VESTA INSURANCE GROUP INC
Form 10-Q
November 14, 2001

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2001

OR

|_| **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from
to
Commission file number 1-12338

VESTA INSURANCE GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware	**63-1097283**
(State of other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
3760 River Run Drive **Birmingham, Alabama**	**35243**
(Address of principal executive offices)	*(Zip Code)*

(205) 970-7000
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

The number of shares outstanding of the registrant's common stock,
$.01 par value, as of November 12, 2001
34,759,494

Vesta Insurance Group, Inc.
Index

Part I
Item 1. Financial Statements
Vesta Insurance Group, Inc.
Consolidated Balance Sheets
(amounts in thousands except share and per share data)

	September 30, 2001	De
	(unaudited)	
Assets:		
Investments:		
Fixed maturities available for sale - at fair value (cost: 2001 - $808,984; 2000 - $795,118)	$ 831,321	
Equity securities-at fair value: (cost: 2001-$29,340; 2000-$30,221)	29,798	
Mortgage and collateral loans	54,774	
Policy loans	64,137	
Short-term investments	23,607	
Other invested assets	35,607	
Total investments	1,039,244	
Cash	33,375	

Accrued investment income	16,157
Premiums in course of collection (net of allowances for losses of $4,106 in 2001 and $3,937 in 2000)	46,646
Reinsurance balances receivable	355,418
Reinsurance recoverable on paid losses	67,560
Deferred policy acquisition costs	52,394
Deferred income taxes	38,180
Other assets	124,417
Total assets	$ 1,773,391
Liabilities:	
Policy liabilities	$ 689,068
Losses and loss adjustment expenses	281,212
Unearned premiums	145,259
Federal Home Loan Bank advances	162,599
Short term debt	9,973
Long term debt	79,432
Other liabilities	118,514
Total liabilities	1,486,057
Commitments and contingencies: See Note B	
Deferrable Capital Securities	29,750
Stockholders' equity:	
Preferred stock, $.01 par value, 5,000,000 shares authorized, issued: 2001 - 0 and 2000 - 2,950,000	--
Common stock, $.01 par value, 100,000,000 shares authorized, issued: 2001 - 34,907,966 and 2000 - 18,964,322	319
Additional paid-in capital	229,962
Accumulated other comprehensive income, net of tax expense of $7,978 and $1,453 in 2001 and 2000, respectively	14,817
Retained earnings	34,113
Treasury stock (148,472 shares and 166,294 shares at cost at September 30, 2001 and December 31, 2000, respectively)	(1,644)
Unearned stock	(19,983)
Total stockholders' equity	257,584
Total liabilities, deferrable capital securities and stockholders' equity	$1,773,391

See accompanying Notes to Consolidated Financial Statements

Vesta Insurance Group, Inc.
Consolidated Statements of Income and Comprehensive Income
Statements of Income
(amounts in thousands except per share data)

	Three months ended September 30, 2001	2000
	(unaudited)	
Revenues:		
Net premiums written	$ 80,152	$ 55,431
Change in unearned premiums	(6,455)	(2,129)
Net premiums earned	73,697	53,302
Policy fees	2,230	1,438
Net investment income	15,450	16,854
Realized gains (losses)	757	(1,829)
Other	3,183	898
Total revenues	95,317	70,663
Expenses:		
Policyholder benefits	8,436	4,302
Losses and loss adjustment expenses incurred	43,896	29,421
Policy acquisition expenses	17,506	13,532
Litigation settlement charge	30,000	--
Operating expenses	17,575	12,369
Interest on debt	4,054	4,188
Goodwill and other intangible amortization	935	351
Total expenses	122,402	64,163
Income (loss) from continuing operations before taxes, minority interest, and deferrable capital securities	(27,085)	6,500
Income tax expense (benefit)	(9,510)	2,078
Minority interest, net of tax	200	858
Deferrable capital security distributions, net of tax	387	571
Net income (loss) from continuing operations	(18,162)	2,993
Income (loss) from discontinued operations, net of tax	(19,800)	1,003
Extraordinary gain on debt extinguishments, net of tax	910	--
Net income (loss)	(37,052)	3,996
Preferred stock dividend	--	(1,272)
Gain on redemption of preferred securities, net of tax	5,099	--
Net income (loss) available to common shareholders	$ (31,953)	$ 2,724
Net income (loss) from continuing operations per share - Basic	$ (0.57)	$ 0.17
Net income (loss) available to common shareholders per share - Basic	$ (1.00)	$ 0.15
Net income (loss) from continuing operations per share - Diluted	$ (0.57)	$ 0.12
Net income (loss) available to common shareholders per share - Diluted	$ (1.00)	$ 0.14

Statements of Comprehensive Income

Net income (loss)	$ (37,052)	$ 3,996
Other comprehensive income, net of tax:		
Unrealized holding gains on available-for-sale securities net of tax of $4,224, $1,292, $8,270 and $2,515, respectively	7,845	2,400
Less realized gains on available-for-sale securities net of tax of $265, $(12), $1, 745 and $(184), respectively	492	(22)
	7,353	2,422
Gain on redemption of preferred securities, net of tax	5,099	--

Comprehensive income	$ (24,600)	$ 6,418

See accompanying Notes to Consolidated Financial Statements

Vesta Insurance Group, Inc.
Consolidated Statements of Cash Flows
(amounts in thousands)

	Nine months ended 2001
	(unaudite
Operating Activities:	
Net income (loss)	$ (27,366)
Adjustments to reconcile net income (loss) to cash used in operations	
Changes in:	
Loss and LAE reserves, and future policy liabilities	(3,935)
Unearned premium reserves	4,689
Reinsurance balances receivable	12,671
Premiums in course of collection	(7,539)
Reinsurance recoverable on paid losses	(10,259)
Other assets and liabilities	(5,136)
Policy acquisition costs deferred	(15,166)
Policy acquisition costs amortized	16,506
Realized (gains) losses	(4,985)
Amortization and depreciation	6,921
Extraordinary gain	(910)
Net cash used in operations	(34,509)
Investing Activities:	
Investments sold, matured, and called:	
Fixed maturities available for sale	282,566
Other invested assets	9,824
Investments acquired:	
Fixed maturities available for sale	(227,224)
Equity securities	(11,244)
Other invested assets	(5,311)
Net cash paid for acquisition	(46,674)
Net decrease in short-term investments	5,374
Additions to property and equipment	(4,701)
Net cash provided from investing activities	2,610
Financing Activities:	
Net change in FHLB borrowings	8,636
Change in short-term debt	4,973
Net deposits and withdrawals from insurance liabilities	(3,877)
Retirement of long term debt and preferred securities	--
Issuance of common stock	96,381
Acquisition of common stock	(52,322)
Dividends paid	(1,891)
Net cash provided by (used in) financing activities	51,900

Increase (decrease) in cash	20,001
Cash at beginning of period	13,374
Cash at end of period	$ 33,375

See accompanying Notes to Consolidated Financial Statements

Vesta Insurance Group, Inc.
Notes to Consolidated Financial Statements
(Amounts in thousands except per share amounts)

Note A Significant Accounting Policies

Basis of Presentation: The accompanying unaudited interim financial statements have been prepared in conformity with accounting principles generally accepted in the United States and, in the opinion of management, reflect all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of results for such periods. The results of operations and cash flows for any interim period are not necessarily indicative of results for the full year. These financial statements should be read in conjunction with the financial statements and related notes which have been issued by the Company and filed with the Securities and Exchange Commission.

