PROASSURANCE CORP
Form 424B4
November 08, 2002

Table of Contents

Filed Pursuant to Rule 424(b)(4)
Registration No. 333-100526

Prospectus

2,750,000 Shares

ProAssurance Corporation

Common Stock

ProAssurance Corporation is offering 2,650,000 shares of its common stock and the selling stockholder named in this prospectus is offering 100,000 shares of common stock in a firmly underwritten offering. ProAssurance will not receive any proceeds from the sale of shares of common stock by the selling stockholder.

Our common stock is listed on the New York Stock Exchange under the symbol PRA. On November 7, 2002, the closing price of our common stock on the New York Stock Exchange was $16.55 per share.

Investing in our common stock involves risks. See Risk Factors beginning on page 10.

	Per Share	Total
Offering Price	$16.5500	$45,512,500
Discounts and Commissions to Underwriters	$ 0.9516	$ 2,616,900
Offering Proceeds to ProAssurance	$15.5984	$41,335,760
Offering Proceeds to Selling Stockholder	$15.5984	$ 1,559,840

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

ProAssurance has granted the underwriters the right to purchase up to an additional 375,000 shares of common stock to cover any over-allotments. The underwriters can exercise this right at any time within thirty days after the offering. The underwriters expect to deliver the shares of common stock to investors on or about November 13, 2002.

Banc of America Securities LLC

Cochran, Caronia & Co.

Sandler O Neill & Partners, L.P.

November 7, 2002

TABLE OF CONTENTS

PROSPECTUS SUMMARY
RISK FACTORS
FORWARD-LOOKING STATEMENTS
USE OF PROCEEDS
PRICE RANGE OF OUR COMMON STOCK
DIVIDEND POLICY
CAPITALIZATION
SELECTED HISTORICAL FINANCIAL DATA
PRO FORMA FINANCIAL DATA
BUSINESS
MANAGEMENT
CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS
PRINCIPAL STOCKHOLDERS
DESCRIPTION OF CAPITAL STOCK
SHARES ELIGIBLE FOR FUTURE SALE
UNDERWRITING
LEGAL MATTERS
EXPERTS
WHERE CAN YOU FIND MORE INFORMATION
GLOSSARY OF SELECTED INSURANCE TERMS
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

TABLE OF CONTENTS

	Page
Prospectus Summary	1
Risk Factors	10
Forward-Looking Statements	16
Use of Proceeds	17
Price Range of Our Common Stock	18
Dividend Policy	18
Capitalization	19
Selected Historical Financial Data	20
Pro Forma Financial Data	22
Management s Discussion and Analysis of Financial Condition and Results of Operation	25
Business	46
Insurance Regulatory Matters	68
Management	72
Certain Relationships and Related Transactions	79
Principal Stockholders	80
Description of Capital Stock	82
Shares Eligible for Future Sale	83
Underwriting	84
Legal Matters	86
Experts	86
Where You Can Find More Information	86
Glossary of Selected Insurance Terms	G-1
Index to Consolidated Financial Statements	F-1

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with different information. We are not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate as of the date on the front cover of this prospectus only, regardless of the time of delivery of this prospectus or of any sale of our common stock.

PROSPECTUS SUMMARY

The following summary may not contain all of the information that may be important to you. You should read all of the information delivered in connection with this prospectus, including the consolidated financial statements and related notes and the risks of investing in our common stock discussed under Risk Factors, before making an investment decision. This prospectus contains terms that are specific to the insurance industry and may be technical in nature. For a description of these terms, please refer to the Glossary of Selected Insurance Terms in this prospectus. References in this prospectus to ProAssurance, we, us and our refer to ProAssurance Corporation and its subsidiaries, unless the context otherwise requires or otherwise is expressly stated. Figures presented in this prospectus include the results of Professionals Group from June 27, 2001, the date of the consolidation with Medical Assurance, and, prior to that date, of Medical Assurance, unless otherwise expressly stated, which limits the comparability of certain financial information.

Overview

We are a holding company for specialty property and casualty insurance companies focused on the professional liability and the personal automobile insurance markets. We have a regional orientation, applying a focused underwriting strategy to local markets where we have built a strong reputation among our customers and producers. We are the fourth largest writer of medical professional liability insurance in the United States based on direct premiums written in 2001. We are the tenth largest writer of personal automobile insurance in Michigan based on direct premiums written in 2001. We were formed to effect the consolidation of Medical Assurance, Inc. and Professionals Group, Inc. in June 2001, but our predecessor company, Medical Assurance, has been in operation since 1977.

