available-for-sale security below cost that is deemed other than temporary results in a charge to income, resulting in the establishment of a new cost basis for the security. Net unrealized losses for the three months ended March 31, 2010 and 2009 were \$12,937 and \$977,011, respectively.

Premiums and discounts are amortized or accreted, respectively, over the life of the related fixed maturity security as an adjustment to yield using a method that approximates the effective interest method. Dividends and interest income are recognized when earned. Realized gains and losses are included in earnings and are derived using the specific-identification method for determining the cost of securities sold.

**Table of Contents**

A summary of investments follows as of:

	March 31, 2010	December 31, 2009
Short-term investments and bank certificates of deposit	\$ 366,134	\$ 365,717
U.S. Treasury securities and obligations of U.S. government corporations and agencies	4,450,392	4,967,070
Corporate debt securities	3,679,107	3,566,448
Marketable equity securities	1,974,020	1,918,841
<b>Total</b>	<b>\$ 10,469,653</b>	<b>\$ 10,818,076</b>

The amortized cost, fair value and gross unrealized gains or losses of debt securities available-for-sale at March 31, 2010 and December 31, 2009, by contractual maturity, is shown below:

Years to Maturity	March 31, 2010	Gross		Fair Value	
		Amortized Cost	Unrealized Gains		Unrealized Losses
One to five years		\$ 4,487,469	\$ 48,504	\$ 6,731	\$ 4,529,242
Five to ten years		1,822,764	6,889	165,832	1,663,821
Over ten years		918,256	5,146	2,340	921,062
<b>Total</b>		<b>\$ 7,228,489</b>	<b>\$ 60,539</b>	<b>\$ 174,903</b>	<b>\$ 7,114,125</b>

Years to Maturity	December 31, 2009	Gross		Fair Value	
		Amortized Cost	Unrealized Gains		Unrealized Losses
One to five years		\$ 4,501,055	\$ 45,063	\$ 34,560	\$ 4,511,558
Five to ten years		2,325,276	3,674	220,404	2,108,546
Over ten years		918,811		20,771	898,040
<b>Total</b>		<b>\$ 7,745,142</b>	<b>\$ 48,737</b>	<b>\$ 275,735</b>	<b>\$ 7,518,144</b>

The amortized cost, fair value and gross unrealized gains or losses of securities available-for-sale at March 31, 2010 and December 31, 2009, by security type, is shown below:

Security Type	March 31, 2010	Gross		Fair Value	
		Amortized Cost	Unrealized Gains		Unrealized Losses
U.S. Treasury securities and obligations of U.S. government corporations and agencies		\$ 4,510,634	\$ 13,613	\$ 73,855	\$ 4,450,392
Corporate debt securities		2,717,855	46,926	101,048	2,663,733
Marketable equity securities		1,872,593	254,678	153,251	1,974,020
<b>Total</b>		<b>\$ 9,101,082</b>	<b>\$ 315,217</b>	<b>\$ 328,154</b>	<b>\$ 9,088,145</b>

Edgar Filing: ASSURANCEAMERICA CORP - Form 10-Q

<b>Security Type</b>	<b>December 31, 2009</b>	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
U.S. Treasury securities and obligations of U.S. government corporations and agencies		\$ 5,016,183	\$ 3,674	\$ 52,787	\$ 4,967,070
Corporate debt securities		2,728,959	45,063	222,948	2,551,074
Marketable equity securities		1,888,334	176,186	145,679	1,918,841
<b>Total</b>		<b>\$ 9,633,476</b>	<b>\$ 224,923</b>	<b>\$ 421,414</b>	<b>\$ 9,436,985</b>

The amortized cost of securities held to maturity at March 31, 2010 and December 31, 2009, by security type, is shown below:

<b>Security Type</b>	<b>March 31, 2010</b>	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized losses</b>	<b>Fair Value</b>
Corporate debt securities		\$ 1,015,374	\$ 3,968,141	\$	\$ 4,983,515

<b>Security Type</b>	<b>December 31, 2009</b>	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized losses</b>	<b>Fair Value</b>
Corporate debt securities		\$ 1,015,374	\$ 3,966,476	\$	\$ 4,981,850

**Table of Contents**

As of March 31, 2010, the Company has determined that all of the unrealized losses in the table above were temporary.

There were no fundamental issues with any of these securities and the Company has the ability and intent to hold the securities until there is a recovery in fair value. The carrying amounts of individual assets are reviewed at each balance sheet date to assess whether the fair values have declined below the carrying amounts. The Company considers internal and external information, such as credit ratings, in concluding that the impairments are not other than temporary.

The following table shows the gross unrealized losses and fair value of securities, aggregated by category and length of time that securities have been in a continuous unrealized loss position at March 31, 2010 and December 31, 2009.

	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Estimated Market Fair Value	Gross Unrealized Losses	Estimated Market Fair Value
<b>March 31, 2010:</b>				
U.S. Treasury and government agencies	\$ 73,855	\$ 2,546,313	\$	\$
Corporate debt securities	1,144	707,386	99,904	441,474
Equity securities	34,796	118,108	118,455	569,642
	\$ 109,795	\$ 3,371,807	\$ 218,359	\$ 1,011,116
<b>December 31, 2009:</b>				
U.S. Treasury and government agencies	\$ 52,787	\$ 4,467,069	\$	\$
Corporate debt securities	9,604	1,162,896	213,344	327,822
Equity securities	6,308	84,836	139,371	657,196
	\$ 68,699	\$ 5,714,801	\$ 352,715	\$ 985,018

The total proceeds received on investments sold amounted to \$628,676 and \$1,897,436 for the three months ended March 31, 2010 and 2009, respectively. The Company had realized gains and losses of \$16,906 and \$6,362, respectively, during 2010 and \$60,072 and \$299,959, respectively, for the same period last year.

**(4) Fair Value Disclosures**

The fair value of our investments in fixed income and equity securities is based on observable market quotations, other market observable data, or is derived from such quotations and market observable data. We utilize third party pricing servicers, brokers and internal valuation models to determine fair value. We gain assurance of the overall reasonableness and consistent application of the assumptions and methodologies and compliance with accounting standards for fair value determination through our ongoing monitoring of the fair values received or derived internally.

Level 1 inputs are unadjusted, quoted prices in active markets for identical instruments at the measurement date (e.g., U.S. Treasury securities and active exchange-traded equity securities). Level 2 securities are comprised of securities whose fair value was determined by a nationally recognized pricing service using observable market inputs. Level 3 securities are comprised of (i) securities for which the pricing service is unable to provide a fair value, (ii) securities whose fair value is determined by the pricing service based on unobservable inputs and (iii) securities, other than securities backed by the U.S. Government, that are not rated by a nationally recognized statistical rating organization.

The following table illustrates the fair value measurements as of March 31, 2010:

	Quoted Prices in Active Markets	Significant Other	Significant Other
--	------------------------------------	----------------------	----------------------

Edgar Filing: ASSURANCEAMERICA CORP - Form 10-Q

Description:	(Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Available for sale securities	\$ 4,450,392	\$ 2,663,733	\$
Marketable equity securities	1,974,020		
Total	\$ 6,424,412	\$ 2,663,733	\$

**Table of Contents****(5) Losses and Loss Adjustment Expenses**

The estimated liabilities for losses and loss adjustment expenses ( LAE ) include the accumulation of estimates for losses for claims reported prior to the balance sheet dates ( case reserves ), estimates (based upon actuarial analysis of historical data) of losses for claims incurred but not reported ( IBNR ) and for the development of case reserves to ultimate values, and estimates of expenses for investigating, adjusting and settling all incurred claims. Amounts reported are estimates of the ultimate costs of settlement, net of estimated salvage and subrogation. These estimated liabilities are subject to the outcome of future events, such as changes in medical and repair costs as well as economic and social conditions that impact the settlement of claims. Management believes that, given the inherent variability in any such estimates, the aggregate reserves are reasonably adequate. The methods of making such estimates and for establishing the resulting reserves are reviewed and updated quarterly and any resulting adjustments are reflected in current operations.