Reclassifications: Certain amounts in the financial statements presented have been reclassified from amounts previously reported in order to be comparable between years. These reclassifications have no effect on previously reported stockholders' equity or net income during the periods involved.

New Accounting Standards: In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (Statement 142). Statement 142 supersedes Accounting Principles Board Opinion 17, Intangible Assets, and addresses how intangible assets acquired individually or within a group of other assets are accounted for in financial statements upon their acquisition. Statement 142 is effective for fiscal years beginning after December 15, 2001.

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 141, *Business Combinations* (Statement 141). Statement 141 requires the use of the purchase method for all business combinations. Statement 141 is effective for all business combinations occurring after June 30, 2001.

In August, 2001, the FASB issued Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (Statement 144). Statement 144 revises Statement 121 by requiring the use of a single accounting model for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and by modifying the use of discontinued operations accounting on future transactions. Statement 144 is effective for fiscal years beginning after December 15, 2001.

The Company is currently evaluating the impact of these statements on our operating results and financial condition.

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (Statement 133). Statement 133 and subsequent amendments standardize the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, by requiring that an entity recognize those items as assets or liabilities in the financial statements and measure them at fair value. Management has evaluated our activities and has determined that Vesta does not currently have any material derivative exposures and that the adoption of the Statement 133 on January 1, 2001 did not have a material impact on the financial statements.

Change in Compensation Plan: Effective June 30, 2001, the Board of Directors approved a change to the Executive Officer Incentive Compensation Plan such that Messrs. Gayle, Tait, and Thornton agreed to accept 1.25 million shares of restricted stock and a $5.0 million loan as satisfaction of Vesta's obligations under the terms of the plan. The restrictions on the stock award and the loan repayments are lifted over a 10 year vesting period in accordance with the terms of the plan and charged to compensation expense.

Discontinued Operations: Although our reinsurance assumed operations and our commercial operations have been discontinued and segregated from our continuing operations, we continue to incur and pay losses on policies with coverage periods prior to the relevant measurement dates under APB 30. At the time these operations were discontinued, we established reserves that we believed were adequate to fund the ultimate settlement and administration of current and future claims from these discontinued operations. Reserves are estimates involving actuarial projections at a given point in time of what we expect to be the costs of the ultimate settlement and administration of claims based on facts and circumstances then known, estimates of trends in claims severity and other variables such as inflation.

In the third quarter of 2001, we undertook an analysis of our assumed reinsurance and commercial results for 2001. This review of paid losses and other activity, in particular those losses paid in the third quarter resulted in a conclusion that we should increase the reserves associated with our discontinued operations by approximately $30.0 million. Remaining gross reserves, before reinsurance, for loss and loss adjustment expenses for our discontinued operations approximated $123.7 million at September 30, 2001.

Litigation Settlement: As discussed more fully in the Commitment and Contingencies footnote, we settled a securities class action lawsuit in the third quarter. Related to this we recorded a pre-tax charge of $30.0 million to cover the amount we funded on behalf of Cincinnati Insurance Company and other expenses incurred related to this litigation. See Note B for further discussion.

Income per Share. Basic EPS is computed by dividing income available to common shareholders by the weighted average common shares outstanding for the period. Diluted EPS is calculated by adding to shares outstanding the additional net effect of potentially dilutive securities or contracts which could be exercised or converted into common shares except when the additional shares would produce anti-dilutive results.

Reconciliation of income available to common shareholders and average shares outstanding for the nine months ending September 30, 2001 and 2000 and the three months ending September 30, 2001 and 2000 are as follows:

	Three months ended September 30, 2001	Three months ended September 30, 2000
Net (loss) income available to common shareholders	$ (31,953)	$ 2,724
Preferred stock dividends on convertible preferred stock		563
Adjusted net (loss) income available to common shareholders	$ (31,953)	$ 3,287
Weighted average shares outstanding-basic (1)	31,837	17,918
Stock options and restricted stock (2)	--	232
Weighted average convertible preferred stock (1)	--	5,900
Weighted average shares outstanding-diluted (1)	31,837	24,050

	Nine months ended September 30, 2001	Nine months ended September 30, 2000
Net (loss) income available to common shareholders	$ (22,430)	$ 11,340
Preferred stock dividends on convertible preferred stock	163	1,689
Adjusted net (loss) income available to common shareholders	$ (22,267)	$ 13,029
Weighted average shares outstanding-basic (1)	24,848	18,231
Stock options and restricted stock (2)	--	233
Weighted average convertible preferred stock (1), (2)	--	5,900

Weighted average shares outstanding-diluted (1)	24,848	24,364

(1) Reflects weighted averages. At September 30, 2001, Vesta had 34.7 million shares outstanding and zero shares of convertible preferred stock outstanding. Weighted average shares outstanding for earnings per share purposes do not include shares held by the Agent s Stock Incentive Plan Trust that have not been allocated to participants, and shares issued as restricted stock that represent unearned amounts.

(2) Under the provisions of SFAS No. 128, *Earnings per Share,* contingently issuable shares that would have the effect of being anti-dilutive are excluded for the average shares outstanding calculation. Potentially dilutive securities for the three month and nine month periods ending September 30, 2001 are .8 million shares and 1.2 million shares respectively.