We conduct our business through two operating segments, each of which maintains a strong position in its local markets:

Our *professional liability* segment, which represents our commercial lines business, primarily focuses on providing medical professional liability insurance. We provide protection against claims arising out of the death, injury or disablement of a person resulting from the negligence or other misconduct of medical and other healthcare professionals.

Our *personal lines* segment primarily offers personal automobile, and to a lesser extent, homeowners, boat and umbrella insurance to teachers, administrators, college professors and other members of the educational community and their families in Michigan.

Our professional liability segment represented 72.4% of our gross premiums written for the six months ended June 30, 2002 while our personal lines represented 27.6% for the same period. Approximately 96.2% of our business related to casualty coverages, including automobile coverages, and 3.8% to property coverages primarily through homeowners insurance, as measured by gross premiums written for the six months ended June 30, 2002. We believe we do not have any exposure to asbestos claims which are currently prevalent in the insurance industry.

By concentrating on specialty markets where customers have specialized needs, we seek to provide value added solutions through our underwriting expertise and our emphasis on strong customer service. Our regional presence allows us to maintain active relationships with our customers and be more responsive to their needs. We seek to maintain a strong financial position to protect our customers. We believe these factors have allowed us to establish a leading position in our markets, enabling us to compete on a basis other than just price.

Professional Liability. Our customers include physicians, hospitals, dentists and other healthcare providers. We focus on physicians who are sole practitioners or who practice in small groups, who we believe exhibit greater customer loyalty and provide us a better opportunity to achieve an underwriting profit. We estimate that at least 90% of our policies in force on June 30, 2002 cover physicians and dentists who are sole practitioners or who practice in small groups of less than 20 professionals. While we are licensed in 48 states, we currently write insurance primarily in 19 states, mainly in the southeast and midwest, with Alabama, Florida, Ohio, Indiana and Michigan representing our five largest states based on direct premiums written in 2001.

Table of Contents

We operate through our home office and 12 regional offices, allowing us to better control our underwriting and claims process, respond to local market conditions and more effectively serve our customers and producers. We believe our size, financial strength and flexibility of distribution differentiates us from our competitors.

Given the long tail nature of our professional liability business, we focus on our operating ratio, which combines the ratio of underwriting income or loss to net premiums earned, referred to as the combined ratio, offset by the benefit of investment income generated from our cash and invested assets, also expressed as a percentage of net premiums earned. Our average statutory operating ratio for the five year period ended December 31, 2001 was 78.5%. This compares favorably to an average statutory operating ratio of 94.4% for the property and casualty industry over the same period, according to data published by A.M. Best Company, Inc. The long tail nature also results in a higher level of invested assets and investment income as compared to other property and casualty lines of business. At December 31, 2001, our ratio of cash and invested assets (including personal lines), which totaled $59.49 per share, to statutory surplus was 4.3x as compared to 2.7x for the property and casualty industry according to information reported by A.M. Best. For the five years ended December 31, 2001, our net investment income averaged 24.6% of net premiums earned compared to 14.0% for the property and casualty industry over the same period according to information reported by A.M. Best, in each case determined on a statutory basis.

Personal Lines. We conduct our personal lines business through our publicly-traded subsidiary, MEEMIC Holdings, Inc. (Nasdaq: MEMH). We believe our focus on the educational community provides better than average risk-selection, which contributes to our historically profitable underwriting results. We distribute our products directly to insureds through a network of 93 captive agents who are primarily current and former teachers, administrators and other educational employees.

Our senior management team is led by A. Derrill Crowe, M.D., our Chairman and Chief Executive Officer, and Victor T. Adamo, Esq., our President and Chief Operating Officer. Dr. Crowe has acted as the Chief Executive Officer of Medical Assurance since its founding in 1977. He has applied a hands-on management style in developing our underwriting and claims strategies and was instrumental in establishing us as a leading professional liability specialist. Mr. Adamo has held various positions with Professionals Group since 1985 and as its president was largely responsible for building it into a successful regional professional liability company. Dr. Crowe practiced medicine as his principal occupation for more than 25 years and Mr. Adamo was in the private practice of law for 10 years, providing them with knowledge of medical and legal issues that are critical to our insurance operations. We also have a knowledgeable and experienced management team with established track records in building and managing successful insurance operations. In total, our senior management team has average experience in the insurance industry of 22 years.