A summary of unpaid losses and loss adjustment expenses, net of reinsurance ceded, is as follows:

	March 31, 2010	December 31, 2009
Case basis	\$ 5,714,464	\$ 6,412,373
IBNR	4,760,043	5,850,751
<b>Total</b>	<b>\$ 10,474,507</b>	<b>\$ 12,263,124</b>

**(6) Reinsurance**

In the normal course of business, the Company seeks to reduce its overall risk levels by obtaining reinsurance from other insurance companies or reinsurers. Reinsurance premiums and reserves on reinsured business are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Reinsurance contracts do not relieve the Company from its obligations to policyholders. The Company periodically reviews the financial condition of its reinsurers to minimize its exposure to losses from reinsurer insolvencies.

Reinsurance assets include balances due from other insurance companies under the terms of reinsurance agreements. Amounts applicable to ceded unearned premiums, ceded loss payments and ceded claims liabilities are reported as assets in the accompanying balance sheets. The Company believes the fair value of its reinsurance recoverables approximates their carrying amounts.

The impact of reinsurance on the statements of operations for the periods ended March 31, 2010 and 2009, was as follows:

	March 31, 2010	March 31, 2009
<b>Premiums written:</b>		
Direct	\$ 32,379,870	\$ 33,459,712
Assumed	(157)	140,257
Ceded	(22,026,028)	(22,768,697)
<b>Net</b>	<b>\$ 10,353,685</b>	<b>\$ 10,831,272</b>
<b>Premiums earned:</b>		
Direct	\$ 25,997,766	\$ 24,773,774
Assumed	(157)	185,028
Ceded	(17,565,630)	(16,671,291)
<b>Net</b>	<b>\$ 8,431,979</b>	<b>\$ 8,287,511</b>



Edgar Filing: ASSURANCEAMERICA CORP - Form 10-Q

<b>Losses and loss adjustment expenses incurred:</b>		
Direct	\$ 21,745,841	\$ 19,486,037
Assumed	17,421	199,338
Ceded	(15,805,804)	(13,925,384)
Net	\$ 5,957,458	\$ 5,759,991

**Table of Contents**

The impact of reinsurance on the balance sheets as of the dates indicated was as follows:

	March 31, 2010	December 31, 2009
<b>Unpaid losses and loss adjustment expense:</b>		
Direct	\$ 35,823,430	\$ 41,814,027
Assumed	142,990	158,956
Ceded	(25,491,913)	(29,709,859)
Net	\$ 10,474,507	\$ 12,263,124
<b>Unearned premiums:</b>		
Direct	\$ 42,297,697	\$ 35,915,592
Assumed	563	564
Ceded	(29,558,449)	(25,098,051)
Net	\$ 12,739,811	\$ 10,818,105

The Company received \$5,087,537 in commissions on premiums ceded during the three-month period ended March 31, 2010. Had all of the Company's reinsurance agreements been cancelled at March 31, 2010, the Company would have returned \$7,327,246 in reinsurance commissions to its reinsurers and its reinsurers would have returned \$29,558,449 in unearned premiums to the Company.

**(7) Income Taxes**

The provisions for federal and state income taxes for the periods ended March 31, 2010 and 2009, were as follows:

	2010	2009
Current	\$ 544,732	\$ 393,160
Deferred	15,345	136,287
Total provision for income taxes	\$ 560,077	\$ 529,447

**(8) Capital Stock****Common Stock**

During the first three months of 2010 and 2009, the Company issued 350,000 and 190,476 shares of common stock, \$.01 par value to its board of directors, respectively.

**Stock-Based Compensation**

In April of 2010, the Company's shareholders approved the 2010 Incentive Plan (2010 Plan). The aggregate number of shares of common stock reserved and available for issuance pursuant to awards granted to participants under the 2010 Plan consists of 2,000,000 shares. As of March 31, 2010, there were 7,789,721 shares of the Company's common stock subject to outstanding awards under the prior 2000 Incentive Plan (the Prior Plan). As of such date, there were 102,629 shares of the Company's common stock reserved and available for future awards under the Prior Plan. The company will not grant any additional awards under the Prior Plan, and it will expire in June 2010.

There were no options granted during the three-months ended March 31, 2010. The weighted-average grant date fair value of options granted during the three months ended March 31, 2009, using the Black-Scholes-Merton option-pricing model, was \$0.2416. There were no options exercised during the three month periods ended March 31, 2010 and 2009.



**Table of Contents**

Total compensation cost for share-based payment arrangements recognized for the three-month periods ended March 31, 2010 and March 31, 2009 was \$89,495 and \$78,895, respectively. The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton option-pricing model using the assumptions noted in the following table.

	<b>March 31, 2009</b>
Weighted-average-grant-date fair value	\$0.2416
Expected volatility	108% - 109%
Weighted average volatility	109%
Risk-free interest rate	2.47% - 3.02%
Expected term (in years)	9.72
Forfeiture rate (per year)	7.0%

A summary of all stock option activity during the three months ending March 31, 2010 and 2009, were as follows:

	<b>March 31, 2010</b>		<b>March 31, 2009</b>	
	<b>Number of Shares</b>	<b>Weighted Average_ Exercise Price</b>	<b>Number of Shares</b>	<b>Weighted Average_ Exercise Price</b>
<b>Options Outstanding</b>				
January 1	7,789,721	\$ 0.53	6,230,008	\$ 0.66
Add (deduct):				
Granted			392,190	\$ 0.25
Forfeited			(52,577)	\$ 0.84
March 31	7,789,721	\$ 0.53	6,569,621	\$ 0.64
Exercisable, March 31	3,168,875	\$ 0.68	2,309,439	\$ 0.71

**(9) Commitments and Contingencies****Contingencies**

In the normal course of business, the Company is named as a defendant in lawsuits related to claims and other insurance policy issues. Some of the actions seek extra-contractual and/or punitive damages. These actions are vigorously defended unless a reasonable settlement appears appropriate. In the opinion of management, the ultimate outcome of known litigation is not expected to be material to the Company's financial condition, results of operations, or cash flows.

**Contractual Commitments**

The Company leases office space for its corporate headquarters in Atlanta, Georgia. Effective October 1, 2009 the Company signed an amendment to extend its lease until 2019 under more favorable lease terms. The Company leases retail office space at various locations in Georgia, Florida and Alabama under short to medium term commercial leases. The Company also leases office equipment for use in its various locations. Rent expense for long-term leases with predetermined minimum rental escalations is recognized on a straight-line basis, and the difference between the recognized rental expense and amounts payable under the leases, or deferred rent, is included in other liabilities. The Company has a software license agreement with terms greater than one year.

The Company also has contractual commitments in association with long-term debt owed to its current Chairman and Chief Executive Officer in the amount of \$230,723 and \$244,257 owed to unrelated parties. Further, the Company has a long-term commitment in connection with Junior Subordinated Debentures issued in December 2005. On March 10, 2009, AAIC purchased all of the Capital Securities issued by the Trust at a discounted price of \$1,000,000 from the non-affiliated holder of those securities. The discount is being accreted to interest income over the remaining life of the Capital Securities using the interest method. The purchase resulted in an increase in our investment portfolio for redeemable preferred stock in the amount of \$1,015,374. Please refer to Note 7 of the *Notes to Consolidated Financial Statements*, as of December 31, 2009 included in our Annual Report on Form 10-K for additional information about the long-term debt arrangements.



**Table of Contents**

Minimum amounts due under the Company's non-cancelable commitments at March 31, 2010 are as follows:

	<b>Long-Term Debt Obligations</b>	<b>Operating Lease Obligations</b>	<b>Total</b>
<b>Payments due by period</b>			
<b>Less than 1 year</b>	\$ 359,725	\$ 1,082,114	\$ 1,441,839
<b>1-3 years</b>	115,468	2,733,920	2,849,388
<b>4-5 years</b>		1,346,854	1,346,854
<b>More than 5 years</b>	4,983,515	2,974,152	7,957,667
<b>Total</b>	<b>\$ 5,458,708</b>	<b>\$ 8,137,040</b>	<b>\$ 13,595,748</b>

**Defined Contribution Plan**

The Company's associates participate in the AssuranceAmerica Corporation 401(k) defined contribution retirement plan. Under the plan, the Company can elect to make discretionary contributions. Effective January 1, 2008, the Company elected to match 33% of employee contributions up to 6% of gross earnings. Matching contributions during the first three months of 2010 and 2009 were \$29,868 and \$23,925, respectively. The eligibility requirements are 21 years of age, 6 months of service and full time employment.