Earnings per share for discontinued operations and extraordinary gains for the three and nine months ended September 30, 2001 and 2000 are as follows:

	2001		2000	
	3 month	**9 month**	**3 month**	**9 month**
Basic Earnings per share:				
Discontinued Operations	$ (0.62)	$ (0.80)	$ 0.06	$ 0.11
Extraordinary Gain	0.03	0.04	--	0.29
Diluted Earnings per share:				
Discontinued Operations	$ (0.62)	$ (0.80)	$ 0.04	$ 0.09
Extraordinary Gain	0.03	0.04	--	0.22

5

Note B Commitments and Contingencies

Securities Litigation

On October 26, 2001, Vesta executed a definitive agreement to settle the securities litigation that has been pending since June 1998 against Vesta and certain current and former officers and directors. Subject to court approval, the consolidated class action securities litigation in U.S. District Court in Alabama is being settled as to Vesta and its officers and directors for a total of $61 million in cash. A related derivative action lawsuit in the Circuit Court of Jefferson County, Alabama is being dismissed with prejudice. Vesta will fund $18.5 million towards the settlement and the Company's excess directors and officers liability insurance carriers will fund the remaining $42.5 million. Vesta used its line of credit to finance its portion of the settlement and recorded a pre-tax one-time charge of approximately $30 million against earnings to cover Vesta's contribution to the settlement and other expenses incurred.

Vesta determined to participate in the funding of the settlement and to take the related one-time charge against earnings as a result of the Cincinnati Insurance Company's attempted rescission of their primary $25 million directors and officers liability policy and denial of coverage. Vesta has sued Cincinnati in Alabama state court alleging that its actions were taken in bad faith and is vigorously pursuing that claim.

Indemnification Agreements and Liability Insurance

Pursuant to Delaware law and our Bylaws, we are obligated to indemnify our current and former officers and directors for certain liabilities arising from their employment with or services to Vesta, provided that their conduct complied with certain requirements. Pursuant to these obligations, we have agreed to advance costs of defense and other expenses on behalf of certain current and former officers and directors, subject to an undertaking from such individuals to repay any amounts advanced in the event a court determines that they are not entitled to indemnification.

Arbitration

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2000, we corrected our accounting for assumed reinsurance business through restatement of our previously-issued 1997 financial statements and our first quarter 1998 Form 10-Q. Similar corrections were made on a statutory accounting basis by recording cumulative adjustments in Vesta Fire's 1997 statutory financial statements. The impact of this correction has been reflected in amounts ceded under our 20% whole account quota share treaty which was terminated on June 30, 1998 on a run-off basis. We believe such treatment is appropriate under the terms of this treaty and have calculated the quarterly reinsurance billings presented to the three treaty participants accordingly. The aggregate amount included herein as recoverable from such reinsurers totaled approximately $55.2 million as of September 30, 2001. We have collected approximately $48.5 million from the drawdown of collateral on hand.

NRMA Insurance, Ltd. ("NRMA"), one of the participants in the 20% whole account quota share treaty, filed a lawsuit in the United States District Court for the Northern District of Alabama contesting our billings. NRMA sought rescission of the treaty and a temporary restraining order preventing us from drawing down approximately $34.5 million of collateral. We filed a demand for arbitration as provided for in the treaty and also filed a motion to compel arbitration which was granted in the United States District Court action. Vesta reached an agreement with NRMA to collect the $34.5 million of collateral in exchange for posting a $25 million letter of credit in favor of NRMA to fund any amounts NRMA may recover as a result of the arbitration. We filed for arbitration against the other two participants in the treaty and all of these arbitrations are in their discovery stages. While management believes its interpretation of the treaty's terms and computations based thereon are correct, the ultimate outcome of these arbitrations is uncertain and their ultimate outcome cannot be determined at this time.

During 1999, F&G Re (on behalf of USF&G), filed for arbitration under two aggregate stop loss reinsurance treaties whereby F&G Re assumed certain risk from us. F&G Re is seeking to rescind the treaties and avoid its obligation. Under the terms of the two treaties, we believe we will be entitled to recoveries of approximately $28.2 million as losses mature from prior accident years. Vesta has recorded a reinsurance recoverable of approximately $28.2 million as of September 30, 2001 and December 31, 2000 related to these two treaties. The hearing in this arbitration is currently scheduled for February 2002 and the ultimate outcome cannot be determined at this time.

We are in arbitration with CIGNA Property and Casualty Insurance Company ("CIGNA") (now ACE USA) under a personal lines insurance quota share reinsurance agreement, whereby we assumed certain risks from CIGNA. During September 2000, CIGNA filed for arbitration under the reinsurance agreement, seeking payment of the balances that CIGNA claims are due under the terms of the treaty. In addition, during the fourth quarter of 2000, the treaty was terminated on a cut-off basis. Vesta is seeking recoupment of all improper claims payments and excessive expense allocations and charges from CIGNA. The arbitration has been bifurcated into two phases with phase one concentrating on the interpretation of the agreement and phase two relating to damages. This arbitration is in the discovery stage with the phase one hearing currently scheduled for February, 2002 and the ultimate outcome cannot be determined at this time.

If the amounts recoverable under the relevant treaties are ultimately determined to be materially less than the amounts that we have reported as recoverable, we may incur a significant, material, and adverse impact on our financial condition and results of operations.

Other Litigation

Vesta, through its subsidiaries, is routinely a party to pending or threatened legal proceedings and arbitration relating to the regular conduct of its insurance business. These proceedings involve alleged breaches of contract, torts (including bad faith and fraud claims), and miscellaneous other specified relief. Based upon information presently available, and in light of legal and other defenses available to us and our subsidiaries, management does not consider liability from any threatened or pending litigation regarding routine matters to be material.

Note C-Segment Information

We operate several segments, which are distinguishable by their product offerings. The accounting policies of the operating segments are the same as used in preparing the consolidated financial statements. Segment pre-tax income is generally income before income tax, and minority interest, if any. Premiums, policy fees, other income, loss and benefit expenses, and amortization of deferred acquisition costs are attributed directly to each operating segment. Operating expenses are allocated to the segments in a manner which most appropriately reflects the operations of that segment. Net investment income and interest expense are allocated only to those segments for which such amounts are considered an integral part of the financial results for that segment.

A brief description of each segment is as follows:

Standard Property-Casualty

The standard property-casualty segment primarily consists of the marketing and distribution of personal lines products including Homeowners and Personal Auto coverages. Vesta's products are distributed through approximately 1,900 independent agencies in 24 states. Our personal auto line targets drivers over age thirty-five with above average driving records and our homeowners products cover the full range of homes.

Life and Health Insurance

On June 30, 2000, we entered the life and annuity business through a 71% investment in American Founders Financial Corporation, a holding company for two life insurance companies domiciled in Texas and we entered the health insurance business through the acquisition of Aegis Financial Corporation in December 2000. American Founders and Aegis have approximately $2.2 billion (face value) of life and annuity products in force and $22.5 million of health insurance premiums in force at September 30, 2001. American Founders markets traditional life products, universal life products, fixed-rate annuities, pension contracts and related products through independent agents throughout the majority of the United States. Aegis Financial markets health insurance through captive agents throughout the United States.