For the year ended December 31, 2001, we generated $389.0 million of gross premiums written, $313.3 million of net premiums earned and $382.6 million of total revenues. For the six months ended June 30, 2002, we generated gross premiums written of $304.2 million. As of June 30, 2002, we had cash and invested assets of $1.7 billion, total assets of $2.4 billion and stockholders equity of $426.8 million. Following completion of this offering, we expect to have total capitalization, including debt, of approximately $545.1 million. Each of our insurance subsidiaries is rated A- (Excellent) by A.M. Best.

Our predecessor company, Medical Assurance, was founded by physicians as a mutual company in Alabama in 1977 and demutualized into a public company in 1991. From its initial public offering in September 1991, to June 27, 2001, Medical Assurance produced a compounded annual return of 14.6% for its common stockholders. Professionals Group was founded as Physicians Insurance Company of Michigan in 1980 to assume the business of the Brown-McNeeley Fund, which was founded by the State of Michigan in 1975. From the first date of trading on Nasdaq in June 1993 through June 27, 2001, Professionals Group produced a compounded annual return of 15.1% for its common stockholders. MEEMIC s insurance subsidiary was founded as a mutual company by Michigan teachers in 1950. Professionals Group became affiliated with MEEMIC in 1997 and acquired majority ownership through transactions relating to MEEMIC s demutualization in July 1999.

Corporate Strategy

Our objective is to build value for our stockholders through superior underwriting of classes of business in which we have a comprehensive understanding and which offer us the opportunity to generate competitive returns on capital. We target an operating return on equity, which includes investment income but excludes realized gains and losses, of 12% to 14% over the long term. Over the five years ending December 31, 2001, however, we achieved an average operating return on equity of 10.1%, with a high of 14.0% in 1999 and a low of 2.4% in 2001. The major elements of our strategy are:

Adhere to a Strict Underwriting Philosophy. We emphasize disciplined underwriting and do not manage our business to achieve a certain level of premium growth or market share. In our professional liability business, we apply our local knowledge to individual risk selection to determine the appropriate price based on our assessment of the specific characteristics of each risk. In our personal lines business, we target the educational community, which we believe provides a stable and predictable group of risks.

Aggressively Manage Policyholder Claims. In addition to prudent risk selection, we seek to control our underwriting results through effective claims management. We investigate each professional liability claim and have fostered a strong culture of aggressively defending those claims that we believe have no merit. We manage these claims at the local level, tailoring claims handling to the legal climate of each state, which we believe differentiates us from national writers. In our personal lines business, we seek to quickly and efficiently settle claims through an established network of auto repair shops and other repair facilities, focusing on minimizing the cost of handling each claim.

Operate Through Regional Offices in Local Markets. We believe that our business is most effectively managed at the local level. We operate our professional liability business through 12 regional offices in 9 states and our personal lines business through 93 agents in Michigan. Through our regional underwriting and claims office structure, we are able to gain a strong understanding of local market conditions and efficiently adapt our underwriting and claims strategies to regional conditions.

Expand Our Position in Regional Markets. Our goal is to build upon our position as a leading writer of professional liability and personal lines insurance and expand within a defined geographic area, while maintaining our commitment to disciplined underwriting and aggressive claims management. The withdrawal and reduced capacity of several competitors in the medical professional liability market has led to significant increases in the number of new policy applications we received over the past 12 months. We believe that our strong reputation in our regional markets, combined with our financial strength, strong customer service and proven ability to manage claims, should enable us to profitably expand our position in select states. In our personal lines business, we estimate that we currently insure approximately 20% of educational professionals in Michigan. Through the appointment of additional agents and broadening our relationships with educational institutions, we intend to increase our penetration of the educational community.

Pursue Consolidating Acquisitions. We have successfully acquired and integrated companies and books of business in the past and believe our financial size and strength make us an attractive acquiror. We continually evaluate opportunities to acquire professional liability companies or books of business that leverage our core underwriting and claims expertise. We believe that higher claim costs on historical business and capacity constraints may create disruption among other professional liability writers, thereby providing acquisition opportunities.