**(10) Net Income Per Share**

Basic and diluted income per common share is computed using the weighted average number of common shares outstanding during the period. Potential common shares not included in the calculations of net income per share for the three-month periods ended March 31, 2010 and 2009, because their inclusion would be anti-dilutive, are as follows:

	<b>2010</b>	<b>2009</b>
Stock options	4,740,845	4,499,021

The reconciliation of the amounts used in the computation of both basic earnings per share and diluted earnings per share for the three-month periods ended March 31, 2010 and 2009 are as follows:

	<b>Net Income</b>	<b>Average Shares Outstanding</b>	<b>Per Share Amount</b>
<b>For the three months ended March 31, 2010:</b>			
Net income - basic	\$ 838,604	65,385,468	\$ 0.013
Effect of dilutive stock warrants and options		562,851	
Net income - diluted	\$ 838,604	65,948,319	\$ 0.013
<b>For the three months ended March 31, 2009:</b>			
Net income - basic	\$ 816,978	65,047,708	\$ 0.013
Effect of dilutive stock warrants and options		100,000	
Net income - diluted	\$ 816,978	65,147,708	\$ 0.013

**(11) Supplemental Cash Flow Information**

	<b>2010</b>	<b>2009</b>
Cash paid during the three months ended March 31:		
Interest	\$ 97,481	\$ 134,357
Income taxes	2,985	

On March 1, 2009 the Company purchased the assets of First Choice Insurance, LLC. for cash of \$28,800 and as part of the purchase agreement the Company issued a note payable in the amount of \$115,200.

The following table illustrates the composition of acquisitions for the three months ended March 31, 2010 and 2009:

	<b>2010</b>	<b>2009</b>
Fair value of assets acquired, including identifiable intangibles	\$	\$ 80,000
Goodwill		64,000
Cash paid to sellers		(28,800)
Note payable to seller	\$	\$ 115,200

**Table of Contents****(12) Pending Accounting Pronouncements**

The Company periodically reviews recent accounting pronouncements issued by the FASB and Staff Accounting Bulletins issued by the United States Securities and Exchange Commission to determine the potential impact on the Company's financial statements.

The following accounting standard that has been issued by the FASB and other standard setting entities that does not require adoption until a future date is not expected to have a material impact on the Company's financial statements upon adoption. In addition, ASUs that are not relevant to the Company have been omitted.

In March 2010, the FASB issued ASU 2010-11, Derivatives and Hedging, (Topic 815), provided accounting guidance that clarifies the scope exception for embedded credit derivative features related to the transfer of credit risk in the form of subordination of one financial instrument to another. The guidance addresses how to determine which embedded credit derivative features, including those in collateralized debt obligations and synthetic collateralized debt obligations, are considered to be embedded derivatives that should not be analyzed for potential bifurcation and separate accounting under the existing accounting guidance for embedded derivatives. The guidance is effective for fiscal quarters beginning after June 15, 2010. The Company does not expect this accounting standard to have any effect on the results of operations or financial position.

**(13) Segment Reporting**

The Company's subsidiaries are each unique operating entities performing a separate business function. AAIC, a property and casualty insurance company focuses on writing nonstandard automobile business in the states of Georgia, Alabama, Arizona, Florida, Indiana, Louisiana, Mississippi, South Carolina, Texas and Virginia. MGA markets AAIC's policies through more than 2,500 independent agencies in these states. MGA provides all of the underwriting, accounting, product management, legal, policyholder administration and claims functions for AAIC and for two unaffiliated insurers that retain the non-standard automobile insurance policies produced by MGA in Florida and Texas. MGA receives various fees related to insurance transactions that vary according to state insurance laws and regulations. TrustWay is comprised of 43 retail insurance agencies that focus on selling nonstandard automobile policies and related coverages in Georgia, Florida and Alabama. TrustWay receives commissions and various fees associated with the sale of the products and services from its appointing insurance carriers.

The Company evaluates profitability based on pretax income. Pretax income for each segment is defined as the revenues less the segment's operating expenses including depreciation, amortization and interest.

Following are the operating results for the Company's various segments and an overview of segment assets:

(\$ in thousands)	MGA	TrustWay	AAIC	Company	Eliminations	Consolidated
<b>FIRST QUARTER 2010</b>						
<b>Revenues</b>						
External customer	\$ 7,574	\$ 1,951	\$ 8,651	\$	\$	\$ 18,176
Intersegment	2,144	575	1,039	848	(4,606)	
<b>Income</b>						
Segment pretax income (loss)	986	(35)	468	(20)		1,399
<b>Assets</b>						
Segment assets	17,206	11,359	135,619	24,408	(36,723)	151,869



**Table of Contents**

(\$ in thousands)	MGA	TrustWay	AAIC	Company	Eliminations	Consolidated
<b>FIRST QUARTER 2009</b>						
<b>Revenues</b>						
External customer	\$ 7,742	\$ 1,794	\$ 8,238	\$	\$	\$ 17,774
Intersegment	2,363	980	1,106	711	(5,160)	
<b>Income</b>						
Segment pretax income (loss)	963	23	401	(41)		1,346
<b>Assets</b>						
Segment assets	16,247	13,076	128,069	21,884	(33,453)	145,823

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Results of Operations**

The Company reported net income of \$839 thousand for the three months ended March 31, 2010 compared to a net income of \$817 thousand for the three-months ended March 31, 2009. The Company's fully diluted earnings per common share for the first quarter of March 31, 2010 were \$0.013 compared to fully diluted earnings of \$0.013 for the first quarter March 31, 2009. The slight increase in net income resulted from higher premiums earned along with an improvement in investment gains and losses for the period.

**Revenues****Premiums**

Gross premiums written for the three-months ended March 31, 2010 were \$32.4 million compared to \$33.6 million in gross premiums written in 2009. The decline in premium of \$1.2 million was mainly related to a \$3.2 million decrease in premium for the state of Florida due to an increase in rates and underwriting actions taken in response to difficult market conditions. This decline was offset by growth in Texas and Virginia. The Company implemented a new one month policy product in Texas during 2009, and it generated \$0.7 million in additional premium in the first three months of 2010 when compared to 2009. Further, the Company entered into the state of Virginia in the month of February which resulted in \$0.9 million in premium growth. Policies in force increased 8% during the first three-months of 2010. The Company ceded approximately 70% of its direct premiums written to its reinsurers during 2010, constant with the rate in 2009.

Premiums written refers to the total amount of premiums billed to the policyholder less the amount of premiums returned, generally as a result of cancellations, during a given period. Premiums written become premiums earned as the policy ages. Barring premium rate changes, if an insurance company writes the same mix of business each year, premiums written and premiums earned will be equal and the unearned premium reserve will remain constant. During periods of growth, the unearned premium reserve will increase, causing premiums earned to be less than premiums written. Conversely, during periods of decline, the unearned premium reserve will decrease, causing premiums earned to be greater than premiums written. The Company's net premiums earned, after deducting reinsurance, was \$8.4 million for the first quarter of 2010 compared to \$8.3 million for the same period in 2009.

**Commission and Fee Income**

In our MGA operations, we receive managing general agent fees for agency, underwriting, policy administration, and claims adjusting services performed on behalf of insurers. We also receive commission and service fee income in TrustWay on other insurance products produced for unaffiliated insurance companies on which we do not bear underwriting risk, including travel protection, vehicle protection and hospital indemnity insurance policies. Commission rates vary between carriers and are applied to premiums written to determine commission income.

Commission income for the first three months of 2010 was \$6.5 million, a decrease of \$0.2 million, compared to the same period ended March 31, 2009, primarily due to the lower premium volume generated by the MGA. AAIC pays MGA commission on 30% of premium, which AAIC retains and this amount is subsequently eliminated upon consolidation.

Managing general agent fees for the period ended March 31, 2010 were \$3.0 million, an increase of \$0.2 million when compared to the same period of 2009, due to higher policy related fees on renewal premium.

---

## **Table of Contents**

Other fee income for the period ended March 31, 2010 was \$138 thousand, an increase of \$31 thousand when compared to the same period last year, due to higher revenue generated from towing and rental products offered to insureds in the retail (TrustWay) segment.

### ***Net Investment Income and investment gains and (losses)***

Our investment portfolio is generally highly liquid and consists substantially of readily marketable, investment-grade debt and equity securities. Net investment income is primarily comprised of interest and dividends earned on these securities and related investment expenses, net of realized investments gains and losses. Net investment income, including realized investment gains (losses) was \$143 thousand for the period ended March 31, 2010 compared to a loss of \$95 thousand for 2009. The increase of \$238 thousand mainly resulted from higher realized investment gains due to improved market conditions.