Specialty Lines

In 2000, we began utilizing our licenses to write business for the benefit of certain reinsurance companies. In this segment, we enter into arrangements whereby we write targeted property-casualty insurance coverages and reinsure substantially all of the risks to reinsurers in exchange for fees. This business takes advantage of our certificates of authority granting us license to write insurance in many states. Income in this segment is primarily generated on a fee-for-service basis.

Non-Standard

In December 2000, we acquired a 52% economic interest in Instant Auto Insurance Holdings, Inc. Instant Auto operates as a non-standard insurance agency. Its principal revenue stream is agents' fees and commissions.

Corporate and Other

Our corporate and other segment primarily consists of unallocated net investment income, unallocated interest expense, and certain overhead expenses not directly associated with a particular segment.

A summary of segment results for the nine months ended September 30, 2001 and 2000 is as follows:

2001	Standard Property-	Life and Health	Specialty

	Casualty	Insurance	Lines	N
			(in thousands)	
Revenues:				
Premiums earned	$185,443	$ 22,312	$ 5,528	
Net investment income	--	32,138	--	
Policy fees	2,285	2,926	--	
Realized gains	--	2,258	--	
Other	586	549	3,150	
Total revenues	188,314	60,183	8,678	
Expenses:				
Loss, LAE and policyholder benefits	117,371	25,431	4,297	
Policy acquisition costs	41,096	6,558	1,229	
Litigation settlement charge	--	--	--	
Operating expenses	22,143	9,815	211	
Interest on debt	--	6,695	--	
Goodwill and other intangible amortization	--	--	--	
Total expenses	180,610	48,499	5,737	
Pre-tax income (loss) from continuing operations	$ 7,704	$ 11,684	$ 2,941	
Operating segment assets:				
Investments and other assets	$323,819	$ 940,395	$ 35,876	
Deferred acquisition costs	30,485	20,955	434	
	$354,304	$ 961,350	$ 36,310	

2000	**Standard Property-Casualty**	**Life and Health Insurance**	**Specialty Lines**	**N**
		(in thousands)		
Revenues:				
Premiums earned	$160,286	$ 1,578	$ 141	
Net investment income	--	10,618	--	
Policy fees	503	1,174	--	
Realized losses	--	--	--	
Other	--	511	158	
Total revenues	160,789	13,881	299	
Expenses:				
Loss, LAE and policyholder benefits	94,960	4,302	55	
Policy acquisition costs	36,844	1,091	34	
Operating expenses	20,693	3,024	--	
Interest on debt	--	2,497	--	
Goodwill and other intangible amortization	--	--	--	
Total expenses	152,497	10,914	89	
Pre-tax income (loss) from continuing operations	$ 8,292	$ 2,967	$ 210	
Operating segment assets:				
Investments and other assets	$363,961	$ 873,077	1,862	
Deferred acquisition costs	32,320	33,380	--	
	$396,281	$ 906,457	$ 1,862	

Note B Commitments and Contingencies

8

A summary of segment results for the three months ended September 30, 2001 and 2000 is as follows:

2001	Standard Property-Casualty	Life and Health Insurance	Specialty Lines	No
		(in thousands)		
Revenues:				
Premiums earned	$ 63,890	$ 7,365	$ 2,442	
Net investment income	--	10,348	--	
Policy fees	1,254	976	--	
Realized gains (losses)	--	860	--	
Other	166	314	1,346	
Total revenues	65,310	19,863	3,788	
Expenses:				
Loss, LAE and policyholder benefits	41,896	8,436	2,000	
Policy acquisition costs	14,519	2,401	586	
Litigation settlement charge	--	--	--	
Operating expenses	7,738	3,248	54	
Interest on debt	--	2,067	--	
Goodwill and other intangible amortization	--	--	--	
Total expenses	64,153	16,152	2,640	
Pre-tax income (loss) from continuing operations	$ 1,157	$ 3,711	$ 1,148	

2000	Standard Property-Casualty	Life and Health Insurance	Specialty Lines	No
		(in thousands)		
Revenues:				
Premiums earned	$ 51,583	$ 1,578	$ 141	
Net investment income	--	10,618	--	
Policy fees	264	1,174	--	
Realized gains (losses)	--	--	--	
Other	--	511	158	
Total revenues	51,847	13,881	299	
Expenses:				
Loss, LAE and policyholder benefits	29,366	4,302	55	
Policy acquisition costs	12,407	1,091	34	
Operating expenses	7,566	3,024	--	
Interest on debt	--	2,497	--	
Goodwill and other intangible amortization	--	--	--	
Total expenses	49,339	10,914	89	

Pre-tax income (loss) from continuing operations	$ 2,508	$ 2,967	$ 210

Note D Stock Transactions

In the first quarter of 2001, we engaged in a number of stock transactions. On January 20, 2001, we issued approximately 380,000 shares of common stock in exchange for $3.475 million face amount of Deferrable Capital Securities. On January 26, 2001, the holders of our Series A Convertible Preferred Stock converted their shares into 5.9 million shares of common stock pursuant to their original conversion terms. We repurchased that common stock for approximately $47.2 million. In separate transactions, we sold 5.5 million shares of common stock to a number of investors for approximately $32.3 million. These transactions and other transactions resulted in Vesta repurchasing 6.4 million shares of its common stock for approximately $50.8 million and issuing 5.9 million shares of its common stock for approximately $32.3 million of cash and $3.475 million face amount of Deferrable Capital Securities.

In the second quarter of 2001, we engaged in a follow-on offering of our common stock. We sold 8.625 million shares of common stock for approximately $64.0 million after expenses.

In the third quarter of 2001, we issued 568,644 shares of our common stock for $7 million face amount of our 8.75% Senior Debentures due 2025. In connection with this transaction, we recorded an after-tax extraordinary gain of $.9 million. Also in the third quarter, we redeemed $7.0 million face amount of a subsidiary's preferred stock for $3.5 million. In addition, a $3.5 million payable related to a prior redemption of the subsidiary's preferred stock was determined to not be due as the preferred stockholder had not fulfilled certain obligations of the redemption agreement. In connection with these two redemptions, Vesta recorded an after-tax gain, net of minority interest, of $5.1 million

Note E Acquisition of Florida Select Insurane Holdings, Inc.

Effective April 1, 2001, we acquired Florida Select Insurance Holdings Inc., the parent company of Florida Select Insurance Company. Florida Select is the 8th largest residential homeowners insurer in the State of Florida with approximately $140.0 million of assets and $60.0 million of annual gross written premium. The transaction has been accounted for as a purchase. Summarized below is a preliminary allocation of assets and liabilities acquired and the consolidated results of operations for the nine-month periods ended September 30, 2001 and 2000 on an unaudited pro forma basis as if the acquisition had occurred as of January 1, 2000. The pro forma information is based on our consolidated results of operations for the nine months ended September 30, 2001 and 2000 and on data provided by the acquired company, after giving effect to certain pro forma adjustments, including the issuance of 8.625 million shares of common stock. The pro forma financial information does not purport to be indicative of results of operations that would have occurred had the transactions occurred on the basis assumed above nor are they indicative of results of the future operations of the combined enterprises.

Assets and liabilities acquired (in thousands except per share amounts and unaudited):

Assets acquired:	
Invested assets	$ 56,707
Cash	20,764
Other assets	27,107
Goodwill	35,288
Total assets	139,866
Liabilities acquired:	
Loss and LAE reserves	22,019
Unearned premiums	35,100
Other liabilities	16,334
Total liabilities	73,453

Pro forma consolidated results of operations are as follows (unaudited):

	Nine months ended September 3	
	2001	2000
Total revenues	$ 296,148	$ 231,
Income (loss) available to common shareholders	$ (18,628)	$ 19,
Income (loss) available to common shareholders per share - basic	$ (0.75)	$ 1
Income (loss) available to common shareholders per share - diluted	$ (0.75)	$ 0

Note F Subsequent Events

Subsequent to September 30, 2001, Instant Auto completed the acquisition of SpaceCoast Agency for $2.3 million and A-Affordable Insurance Agency for approximately $8.5 million. These acquisitions will be accounted for as purchased in accordance with Statement 141.

In November, 2001, we announced our intention to purchase up to 1.3 million shares of our common stock. As of November 13, 2001, we had purchased approximately 350 thousand shares under this plan.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Vesta writes insurance on selected personal lines risks only. Our standard property-casualty writings are balanced between risks of property damage (faster determination of ultimate loss but highly unpredictable) and casualty exposure (more predictable but takes longer to determine the ultimate loss). We also write life, annuity, and health insurance business. Additionally, we are actively involved in the writing of insurance on our policies for the benefit of reinsurance companies, commonly referred to as servicing carrier or fronting, which generates fee-for-service income.

Our revenues from operations are derived primarily from net premiums earned on risks written by our insurance subsidiaries, investment income and investment gains or losses. Our expenses consist primarily of payments for claims and underwriting expenses, including agents' commissions and operating expenses.

Comparison of Third Quarter 2001 to Third Quarter 2000

Income available to common shareholders decreased by $34.7 million, to a $32.0 million loss for the quarter ended September 30, 2001, from $2.7 million for the quarter ended September 30, 2000. On a diluted per share basis, net loss available to common shareholders for the third quarter of 2001 was $(1.00) per share versus net income of $0.14 per share for the third quarter of 2000. The decrease in income available to common shareholders is primarily attributable to a $30.0 million pre-tax charge for settlement of a securities class action litigation and a $30.0 million pre-tax charge for our discontinued operations.

Standard Property-Casualty

Net premiums written for standard property-casualty lines increased by $16.5 million, or 30.8%, to $70.0 million for the quarter ended September 30, 2001, from $53.5 million for the quarter ended September 30, 2000. Net premiums earned for standard property-casualty lines increased $12.3 million, or 23.8% to $63.9 million for the quarter ended September 30, 2001, from $51.6 million for the quarter ended September 30, 2000. The increase in net premiums written and net premiums earned is primarily attributable to the acquisition of Florida Select, offset by decreases in other lines of business.

Loss and loss adjustment expenses ("LAE") for standard property-casualty lines increased by $12.5 million, or 42.5%, to $41.9 million for the quarter ended September 30, 2001, from $29.4 million for the quarter ended September 30, 2000. The loss and LAE ratio for property-casualty lines for the quarter ended September 30, 2001 was 64.3% as compared to 56.6% at September 30, 2000. The increase in the loss and LAE incurred and the loss and LAE ratio is primarily attributable to deteriorating underwriting results in the current period and an increase in earned premium. The deterioration in our underwriting results is being primarily driven by increases in frequency and severity of claims.

Policy acquisition expenses increased $2.1 million for the quarter-to-quarter comparison, consistent with the increase in earned premium. Operating expenses increased by $.2 million, to $7.7 million for the quarter ended September 30, 2001, as increased expenses from Florida Select were offset by expense reductions.

Life and Health Insurance

In June, 2000, we entered the life and annuity business through a 71% investment in American Founders Financial Corporation, a holding company for two life insurance companies domiciled in Texas and we entered the health insurance business through the acquisition of Aegis Financial Corporation, a holding company for two life and health insurance companies domiciled in Texas, in December, 2000. American Founders and Aegis have approximately $2.2 billion (face value) of life and annuity products in force and $21.8 million of health insurance premiums in force at September 30, 2001. Life insurance premiums and policy fees were $2.4 million for the quarter ended September 30, 2001 compared to $1.6 million for the comparable prior period in 2000. The increase is due to the acquisition of Aegis in December 2000 and Washington Life in August 2001. Health insurance premiums totaled $5.0 million for the quarter ended September 30, 2001 versus zero for the comparable prior period. Health insurance benefits incurred totaled $3.0 million for the quarter and health insurance commission expense was $1.5 million.

Specialty Lines

In 2000, we began utilizing our licenses to write business for the benefit of reinsurance companies. In this segment, we enter into arrangements whereby we write targeted property-casualty insurance coverages and reinsure substantially all of the risks to reinsurers in exchange for fees. This business takes advantage of our certificates of authority granting us license to write insurance in many states. Income in this segment is primarily generated on a fee-for-service basis. For the quarter ended September 30, 2001, this segment reported a $.2 million underwriting loss on net premiums written of $2.8 million and net premiums earned of $2.4 million. Additionally, we earned approximately $1.3 million of fees for the quarter ended September 30, 2001.

Non-Standard

In December 2000, we acquired a 52% economic interest in Instant Auto Insurance Holdings, Inc. Instant Auto operates as a non-standard insurance agency. Its principal revenue stream is agents' fees and commissions. Fees and commissions totaled $.3 million for the three months ended September 30, 2001 as Instant Auto began executing its strategy of building its agency business. Effective October 1, 2001, Instant Auto acquired the assets of SpaceCoast Agency in Florida and A-Affordable Insurance Agency in Texas for a total purchase price of $10.8 million. These acquisitions are expected to make Instant Auto profitable in 2002.