### **Expenses**

#### ***Loss and Loss Adjustment Expenses***

Losses and loss adjustment expenses include payments made to settle claims, estimates for future claim payments and changes in those estimates for current and prior periods, as well as loss adjustment expenses incurred in connection with settling claims. Losses and loss adjustment expenses are influenced by many factors, such as claims frequency and severity trends, the impact of changes in estimates for prior accident years, and increases in the cost of medical treatment and automobile repairs. The anticipated impact of inflation is considered when we establish our premium rates and set loss reserves. We work with our actuary to prepare a rolling quarterly actuarial analysis each month and establish or adjust (for prior accident quarters) reserves, based upon our estimate of the ultimate incurred losses and loss adjustment expenses to reflect loss development information and trends that have been updated for the most recent quarter's activity. Each quarter our estimate of ultimate loss and loss adjustment expenses is evaluated by accident quarter, by state and by major coverage group (e.g., bodily injury, physical damage) and changes in estimates are reflected in the period the additional information becomes known.

We have historically used reinsurance to manage our exposure to loss by ceding a portion of our gross losses and loss adjustment expenses to reinsurers. We remain obligated for amounts covered by reinsurance in the event that the reinsurers do not meet their obligations under the agreements due to, for example, disputes with the reinsurer or the reinsurer's insolvency. The Company cedes approximately 70% of its direct loss and loss adjustment expenses incurred to its reinsurers and the amount ceded for the first three months of 2010, was \$15.8 million compared to \$13.9 million as of March 31, 2009.

After making deductions for the effect of reinsurance, losses and loss adjustment expenses were \$6.0 million for the period ended March 31, 2010, compared to \$5.8 million for the same period in 2009. As a percentage of earned premiums, this amount increased slightly for the period ended March 31, 2010, from 69.5% to 70.7%, when compared with the same period in 2009. The amount represents actual payments made and changes in estimated future payments to be made to or on behalf of AAIC's policyholders, including the expenses associated with settling claims. The higher year-over-year loss ratio is mainly attributable to an increase in premium volume.

#### ***Other Expenses***

The selling, general and administrative expenses increased \$0.2 million for the period ended March 31, 2010 compared to the same period of 2009. As a percentage of revenue, selling, general and administrative expenses for the three-month period ended March 31, 2010 remained stable at 57.0% when compared to 2009. Depreciation and amortization expense decreased \$22 thousand for the three-month period of March 31, 2010 when compared to the same period of 2009. This decrease is associated with the decrease in fixed and intangible assets additions during the year. Lastly, the interest expense was lower in 2010 as compared to 2009 by \$37 thousand due to a decrease in the interest rate on the Trust Preferred Junior Subordinated Debenture.

#### ***Income Tax Provision (Benefit)***

The provision for income taxes for the year ended March 31, 2010 was \$0.6 million, compared to \$0.5 million for 2009 and consists of federal and state income taxes at an effective rate of 40%. The effective tax rate remained flat in 2010 compared to 2009 due to the minimal change in net income before taxes.

---

**Table of Contents****Financial Condition**

As of March 31, 2010, the Company had investments and cash of \$18.7 million, compared to \$19.0 million as of December 31, 2009. The Company's investment strategy is to invest in highly liquid, short-term investments, and equity securities as well as investing in bonds with short durations in order to meet its insurance obligations. For the year ended March 31, 2010, the Company had \$8.5 million in cash and short-term investments, which included \$1.8 million of cash restricted to provide security for certain reinsurance reserve obligations. The equity security portfolio amounted to \$2.0 million and is diversified amongst various industries. The Company's long term investments of \$8.1 million are spread among direct obligations of the U.S. Treasury as well as those securities unconditionally guaranteed as to the payment of principal and interest by the United States government or any agency thereof and in corporate bonds. The Company's investment activities are made in accordance with the Company's investment policy. The objectives of the investment policy are to obtain favorable after-tax returns on investments through a diversified portfolio of fixed income, equity and real estate holdings. The Company's investment criteria and practices reflect the short-term duration of its contractual obligations with policyholders and regulators. Tax considerations include federal and state income tax as well as premium tax abatement and credit opportunities offered to insurance companies in the states where AAIC writes policies.

Premiums receivable as of March 31, 2010, increased \$5.6 million to \$40.8 million compared to \$35.2 million as of December 31, 2009. The balance represents amounts due from AAIC's insureds and the increase is directly attributable to the increase in AAIC's premium writings during 2010. The Company's policy is to write off receivable balances immediately upon cancellation or expiration, and the Company does not consider an allowance for doubtful accounts to be necessary.

Reinsurance recoverables as of March 31, 2010, increased \$1.5 million, to \$45.3 million compared to \$43.8 million as of December 31, 2009. The increase is directly related to AAIC's unpaid reinsurance recoverable of \$5.7 million, offset by a decrease in ceded reinsurance reserves of \$4.2 million due to increase ceded loss and loss adjustment expenses. AAIC maintains a quota-share reinsurance treaty with its reinsurers in which it cedes approximately 70% of both premiums and losses. The \$45.3 million represents the reinsurers' portion of losses and loss adjustment expense, both paid and unpaid.

Prepaid reinsurance premiums as of March 31, 2010, increased \$4.5 million to \$29.6 million compared to \$25.1 million as of December 31, 2009. The increase results from AAIC's continued growth and represents premiums ceded to its reinsurers which have not been fully earned.

Deferred acquisitions costs as of March 31, 2010, increased \$0.4 million to \$2.9 million compared to \$2.5 million as of December 31, 2009. The increase results from AAIC's premium produced for the quarter.

Other receivables as of March 31, 2010 decreased \$0.5 million to \$1.3 million compared to \$1.8 million as of December 31, 2009. The balances represent TrustWay receivables from insurance carriers for direct bill commissions and balances due to MGA from insurance carriers for amounts owed in accordance with the terms of its managing general agency agreements. The decrease in the receivable is directly attributable to expense reimbursements due from two non-affiliated MGA's in the states of Florida and Texas of \$0.3 million and \$0.1 million received for uncollected agents balances.

Intangible assets as of March 31, 2010, decreased \$0.1 million to \$7.4 million from the balance of \$7.5 million as of December 31, 2009. This decrease is related to the reduced amortization of intangible assets in 2010.

Prepaid income taxes decreased \$0.2 million as of March 31, 2010 due to an increase in net income during the first quarter of March 31, 2010 and the Company is now in an income tax payable position.

Deferred tax assets decreased \$0.1 million to \$2.8 million as of March 31, 2009, compared to the balance of \$2.9 million as of December 31, 2009. This decrease primarily related to the utilization of net operating loss carry forwards during 2009.

Accounts payable and accrued expenses as of March 31, 2010, increased approximately \$0.8 million from December 31, 2009 to \$9.4 million from \$8.6 million. The increase is primarily due to \$0.6 million in premium taxes accrued, \$0.4 million in accrued expenses for payroll, \$0.3 million due to carriers and agents, offset by a decrease in deferred revenue of \$0.3 million.

## **Table of Contents**

Unearned premium as of March 31, 2010 increased \$6.4 million to \$42.3 million, compared to \$35.9 million as of December 31, 2009, and represents premiums written but not earned. This is directly attributable to the increase in AAIC's premium writings during 2010.

Unpaid losses and loss adjustment expenses decreased \$6.0 million to \$36.0 million as of March 31, 2010 from \$42.0 million at December 31, 2009. The decrease is mainly due to the increase in claim settlements during the period as the Company is accelerating and paying claims faster, which should improve claim results. This unpaid amount represents management's estimates of future amounts needed to pay claims and related expenses.

Reinsurance payable as of March 2010 increased \$8.2 million to \$36.7 million, compared to \$28.5 million as of December 31, 2009. The amount represents premiums owed to the Company's reinsurers. AAIC maintains seven quota-share reinsurance treaties with its reinsurers in which it cedes 70% of both premiums and losses for the majority of its states. The increase is attributable to the higher AAIC's premium writings. The increase also reflects a reimbursement of \$1.0 million of premiums received from its reinsurers as a result of an overpayment in prior years.

Provisional commission reserves represent the difference between our minimum ceding commission and the provisional amount paid by the reinsurers. These balances as of March 31, 2010 increased \$0.4 million to \$4.0 million, compared to the balance at December 31, 2009. The increase is related to increases in AAIC writings.

Federal income taxes payable increased \$0.3 million as of March 31, 2010 due to an increase in net income during the first quarter of March 31, 2010.

Revolving line of credit as of March 31, 2010, decreased \$0.3 million to \$1.2 million compared to \$1.5 million as of December 31, 2009. The change resulted from \$0.3 million in payments made to reduce the line of credit.

Notes payable as of March 31, 2010, decreased \$0.3 million to \$0.5 million compared to \$0.8 million as of December 31, 2009. The change resulted primarily from \$0.3 million in payments applied to the principal balances payable on promissory notes to the Company's Chairman.

## **Liquidity and Capital Resources**

Net cash provided by operating activities for the period ended March 31, 2010, was \$0.2 million compared to net cash used by operating activities of \$0.9 million for the same period of 2009. The increase in operating activities was mainly due to a \$1.0 million reimbursement from the reinsurers offset by higher claims paid during the period.

Investing activities provided for the period ended March 31, 2010 amounted to \$0.3 million compared to \$0.5 million used as of December 31, 2009. The increase in the amount provided was mainly attributable to the net sales of investments in the amount of \$0.9 million, offset by \$0.1 million increase in purchases of computer software and hardware and leasehold improvements in our headquarters and in TrustWay.

Financing activities for the period ended March 31, 2010 included debt repayments to a related party in the amount of \$0.3 million and \$0.3 million repayment on the line of credit.

On July 17, 2009, the Company entered into an agreement with Wachovia Bank for a \$1.5 million revolving line of credit which expires July 16, 2010, unless terminated earlier according to the terms. The credit facility is secured by a pledge of the Company's ownership interests in two of the Company's subsidiaries, TrustWay Insurance Agencies, LLC and AssuranceAmerica Managing General Agency LLC, and is guaranteed by the same entities. In addition, TrustWay Insurance Agencies, LLC pledged its ownership interest in TrustWay T.E.A.M., Inc., which is also a guarantor. The Loan Agreement includes customary covenants, including financial covenants regarding minimum fixed charge coverage ratio and minimum net worth. As of March 31, 2010, management believes the Company was in compliance with all these covenants. The interest rate is 3.00% plus 90-day LIBOR due and payable monthly. Currently there is \$1.2 million in borrowings outstanding under the credit agreement.

The Company's liquidity and capital needs have been met in the past through premium, commission and fee income, loans from its Chairman, its former Chief Executive Officer, and former Division President of the Company and the issuance of its Series A Convertible Preferred Stock, Common Stock and Debt Securities. The Company's related party debt consists of unsecured promissory notes payable to its Chairman. The promissory notes carry an interest rate of 8% per annum and provide for the repayment of principal on an annual basis.



**Table of Contents**

On December 22, 2005, the Company consummated the private placement of 5,000 of the Trust's floating rate capital securities, with a liquidation amount of \$1,000 per capital security (the "Capital Securities"). In connection with the Trust's issuance and sale of the Capital Securities, the Company purchased from the Trust 155 of the Trust's floating rate common securities, with a liquidation amount of \$1,000 per common security (the "Common Securities"). The Trust used the proceeds from the issuance and sale of the Capital Securities and the Common Securities to purchase \$5,155,000 in aggregate principal amount of the floating rate junior subordinated debentures of the Company (the "Debentures"). The Capital Securities mature on December 31, 2035, but may be redeemed at par beginning December 31, 2010. The Capital Securities require quarterly distributions by the Trust to the holders of the Capital Securities, at a floating rate of three-month LIBOR plus 5.75% per annum, reset quarterly. Distributions are cumulative and will accrue from the date of original issuance but may be deferred for a period of up to 20 consecutive quarterly interest payment periods, if the Company exercises its right under the Indenture to defer the payment of interest on the Debentures.

On March 10, 2009, AAIC purchased all of the Capital Securities issued by the Trust at a discounted price of \$1,000,000 from the non-affiliated holder of those securities. The discount is being accreted to interest income over the remaining life of the Capital Securities using the interest method. The purchase resulted in an increase in our investment portfolio for redeemable preferred stock in the amount of \$1,015,374.

To support Company growth, the Company maintains a highly liquid investment portfolio and closely manages capital requirements. AAIC is required by the state of South Carolina to maintain minimum statutory capital and surplus of \$3.0 million. As of March 31, 2010, AAIC's statutory capital and surplus was \$12.6 million.

In April of 2010, AssuranceAmerica Corporation shareholder's approved the Company's 2010 Incentive Plan ("2010 Plan"). The aggregate number of shares of common stock reserved and available for issuance pursuant to awards granted to participants under the 2010 Plan consists of 2,000,000 shares. As of March 31, 2010, there were 7,789,721 shares of the Company's common stock subject to outstanding awards under the prior 2000 Incentive Plan (the "Prior Plan"). As of such date, there were 102,629 shares of the Company's common stock reserved and available for future awards under the Prior Plan. The Company will not grant any additional awards under the Prior Plan and it will expire in June 2010.

**Off-Balance Sheet Arrangements**

The Company does not have any off-balance sheet arrangements.

**Loss and LAE Reserves**

AssuranceAmerica is required to make certain estimates and assumptions when preparing its financial statements and accompanying notes in accordance with GAAP. One area which requires estimations and assumptions is the establishment of loss and LAE reserves. Loss and LAE reserves are established to reflect the estimated costs of paying claims and claims expenses under insurance policies we have issued. These reserves are an approximation of amounts necessary to settle all outstanding claims, including claims of which we are aware and claims that have been incurred but not reported ("IBNR") as of the financial statement date.

At March 31, 2010 and 2009, we had \$10.5 million and \$12.3 million of net loss and LAE reserves, which included \$5.7 million and \$6.4 million of case reserves and \$4.8 million and \$5.9 million of IBNR reserves. During 2010, the Company had a decrease in case reserves and IBNR reserves. This decrease is the result of an enhanced claims handling process enabling us to better serve our customers and accelerate claims payments in some cases, which reduces the need for reserves.

**GROSS RESERVES BY LINE OF BUSINESS**

The following table presents the gross reserves by line of business as of March 31, 2010 and December 31, 2009:

	2010	2009
Personal Auto Liability	\$ 33,070,909	\$ 37,545,120
Personal Auto Physical Damage	2,895,511	4,427,863
<b>Total Gross Reserves-Unpaid Losses and LAE</b>	<b>\$ 35,966,420</b>	<b>\$ 41,972,983</b>



**Table of Contents**

The decrease in gross reserves was \$6.0 million due to an increase in claims settlements and improved claim handling in the first quarter of 2010 in the liability line of business and \$4.5 million in auto physical damage of \$1.5 million.

**Variability of Reserves for Loss and LAE**

Management believes that there are no changes in key factors or assumptions that would materially affect the estimate of the reserves for loss and LAE and the financial position of the Company. The Company's low average policy limit and concentration on the nonstandard auto driver classification help stabilize fluctuations in frequency and severity, thereby limiting the potential variability the reserve level may have on reported results. For example, approximately 97% of policies included within the nonstandard book of business include only the state-mandated minimum policy limits for bodily injury and property damage, which mitigates the complexity of estimating average severity. These low limits tend to reduce the exposure of the loss reserves on this coverage to medical cost inflation on severe injuries since the minimum policy limits will limit the total payout.

The following table provides the estimated changes in the liability and related payments made for the calendar periods ended March 31, 2010 and 2009. The increase in paid losses and LAE has enabled us to reduce loss and LAE reserves over time.

	2010	2009
Change in net loss and LAE reserves	\$ (1,788,583)	\$ 32,465
Paid losses and LAE	7,746,041	5,727,526
<b>Total incurred losses and LAE</b>	<b>\$ 5,957,458</b>	<b>\$ 5,759,991</b>
Loss and LAE ratio(1)	70.7%	69.5%

(1) The ratio was calculated by taking losses and LAE divided by the Net Premiums Earned.

**Losses and Loss Adjustment Expenses (LAE)**

The Company's claims costs represents payments made and estimated future payments to be made to or on behalf of our policyholders, including expenses needed to adjust or settle claims. These costs relate to current costs under our non-standard state-mandated automobile insurance programs. Claims costs are impacted by loss severity and frequency and are influenced by inflation and driving patterns, among other factors. Accordingly, anticipated changes in these factors are taken into account when we establish premium rates and loss reserves.