Discontinued Operations

In the third quarter of 2001, we undertook an analysis of our assumed reinsurance and commercial results for 2001. This review of paid losses and other activity, in particular those losses paid in the third quarter, resulted in a conclusion that we should increase the reserves associated with our discontinued operations by approximately $30.0 million.

Net Investment Income

Net investment income decreased by $1.4 million, or 8.3%, to $15.5 million for the quarter ended September 30, 2001, from $16.9 million for the quarter ended September 30, 2000. The weighted average yield on invested assets (excluding realized and unrealized gains) was 6.2% for the quarter ended September 30, 2001, compared with 7.0% for the quarter ended September 30, 2000. The decrease in investment income is primarily attributable to a decrease in the weighted average yield as yields have generally declined in recent months.

Federal Income Taxes

Federal income taxes decreased by $11.6 million to a $9.5 million benefit for the quarter ended September 30, 2001 as a result of less income in the current period compared to the prior period.

Comparison of Nine Months Ended September 30, 2001 with Nine Months Ended September 30, 2000

Income available to common shareholders decreased by $33.7 million, or 298.2% to a $22.4 million loss for the nine months ended September 30, 2001, from $11.3 million for the nine months ended September 30, 2000. On a diluted per share basis, income (loss) available to common shareholders for the nine months ended September 30, 2001 was $(.90) per share versus income of available to common shareholders of $.53 per share for the corresponding period of 2000. The decrease in income available to common shareholders is primarily attributable to a $30 million pre-tax charge for the settlement of our securities litigation and a $30 million pre-tax charge associated with our discontinued operations. The charge for discontinued operations was a result of recent adverse development in our assumed reinsurance and commercial lines that caused us to increase the reserves associated with these lines.

Standard Property-Casualty

Net premiums written for standard property-casualty lines increased by $28.5 million, or 18.0%, to $187 million for the nine months ended September 30, 2001, from $158.5 million for the nine months ended September 30, 2000. Net premiums earned for standard property-casualty lines increased $25.1 million, or 15.7% to $185.4 million for the nine months ended September 30, 2001, from $160.3 million for the nine months ended September 30, 2000. The increase in net premiums written and net premiums earned is primarily attributable to the acquisition of Florida Select.

Loss and loss adjustment expenses ("LAE") for standard property-casualty lines increased by $22.4 million, or 23.6%, to $117.4 million for the nine months ended September 30, 2001, from $95.0 million for the corresponding period ended September 30, 2000. The loss and LAE ratio for property-casualty lines for the nine months ended September 30, 2001 was 62.5% as compared to 59.1% at September 30, 2000. The increase in the loss and LAE incurred and the loss and LAE ratio is primarily attributable to an increase in earned premium, estimated salvage and subrogation recoverable recorded in the prior year, and deteriorating underwriting results in the current year. The deterioration in our underwriting results is being primarily driven by increases in frequency and severity of claims.

Policy acquisition expenses increased for the period-to-period comparison, consistent with earned premium. Operating expenses increased by $1.4 million, or 6.8% to $22.1 million for the nine months ended September 30, 2001, from $20.7 million for the nine months ended September 30, 2000, due to increased expenses related to Florida Select, partially offset by expense reductions.

Life and Health Insurance

In June, 2000, we entered the life and annuity business through a 71% investment in American Founders Financial Corporation, a holding company for two life insurance companies domiciled in Texas and we entered the health insurance business through the acquisition of Aegis Financial Corporation, a holding company for two life and health insurance companies domiciled in Texas, in December, 2000. American Founders and Aegis have approximately $2.2 billion (face value) of life and annuity products in force and $21.8 million of health insurance premiums in force at September 30, 2001. Life insurance premiums and policy fees were $9.0 million for the nine months ended September 30, 2001 compared to $1.6 million for the comparable prior period due to the acquisition of Aegis in December 2000 and Washington Life in

August 2001. Health insurance premiums totaled $15.3 million for the nine months ended September 30, 2001 versus zero for the comparable prior period. Health insurance benefits incurred totaled $8.8 million for the nine months and health insurance commission expense was $4.0 million.

Specialty Lines

In 2000, we began utilizing our licenses to write business for the benefit of reinsurance companies. In this segment, we enter into arrangements whereby we write targeted property-casualty insurance coverages and reinsure substantially all of the risks to reinsurers in exchange for fees. This business takes advantage of our certificates of authority granting us license to write insurance in many states. Income in this segment is primarily generated on a fee-for-service basis. For the nine months ended September 30, 2001, the segment reported a $.2 million underwriting loss on net premiums written of $6.3 million and net premiums earned of $5.5 million. Additionally, we earned approximately $3.2 million of fees for the nine months ended September 30, 2001.

Non-Standard

In December 2000, we acquired a 52% economic interest in Instant Auto Insurance Holdings, Inc. Instant Auto operates as a non-standard insurance agency. Its principal revenue stream is agents' fees and commissions. Fees and commissions totaled $1.1 million for the nine months ended September 30, 2001 as Instant Auto began executing its strategy of building its agency business. Effective October 1, 2001, Instant Auto acquired the assets of SpaceCoast Agency in Florida and A-Affordable Insurance Agency in Texas for a total purchase price of $10.8 million. These acquisitions are expected to make Instant Auto profitable in 2002.

Net Investment Income

Net investment income increased by $19.1 million, or 65.6%, to $48.2 million for the nine months ended September 30, 2001, from $29.1 million for the nine months ended September 30, 2000. The weighted average yield on invested assets (excluding realized and unrealized gains) was 6.3% for the nine months ended September 30, 2001, compared with 6.4% for the nine months ended September 30, 2000. The decrease in investment income is primarily attributable to an increase in average invested assets resulting from our acquisitions, particularly American Founders, partially offset by a decrease in yield as yields have generally declined in recent months.

Federal Income Taxes

Federal income taxes decreased by $7.6 million to a $3.3 million benefit for the nine months ended September 30, 2001 as a result of less income in the current period compared to the prior period.

Liquidity and Capital Resources

Vesta is a holding company whose principal asset is its investment in the capital stock of the companies constituting the Vesta Insurance Group, a group of wholly owned insurance companies including Vesta Fire Insurance Corporation and a majority ownership in a life insurance holding company which includes American Founders Life Insurance Company. The insurance subsidiaries comprising the Vesta Group are individually supervised by various state insurance regulators. Vesta Fire and American Founders are our principal operating subsidiaries.