During the quarter ended March 31, 2010, our loss and LAE ratio increased slightly by 1.2% as compared to a 11.1% decrease in the same period a year ago. The first quarter of March 2010 increase is due to an increase in industry-wide loss costs in both bodily injury and auto physical damage coverages and the March 2009 decrease was mainly related to an increase in premium production and policy fees, which were classified as premium in 2009. We continuously monitor internal and industry-wide severity trends and adjust rates as appropriate to compensate for the higher loss costs.

The table below presents the development experienced in the following periods:

	2010	2009
Prior year incurred losses	\$ 251,022	\$ (149,001)
Current year incurred losses and LAE	5,706,436	5,908,992
<b>Total incurred losses and LAE</b>	<b>\$ 5,957,458</b>	<b>\$ 5,759,991</b>
Increase (decrease) to the calendar year loss and LAE ratio	1.2%	(11.1)%





**Table of Contents**

The 2010 prior year incurred loss development was unfavorable by \$0.3 million for the first quarter of 2010 due to an increase in losses in the 2009 and prior accident years. The 2009 prior year-to-date development was favorable by \$0.1 million, which related to the 2008 and prior accident years. The unfavorable development reflects losses settling for more than previously reserved, particularly in our higher limit bodily injury coverages. Changes in our estimate of severity from what we originally expected when establishing the reserves is the principal cause of prior accident year development. These changes in estimates are the result of what we are observing in the underlying data as it develops. Our personal lines case loss reserves (e.g., claims settling for more than reserved) had minimal development during the year.

**Ceded Reinsurance**

AssuranceAmerica cedes a significant portion of its personal automobile premium to other reinsurers. The Company's reinsurance strategy is to use quota share reinsurance to mitigate the financial impact of losses on its operations, while enabling premium growth within its capital base. Historically, the Company's reinsurance contracts have been one or two years in duration, subject to renewal.

Reinsurance contracts do not relieve the Company from its obligations to policyholders. The Company periodically reviews the financial condition of its reinsurers to minimize its exposure to losses from reinsurer insolvencies. Further, the reinsurers cover up to \$2,000,000 in aggregate claims for extra contractual obligations each policy year.

**The impact of reinsurance on the income statement as of March 31 is as follows:**

	2010	2009
Premiums ceded written:	\$ 22,026,028	\$ 22,768,697
Ceding commissions earned:	\$ 5,087,537	\$ 5,260,537
Ceded losses and loss adjustment expenses incurred:	\$ 15,805,804	\$ 13,925,384

**The impact of reinsurance on the balance sheets as of March 31 is as follows:**

	2010	2009
Reinsurance recoverable:	\$ 45,270,195	\$ 43,809,125
Ceded unpaid losses and loss adjustment expense:	\$ 25,491,913	\$ 29,709,859
Ceded unearned premiums:	\$ 29,558,449	\$ 25,098,051
Reinsurance payable:	\$ 36,745,437	\$ 28,523,284

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policies. The Company reports as assets (a) the estimated reinsurance recoverable on unpaid losses, including an estimate for losses incurred but not reported, and (b) amounts paid to reinsurers applicable to the policies-in-force.

During 2010 and 2009, the Company ceded approximately 70% of its premium and losses to the contracted reinsurers. Premiums ceded under this reinsurance agreement for the three months ended March 31, 2010 and 2009 were \$22.0 million and \$22.8 million, respectively. The related ceding commission was approximately \$5.1 million in 2010 and \$5.3 million in 2009. The decline in ceded premium is mainly due to a decrease in premium volume in the states of Florida, offset by increases in Texas, Virginia and South Carolina.

Ceded reinsurance for all programs reduced the Company's incurred losses and LAE by \$15.8 million and \$13.9 million for the three months ended March 31, 2010 and 2009, respectively.

---

**Table of Contents**

Reinsurance assets include balances due from other contracted reinsurers under the terms of reinsurance agreements. Amounts applicable to ceded unearned premiums, ceded loss payments and ceded claims liabilities are reported as assets in the accompanying balance sheets. Under the reinsurance agreements, the Company has four reinsurers that are required to collateralize the reinsurance recoverables. As of March 31, 2010, all reinsurers have provided a letter of credit or a secured trust account to provide security sufficient to satisfy AssuranceAmerica's obligations under the reinsurance agreement. The Company believes the fair value of its reinsurance recoverables approximates their carrying amounts.

The Company's reinsurance recoverable balances amounted to \$45.3 million and \$43.8 million as of March 31, 2010 and 2009, respectively. The recoverable includes ceded unpaid losses and loss adjustment expenses of \$25.5 million and \$29.7 million of the same periods, respectively. The ceded reserves from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policies ceded. Reinsurance recoverable assets include paid loss balances due from other insurance companies under the terms of reinsurance agreements in the amount of \$19.8 million and \$14.1 million as of March 31, 2010 and 2009, respectively. The paid loss recoverables are in good standing as of March 31, 2010.

The Company's ceded unearned premium relates to policies in force and is earned ratably over the policy period. As of March 31, 2010 and December 31, 2009, the ceded unearned reserves amounted to \$29.6 million and \$25.1 million, respectively. The unearned premium will become earned over the term of the policy. Reinsurance payable of \$36.7 million and \$28.5 million as of March 31, 2010 and December 31, 2009 represents the amounts due to reinsurers for ceded premiums net of commissions. The Company pays its reinsurers on a collected premium basis, and no balances are in dispute through March 31, 2010.

The Company's quota share reinsurance facility has a significant impact on its cash flows. Since the Company cedes approximately 70% of its premium and losses, the Company relies heavily on its reinsurers to settle outstanding reinsurance balances due for loss payments net of premiums collected. The Company's paid premiums net of commissions of \$8.7 million and \$13.9 million and received reinsurance recoverables on paid loss and loss adjustment expenses of \$14.3 million and \$12.7 million in 2010 and 2009, respectively.

The Company's reinsurance strategies have not changed from previous years and the Company's limited loss exposure is approximately 30%, which is based on the existing quota share agreement, whereby the Company cedes approximately 70% of its losses. While the Company monitors conditions within the reinsurance market, adverse conditions could have an impact on the Company's ability to secure reinsurance capacity, thereby limiting its ability to cede future losses.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this report on Form 10-Q, the Company's Chief Executive Officer and Chief Financial Officer carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures in accordance with Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934 (the Exchange Act). Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure and are effective to ensure that such information is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commissions rules and forms.

---

**Table of Contents**

**Management's Annual Report on Changes in Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Management assessed the effectiveness of our internal control over financial reporting as of March 31, 2010. In making this assessment, management used the criteria described in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate. Based on this evaluation, management determined that, as of March 31, 2010, we maintained effective internal control over financial reporting, and there were no changes in our internal control over financial reporting made during our most recent fiscal quarter that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

*An investment in Company common stock involves a number of risks. Investors should carefully consider the following information, together with the other information contained in the Company's Annual Report on Form 10-K, before investing in Company common stock. Further, such factors could cause actual results to differ materially from those contained in any forward-looking statement contained in this report, statements by us in periodic press releases and oral statements by Company officials to securities analysts and stockholders during presentations about us.*

**We face intense competition from other automobile insurance providers.**

The non-standard automobile insurance business is highly competitive and, except for regulatory considerations, there are relatively few barriers to entry. We compete with both large national insurance providers and smaller regional companies. The largest automobile insurance companies include The Progressive Corporation, The Allstate Corporation, State Farm Mutual Automobile Insurance Company, GEICO, Farmers Insurance Group, Safeco Corp., and American International Group (AIG). Our chief competitors include some of these companies as well as Mercury General Corporation, Infinity Property & Casualty Corporation, Affirmative Insurance Holdings, Inc., and Direct General Corporation. Some of our competitors have more capital, higher ratings and greater resources than we have, and may offer a broader range of products and lower prices and down payments than we offer. Some of our competitors that sell insurance policies directly to customers, rather than through agencies or brokerages as we do, may have certain competitive advantages, including increased name recognition among customers, direct relationships with policyholders and potentially lower cost structures. In addition, it is possible that new competitors will enter the non-standard automobile insurance market. Our loss of business to competitors could have a material impact on our growth and profitability. Further, competition could result in lower premium rates and less favorable policy terms and conditions, which could reduce our underwriting margins.