Dividends and Management Fees

The principal uses of funds at the holding company level are to pay operating expenses, principal and interest on outstanding indebtedness and deferrable capital securities and dividends to stockholders if declared by the Board of Directors. During the last three years, our insurance subsidiaries have produced operating results and paid management fees and dividends sufficient to fund our needs. As a holding company with no other business operations, we rely primarily on fees generated by our management agreement with our insurance subsidiaries and dividend payments from Vesta Fire to meet our cash requirements (including our debt service) and to pay dividends to our stockholders.

Transactions between Vesta and its insurance subsidiaries, including the payment of dividends and management fees to Vesta by such subsidiaries, are subject to certain limitations under the insurance laws of those subsidiaries' domiciliary states. The insurance laws of the state of Illinois, where Vesta Fire is domiciled, permit the payment of dividends out of earned surplus in any year which, together with other dividends or distributions made within the preceding 12 months, do not exceed the greater of 10% of statutory surplus as of the end of the preceding year or the net income for the preceding year, with larger dividends payable only after receipt of prior regulatory approval. On October 29, 2001, the Illinois Insurance Department published a Company Bulletin that indicates that the Department interprets these dividend limitations to prohibit the payment of dividends if the insurer has negative or zero "unassigned funds" at the end of the prior year, as reported on its statutorily required annual statement. Our lead insurance subsidiary, Vesta Fire, reported negative "unassigned funds" on its annual statement for 2000. Accordingly, we may not be able to declare and pay a dividend from our lead insurance company subsidiary for the foreseeable future without prior approval.

We rely primarily on fees earned under our management agreement with our insurance company subsidiaries to meet our cash requirements (including debt service) and to pay dividends to our stockholders. We believe that this management agreement will provide us with funds sufficient to meet our anticipated needs (including debt service) for at least the next twelve months.

Credit Facilities

On March 3, 2000, we established a revolving credit facility with First Commercial Bank, Birmingham, Alabama ("First Commercial"). In May, 2001 we increased the amounts available and increased the term of the credit facility to the following:

- a $15 million unsecured line which bears interest at First Commercial's prime rate + ¼%;
- an additional $15 million line which bears interest at First Commercial's prime rate, secured by a pledge of the revenues received under management contract between our wholly owned management company, J. Gordon Gaines, Inc., and our operating insurance subsidiaries.

Each of these credit facilities mature on December 31, 2002. These credit agreements contain covenants which require us to maintain minimum (i) statutory consolidated net income, (ii) GAAP consolidated net income, (iii) statutory surplus and (iv) risk based capital. For the period ending September 30, 2001, our GAAP consolidated net income and statutory surplus did not meet the minimum requirements as set forth in our credit agreements. First Commercial has agreed that any such non-compliance will not be deemed an event of default under the credit agreements. As of September 30, 2001, $20.0 million of credit line was available.

Long Term Debt

In the third quarter of 2001, we exchanged $7.0 million face amount of our Senior Debentures for 569 thousand shares of common stock. We recorded a $.9 million after-tax extraordinary gain in connection with this transaction. Also in the third quarter, we redeemed $7.0 million face amount of a subsidiary's preferred stock for $3.5 million. In addition, a $3.5 million payable related to a prior redemption of the subsidiary's preferred stock was determined to not be due as the preferred stockholder had not fulfilled certain obligations of the redemption agreement. In connection with these two redemptions, Vesta recorded an after-tax gain, net of minority interest, of $5.1 million.

Annual distribution obligations for the Company's long-term debt outstanding at September 30, 2001 are as follows:

Security	**Principal**	**Annual Interest Obligation**
8.75% Senior Debentures due 2025	$80 million	$7.0 million
8.525% Deferrable Capital Securities due 2027	$29.8 million	$2.5 million

Cash Flows

The principal sources of funds for our insurance subsidiaries are premiums, investment income and proceeds from the sale or maturity of invested assets. Such funds are used principally for the payment of claims, operating expenses, commissions and the purchase of investments. As is typical in the insurance industry, we collect cash in the form of premiums and invest that cash until claims are paid. Cash collected from premiums and cash paid for claims is included in cash flow from operations, while the cash impact from our investing activities is included in cash flow from investing activities. In periods such as 2001 and 2000, where we are exiting certain lines of business such as commercial lines and reinsurance assumed lines we are funding the payout of commercial and reinsurance assumed claims through the liquidation of invested assets, consistent with the historical insurance business model. However, this generates cash outflows from operations that can be misleading.

On a consolidated basis, net cash used in operations for the nine months ended September 30, 2001 and 2000, was $34.5 million and $62.8 million, respectively. Cash flow from operations was negative for the current period due to the continued payout of claims from our discontinued operations, the payout of standard-property casualty claims incurred in prior periods, and the timing of payment of certain payables and other operational items. Net cash provided by investing activities was $2.6 million and $104.7 million for the nine months ended September 30, 2001 and 2000, respectively as we funded the discontinuance of the reinsurance assumed and commercial lines of business. Net cash provided by (used in) financing activities was $51.9 million and $(52.5) million for the nine month periods ending September 30, 2001 and 2000, respectively as we engaged in a number of stock transactions in the nine month period ended September 30, 2001 including the issuance of 8.625 million shares of stock in a follow on offering for approximately $64.0 million, net of underwriting discount and expenses and repurchased outstanding debt in the nine month period ending September 30, 2000.

Market Risk of Financial Instruments

Vesta's principal assets are financial instruments, which are subject to the market risk of potential losses from adverse changes in market rates and prices. Our primary risk exposures are interest rate risk on fixed maturity investments, mortgages and collateral loans and annuity liabilities and equity price risk for stocks. Vesta manages its exposure to market risk by selecting investment assets with characteristics such as duration, yield and liquidity to reflect the underlying characteristics of the related insurance. There have been no material changes to the information about our market risk set forth in our Annual Report on Form 10-K for the year ended December 31, 2000.

Special Note Regarding Forward-Looking Statements

Any statement contained in this report which is not a historical fact, or which might otherwise be considered an opinion or projection concerning the Company or its business, whether express or implied, is meant as and should be considered a forward-looking statement as that term is defined in the Private Securities Litigation Reform Act of 1996. Forward-looking statements are based on assumptions and opinions concerning a variety of known and unknown risks, including but not necessarily limited to changes in market conditions, natural disasters and other catastrophic events, increased competition, changes in availability and cost of reinsurance, changes in governmental regulations, and general economic conditions, as well as other risks more completely described in our filings with the Securities and Exchange Commission, including our most recent Annual Report on Form 10-K. If any of these assumptions or opinions prove incorrect, any forward-looking statements made on the basis of such assumptions or opinions may also prove materially incorrect in one or more respects.