**Our concentration on non-standard automobile insurance could make us more susceptible to unfavorable market conditions.**

We underwrite exclusively non-standard automobile insurance. Given this focus, negative developments in the economic, competitive or regulatory conditions affecting the non-standard automobile insurance industry could have a material adverse effect on our results of operations, financial condition and cash flows. In addition, these developments could have a greater effect on us, compared to more diversified insurers that also sell other types of automobile insurance products. Our profitability can be affected by cyclicalities in the non-standard automobile insurance industry caused by price competition and fluctuations in underwriting capacity in the market, as well as changes in the regulatory environment.

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

Our results of operations and financial condition depend on our ability to underwrite and set rates accurately for a full spectrum of risks. Rate adequacy is necessary to generate sufficient premiums to pay losses, loss adjustment expenses and underwriting expenses and to earn a profit. If we fail to assess accurately the risks that we assume, we may fail to establish adequate premium rates, which could reduce our income and have a material adverse effect on our results of operations, financial condition or cash flows.



**Table of Contents**

In order to price our products accurately, we must collect and properly analyze a substantial volume of data; develop, test and apply appropriate rating formulas; closely monitor and timely recognize changes in trends; and project both severity and frequency of losses with reasonable accuracy. Our ability to undertake these efforts successfully, and as a result price our products accurately, is subject to a number of risks and uncertainties, including, without limitation:

availability of sufficient reliable data;

incorrect or incomplete analysis of available data;

uncertainties inherent in estimates and assumptions, generally;

selection and application of appropriate rating formulas or other pricing methodologies;

unanticipated or inconsistent court decisions, legislation or regulatory action;

ongoing changes in our claim settlement practices, which can influence the amounts paid on claims;

changing driving patterns, which could adversely affect both frequency and severity of claims;

unexpected inflation in the medical sector of the economy, resulting in increased bodily injury and personal injury protection claim severity; and

unanticipated inflation in automobile repair costs, automobile parts prices and used automobile prices, adversely affecting automobile physical damage claim severity.

Such risks may result in our pricing being based on inadequate or inaccurate data or inappropriate analyses, assumptions or methodologies, and may cause us to estimate incorrectly future increases in the frequency or severity of claims. As a result, we could underprice our products, which would negatively affect our profit margins, or we could overprice our products, which could reduce our volume and competitiveness. In either event, our results of operations, financial condition and cash flows could be materially and adversely affected.

***Our losses and loss adjustment expenses may exceed our loss and loss adjustment expense reserves, which could adversely impact our results of operation, financial condition and cash flows.***

Our financial statements include loss and loss adjustment expense reserves, which represent our best estimate of the amounts that we will ultimately pay on claims and the related costs of adjusting those claims as of the date of the financial statements. We rely heavily on our historical loss and loss adjustment expense experience in determining these loss and loss adjustment expense reserves. The historic development of reserves for losses and loss adjustment expenses may not necessarily reflect future trends in the development of these amounts. In addition, factors such as inflation, claims settlement patterns and legislative activities, regulatory activities, and litigation trends may also affect loss and loss adjustment expense reserves. As a result of these and other risks and uncertainties, ultimate losses and loss adjustment expenses may deviate, perhaps substantially, from our estimates of losses and loss adjustment expenses included in the loss and loss adjustment expense reserves in our financial statements. If actual losses and loss adjustment expenses exceed our expectations, our net income and our capital would decrease. Actual paid losses and loss adjustment expenses may be in excess of the loss and loss adjustment expense reserve estimates reflected in our financial statements.

***We are subject to comprehensive regulation, and our ability to earn profits may be adversely affected by these regulations.***

## Edgar Filing: ASSURANCEAMERICA CORP - Form 10-Q

We are subject to comprehensive regulation by government agencies in the states where our insurance subsidiaries are domiciled and where these subsidiaries issue policies and handle claims. Certain states impose restrictions or require prior regulatory approval of certain corporate actions, which may adversely affect our ability to operate, innovate, obtain necessary rate adjustments in a timely manner or grow our business profitably. In addition, certain federal laws impose additional requirements on insurers. Our ability to comply with these laws and regulations, and to obtain necessary regulatory action in a timely manner, is and will continue to be critical to our success.

## **Table of Contents**

*Required Licensing.* We operate under licenses issued by various state insurance authorities. If a regulatory authority denies or delays granting a new license, our ability to enter that market quickly can be substantially impaired.

*Transactions Between Insurance Companies and Their Affiliates.* Transactions between our subsidiaries and their affiliates (including us) generally must be disclosed to the state regulators, and prior approval of the applicable regulator generally is required before any material or extraordinary transaction may be consummated. State regulators may refuse to approve or delay approval of such a transaction, which may impact our ability to innovate or operate efficiently.

*Regulation of Insurance Rates and Approval of Policy Forms.* The insurance laws of the states in which our insurance subsidiaries operate require insurance companies to file insurance rate schedules and insurance policy forms for review and/or approval. If, as permitted in some states, we begin using new rates before they are approved, we may be required to issue refunds or credits to our policyholders if the new rates are ultimately deemed excessive or unfair and disapproved by the applicable state regulator. Accordingly, our ability to respond to market developments or increased costs in that state can be adversely affected.

*Restrictions on Cancellation, Non-Renewal or Withdrawal.* Many states have laws and regulations that limit an insurer's ability to exit a market. For example, certain states limit an automobile insurer's ability to cancel or not renew policies. Some states prohibit an insurer from withdrawing from one or more lines of business in the state, except pursuant to a plan approved by the state insurance department. In some states, this restriction applies to significant reductions in the amount of insurance written, not just to a complete withdrawal. These laws and regulations could limit our ability to exit or reduce our writings in unprofitable markets or discontinue unprofitable products in the future.

*Other Regulations.* We must also comply with regulations involving, among other things:

the use of non-public consumer information and related privacy issues;

investment restrictions;

the use of credit history in underwriting and rating;

the payment of dividends;

the acquisition or disposition of an insurance company or of any company controlling an insurance company;

the involuntary assignments of high-risk policies, participation in reinsurance facilities and underwriting associations, assessments and other governmental charges; and

reporting with respect to financial condition.

Compliance with laws and regulations addressing these and other issues often will result in increased administrative costs. In addition, these laws and regulations may limit our ability to underwrite and price risks accurately, prevent us from obtaining timely rate increases necessary to cover increased costs and may restrict our ability to discontinue unprofitable relationships or exit unprofitable markets. These results, in turn, may adversely affect our results of operation or our ability or desire to grow our business in certain jurisdictions. The failure to comply with these laws and regulations may also result in actions by regulators, fines and penalties, and in extreme cases, revocation of our ability to do business in that jurisdiction. In addition, we may face individual and class action lawsuits by our insureds and other parties for alleged violations of certain of these laws or regulations.

***Our insurance subsidiaries are subject to minimum capital and surplus requirements. Our failure to meet these requirements could subject us to regulatory action.***



## Edgar Filing: ASSURANCEAMERICA CORP - Form 10-Q

The laws of the states of domicile of our insurance subsidiaries impose risk-based capital standards and other minimum capital and surplus requirements. Failure to meet applicable risk-based capital requirements or minimum statutory capital requirements could subject us to further examination or corrective action imposed by state regulators, including limitations on our writing of additional business, state supervision or liquidation. Any changes in existing risk-based capital requirements or minimum statutory capital requirements may require us to increase our statutory capital levels, which we may be unable to do.

## **Table of Contents**

### **Regulation may become more extensive in the future, which may adversely affect our business.**

States may make existing insurance laws and regulations more restrictive in the future or enact new restrictive laws. In such events, we may seek to reduce our premium writings in, or to withdraw entirely from, these states. In addition, from time to time, the United States Congress and certain federal agencies investigate the current condition of the insurance industry to determine whether federal regulation is necessary. We are unable to predict whether and to what extent new laws and regulations that would affect our business will be adopted in the future, the timing of any such adoption and what effects, if any, they may have on our financial condition, results of operations, and cash flows.

### **Our failure to pay claims accurately could adversely affect our business, financial condition, results of operations and cash flows.**

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

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

### **The policy service fee revenues could be adversely affected by insurance regulation.**

Policy service fee revenues have provided additional revenues equivalent to approximately 12% of gross premium produced by MGA. These fees include policy origination fees and installment fees to compensate us for the costs of providing installment payment plans, as well as late payment, policy cancellation, policy rewrite and reinstatement fees. Our revenues could be reduced by changes in insurance regulation that restrict our ability to charge these fees. Those arrangements are subject to insurance holding company act regulation in the states where our insurance subsidiaries are domiciled. Continued payment of these fees could be affected if insurance regulators in these states determined that these arrangements are not permissible under the insurance holding company acts.

### **New pricing, claim and coverage issues and class action litigation are continually emerging in the automobile insurance industry, and these new issues could adversely impact our results of operations and financial condition.**

As automobile insurance industry practices and regulatory, judicial and consumer conditions change, unexpected and unintended issues related to claims, coverage and business practices may emerge. These issues can have an adverse effect on our business by changing the way we price our products, including limiting the factors we may consider when we underwrite risks, by extending coverage beyond our underwriting intent, by increasing the size or frequency of claims or by requiring us to change our claims handling practices and procedures or our practices for charging fees. The effects of these unforeseen emerging issues could negatively affect our results of operations, financial condition and cash flows.

### **We may be unable to attract and retain independent agents and brokers.**

We distribute our products exclusively through independent agents and brokers. We compete with other insurance carriers to attract producers and maintain commercial relationships with them. Some of our competitors offer a larger variety of products, lower prices for insurance coverage or higher commissions. We may not be able to continue to attract and retain independent agents and brokers to sell our products. Our inability to continue to recruit and retain productive independent agents and brokers would have an adverse effect on our financial condition and results of operations and could impact our cash flows.

### **We rely on information technology and telecommunication systems, and the failure of these systems could materially and adversely affect our business.**

Our business is highly dependent upon the successful and uninterrupted functioning of our information technology and telecommunications systems. We rely on these systems to process new and renewal business, provide customer service, make claims payments and facilitate collections and cancellations. These systems also enable us to perform actuarial and other modeling functions necessary for underwriting and rate development. The failure of these systems could interrupt our operations or materially impact our



---

**Table of Contents**

ability to evaluate and write new business. Because our information technology and telecommunication systems interface with and depend on third-party systems, we could experience service denials if demand for such service exceeds capacity or such third-party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to write and process new and renewal business and provide customer service or compromise our ability to pay claims in a timely manner. This outcome could result in a material adverse effect on our business and our results of operations, financial condition and cash flows.

**Our ability to operate our company effectively could be impaired if we lose key personnel.**

We manage our business with a number of key personnel, including our executive officers, the loss of whom could have a material adverse effect on our business and our results of operations, financial condition and cash flows. The President and COO, Joseph Skruck, the Executive Vice Present and General Counsel, Mark Hain and the Chief Financial Officer, John Mongelli have employment agreements with us. In addition, as our business develops and expands, we believe that our future success will depend greatly on our continued ability to attract and retain highly skilled and qualified personnel. We may not be able to continue to employ key personnel and may not be able to attract and retain qualified personnel in the future. Failure to retain or attract key personnel could have a material adverse effect on our business and our results of operations, financial condition and cash flows.

**Our debt service obligations could impede our operations, flexibility and financial performance.**

Our level of debt could affect our financial performance. As of March 31, 2010, we had consolidated indebtedness (other than trade payables and certain other short term debt) of approximately \$6.7 million. In addition, borrowings under our trust preferred arrangement bear interest at rates that may fluctuate. Therefore, increases in interest rates on the obligations under our credit agreement would adversely affect our income and cash flow that would be available for the payment of interest and principal on the loans outstanding.

If we do not have enough money to pay our debt service obligations, we may be required to refinance all or part of our existing debt, sell assets, borrow more money or raise equity. In that event, we may not be able to refinance our debt, sell assets, borrow more money or raise equity on terms acceptable to us or at all.

**Adverse securities market conditions can have significant and negative effects on our investment portfolio.**

Our results of operations depend in part on the performance of our invested assets. As of March 31, 2010, 80% of our investment portfolio was invested in fixed maturity securities with the remainder equity investments. Certain risks are inherent in connection with fixed maturity securities, including loss upon default and price volatility in reaction to changes in interest rates, credit spreads, deterioration in the financial condition of the issuers and general market conditions. An increase in interest rates lowers prices on fixed maturity securities, and any sales we make during a period of increasing interest rates may result in losses. Also, investment income earned from future investments in fixed maturity securities will decrease if interest rates decrease.

In addition, our investment portfolio is subject to risks inherent in the capital markets. The functioning of those markets, the values of our investments and our ability to liquidate investments on short notice may be adversely affected if those markets are disrupted by national or international events including, without limitation, wars, terrorist attacks, recessions or depressions, high inflation or a deflationary environment, the collapse of governments or financial markets, and other factors or events.

If our investment portfolio were impaired by market or issuer-specific conditions to a substantial degree, our financial condition, results of operations and cash flows could be materially adversely affected. Further, our income from these investments could be materially reduced, and write-downs of the value of certain securities could further reduce our profitability. In addition, a decrease in value of our investment portfolio could put us at risk of failing to satisfy regulatory capital requirements. If we were not able to supplement our subsidiaries' capital by issuing debt or equity securities on acceptable terms, our ability to continue growing could be adversely affected.

**Our operations could be adversely affected if conditions in the states where our business is concentrated were to deteriorate.**

For the three months ended March 31, 2010, we generated approximately 59% of our gross written premium in our top two states, Florida and Georgia. Our revenues and profitability are therefore subject to prevailing regulatory, legal, economic, demographic, competitive and other conditions in those states. Changes in any of those conditions could have an adverse effect on our results of operations, financial condition and cash flows. Adverse regulatory developments in any of those states, which could include, among others, reductions in the rates permitted to be charged, inadequate rate increases, restrictions on our ability to reject applications for coverage or on how we handle claims, or more fundamental changes in the design or implementation of the automobile insurance regulatory framework, could have a material adverse effect on our results of operations, financial condition and cash flows.



---

**Table of Contents**

**Severe weather conditions and other catastrophes may result in an increase in the number and amount of claims filed against us.**

Our business is also exposed to the risk of severe weather conditions and other catastrophes in the states in which we operate. Catastrophes include severe hurricanes, tornadoes, hail storms, floods, windstorms, earthquakes, fires and other events such as terrorist attacks and riots, each of which tends to be unpredictable. Such conditions may result in higher incidence of automobile accidents and increase the number of claims. Because many of our insureds live near the coastlines, we have potential exposure to hurricanes and major coastal storms. In addition, our business could be impaired if a significant portion of our business or systems were shut down by, or if we were unable to gain access to certain of our facilities as a result of such an event. If such events were to occur with enough severity, our results of operations, financial condition and cash flows could be materially adversely affected.

**Our financial condition may be adversely affected if one or more parties with which we enter into significant contracts becomes insolvent or experiences other financial hardship.**

Our business is dependent on the performance by third parties of their responsibilities under various contractual relationships, including without limitation, contracts for the acquisitions of goods and services (such as telecommunications and information technology software, equipment and support and other services that are integral to our operations) and arrangements for transferring certain of our risks (including our corporate insurance policies). If one or more of these parties were to default on the performance of their obligations under their respective contracts or determine to abandon or terminate support for a system, product or service that is significant to our business, we could suffer significant financial losses and operational problems, which could in turn adversely affect our financial condition, results of operations and cash flows.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

For 2010, each non-officer director may choose between (i) an amount in cash equal to \$15,000 plus the number of shares equal to \$15,000 divided by the share price on December 31, of the prior year or (ii) the number of shares equal to \$30,000 divided by the share price on December 31, of the prior year. During the first three months of 2010, the Company issued 350,000 shares of common stock, \$.01 par value, to members of its board of directors pursuant to this director compensation program. The shares were issued on January 28, 2010 to directors, each an accredited investor, as a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended and Regulation D. The Company received no consideration for the common stock issued.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not Applicable

**ITEM 4. REMOVED AND RESERVED**

Not Applicable

**ITEM 5. OTHER INFORMATION**

Not Applicable

**ITEM 6. EXHIBITS**

(a) Exhibits.

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**Table of Contents**

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ASSURANCEAMERICA CORPORATION

By: /s/ Guy W. Millner  
Guy Millner  
Chairman and CEO

Date: May 14, 2010

By: /s/ John M. Mongelli  
John M. Mongelli  
Chief Financial Officer

Date: May 14, 2010