Part II
Item 1. Legal Proceedings

Securities Litigation

On October 26, 2001, Vesta executed a definitive agreement to settle the securities litigation that has been pending since June 1998 against Vesta and certain current and former officers and directors. Subject to court approval, the consolidated class action securities litigation in U.S. District Court in Alabama is being settled as to Vesta and its officers and directors for a total of $61 million in cash. A related derivative action lawsuit in the Circuit Court of Jefferson County, Alabama is being dismissed with prejudice. Vesta will fund $18.5 million towards the settlement and the Company's excess directors and officers liability insurance carriers will fund the remaining $42.5 million. Vesta used its line of credit to finance its portion of the settlement and recorded a pre-tax one-time charge of approximately $30 million against earnings to cover Vesta's contribution to the settlement and other expenses incurred.

Vesta determined to participate in the funding of the settlement and to take the related one-time charge against earnings as a result of the Cincinnati Insurance Company's attempted rescission of their primary $25 million directors and officers liability policy and denial of coverage. Vesta has sued Cincinnati in Alabama state court alleging that its actions were taken in bad faith and is vigorously pursuing that claim.

Indemnification Agreements and Liability Insurance

Pursuant to Delaware law and our Bylaws, we are obligated to indemnify our current and former officers and directors for certain liabilities arising from their employment with or services to Vesta, provided that their conduct complied with certain requirements. Pursuant to these obligations, we have agreed to advance costs of defense and other expenses on behalf of certain current and former officers and directors, subject to an undertaking from such individuals to repay any amounts advanced in the event a court determines that they are not entitled to indemnification.

Arbitration

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2000, we corrected our accounting for assumed reinsurance business through restatement of our previously-issued 1997 financial statements and our first quarter 1998 Form 10-Q. Similar corrections were made on a statutory accounting basis by recording cumulative adjustments in Vesta Fire's 1997 statutory financial statements. The impact of this correction has been reflected in amounts ceded under our 20% whole account quota share treaty which was terminated on June 30, 1998 on a run-off basis. We believe such treatment is appropriate under the terms of this treaty and have calculated the quarterly reinsurance billings presented to the three treaty participants accordingly. The aggregate amount included herein as recoverable from such reinsurers totaled approximately $55.2 million as of September 30, 2001. We have collected approximately $48.5 million from the drawdown of collateral on hand.

NRMA Insurance, Ltd. ("NRMA"), one of the participants in the 20% whole account quota share treaty, filed a lawsuit in the United States District Court for the Northern District of Alabama contesting our billings. NRMA sought rescission of the treaty and a temporary restraining order preventing us from drawing down approximately $34.5 million of collateral. We filed a demand for arbitration as provided for in the treaty and also filed a motion to compel arbitration which was granted in the United States District Court action. Vesta reached an agreement with NRMA to collect the $34.5 million of collateral in exchange for posting a $25 million letter of credit in favor of NRMA to fund any amounts NRMA may recover as a result of the arbitration. We filed for arbitration against the other two participants in the treaty and all of these arbitrations are in their discovery stages. While management believes its interpretation of the treaty's terms and computations based thereon are correct, the ultimate outcome of these arbitrations is uncertain and their ultimate outcome cannot be determined at this time.

During 1999, F&G Re (on behalf of USF&G), filed for arbitration under two aggregate stop loss reinsurance treaties whereby F&G Re assumed certain risk from us. F&G Re is seeking to rescind the treaties and avoid its obligation. Under the terms of the two treaties, we believe we will be entitled to recoveries of approximately $28.2 million as losses mature from prior accident years. Vesta has recorded a reinsurance recoverable of approximately $28.2 million as of September 30, 2001 and December 31, 2000 related to these two treaties. The hearing in this arbitration is currently scheduled for February 2002 and the ultimate outcome cannot be determined at this time.

We are in arbitration with CIGNA Property and Casualty Insurance Company ("CIGNA") (now ACE USA) under a personal lines insurance quota share reinsurance agreement, whereby we assumed certain risks from CIGNA. During September 2000, CIGNA filed for arbitration under the reinsurance agreement, seeking payment of the balances that CIGNA claims are due under the terms of the treaty. In addition, during the fourth quarter of 2000, the treaty was terminated on a cut-off basis. Vesta is seeking recoupment of all improper claims payments and excessive expense allocations and charges from CIGNA. The arbitration has been bifurcated into two phases with phase one concentrating on the interpretation of the agreement and phase two relating to damages. This arbitration is in the discovery stage with the phase one hearing currently scheduled for February, 2002 and the ultimate outcome cannot be determined at this time.

If the amounts recoverable under the relevant treaties are ultimately determined to be materially less than the amounts that we have reported as recoverable, we may incur a significant, material, and adverse impact on our financial condition and results of operations.

Other Litigation

Vesta, through its subsidiaries, is routinely a party to pending or threatened legal proceedings and arbitration relating to the regular conduct of its insurance business. These proceedings involve alleged breaches of contract, torts (including bad faith and fraud claims), and miscellaneous other specified relief. Based upon information presently available, and in light of legal and other defenses available to us and our subsidiaries, management does not consider liability from any threatened or pending litigation regarding routine matters to be material.

Item 2. Changes in Securities

In the third quarter of 2001, we exchanged 568,644 shares of our common stock for $7.0 million principal amount of our 8.75% Senior Notes due 2025. At the time of each transaction, we issued shares having a market value (based on the five trading days preceding the closing date of each transaction) equal to 80% of the total principal amount of the 8.75% Senior Notes exchanged. The transactions were not registered under the Securities Act of 1933 in reliance on the exemption afforded by Section 3(a)(9) thereof.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other information

None.

18

Item 6. Exhibits and Reports on Form 8-K

a) EXHIBITS

10.25 Employment agreement between the registrant and William P. Cronin, dated as of February 5, 2001.

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b) Reports on Form 8-K.

Current reports were filed on Form 8-K on August 1, 2000 and September 17, 2001 in connection with press releases and on July 18, 2001 in connection with the acquisition of Florida Select Insurance Holdings Inc.

19

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Vesta Insurance Group, Inc.

Date: November 14, 2001

/s/ W. Perry Cronin

W. Perry Cronin
Senior Vice President
and Chief Financial Officer
(Principal Financial Officer)

Date: November 14, 2001

/s/ Hopson B. Nance

Hopson B. Nance
Vice President and Controller
(Principal Accounting Officer)

20

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