Maintain Our Financial Strength and Security. We have sustained our financial stability during difficult market conditions through responsible pricing and loss reserving practices. We are committed to maintaining prudent operating and financial leverage and conservatively investing our assets. We recognize the importance of our A- (Excellent) A.M. Best rating to our customers and producers and intend to manage our business to protect our financial security.

Growth Opportunities and Outlook

We believe our current market position and reputation allows us to take advantage of improving marketing conditions and opportunities in the market. Based on improving market conditions and our assessment of our ability to effectively compete, we expect to achieve gross premiums written of at least $500 million in 2002. We expect to achieve our growth primarily through the (i) increased prices in our professional liability business and (ii) expansion of our personal automobile business in Michigan.

We expect the growth of our professional liability business will be primarily generated through increased pricing across our portfolio. Through June 2002, we achieved average gross price increases of approximately 25% on renewal business across our professional liability business (weighted by premium volume). These increases are in addition to average gross price increases achieved during 2001 of approximately 23% on renewal business across our professional liability business (weighted by premium volume).

We expect our future growth will also be supported by controlled expansion in states where we have recently commenced writing business but have little or no presence. These states include Arkansas and Virginia, where The St. Paul Companies, Inc. was a leading writer prior to its departure from the market and which we believe have favorable medical and legal climates. We anticipate there will be additional opportunities for profitable expansion as a number of insurers are experiencing financial difficulties, requiring them to reduce their business or completely exit the marketplace.

We believe we can achieve our growth while improving our combined ratio. Based on price increases achieved to date, we expect the ultimate combined ratio on our professional liability business currently written to be reduced to 102% or lower, as premiums are earned. This takes into account expected increases in the cost of claims and reinsurance protection purchased. As with all property and casualty companies, we expect the beneficial impact of price increases and any development of losses to be fully reflected in our financial results over time. We recognize the impact of higher prices as the associated premiums are earned which generally occurs over the course of the year after the policy is written. In our personal lines business our objective is to achieve an underwriting profit, targeting a combined ratio of 96% or lower, which is in line with our historical financial results.

Recent Events

Financial Outlook. We estimate our net operating income per share will be between $0.13 and $0.16 for the three months ended September 30, 2002, and between $0.30 and $0.35 for the last six months of 2002. We calculate net operating income excluding the effects of guaranty fund assessments, as well as realized investment gains and losses, net of applicable taxes. These estimates reflect our current views as of the date of this prospectus. As such, they are subject to uncertainty and may change as a result of a number of factors, many of which are beyond our control. See Forward-Looking Statements.

At September 30, 2002, our investment portfolio of fixed maturity and equity securities had a market value of $1,557 million which, after giving effect to the expected impairment expense discussed below, includes an unrealized pre-tax net gain of $64.5 million. This compares to an unrealized pre-tax net gain of $18.6 million at June 30, 2002. We regularly review our investment portfolio to evaluate our securities for any meaningful decline in market value below amortized cost. We expect to incur a non-cash pre-tax expense associated with the impairment of equity securities in our investment portfolio of approximately $13.3 million for the three months ended September 30, 2002. This impairment expense will reduce our net income but will not affect our book value at September 30, 2002 or our previously estimated net operating income for the three months ended September 30, 2002 or the six months ended December 31, 2002.

Table of Contents

Purchase of MEEMIC Shares. We currently own 83.9% of the issued and outstanding common stock of MEEMIC. On July 9, 2002, we agreed to purchase the remaining 16.1% of the common stock of MEEMIC. The purchase price of $29.00 per share in cash, representing an aggregate purchase price of $34.4 million, will be financed through existing cash and investment resources of MEEMIC. The acquisition of these minority shares is subject to regulatory approval, a vote of minority stockholders and other conditions. The proposed transaction, including the financial terms, has been unanimously approved by the board of directors of MEEMIC, including its independent directors not affiliated with us. We expect to complete the acquisition of the remaining shares that we do not already own by January 2003, but there can be no assurance that we will be successful.

Industry Trends

The medical malpractice, or medical professional liability, market totaled $7.3 billion in direct premiums written for the year ended December 31, 2001, which represented 3.9% of the total commercial premiums in the property and casualty industry, according to data published by A.M. Best. Since 1999, insurance companies focused on medical professional liability coverage have experienced higher claim costs on business written in prior years than they had reserved for initially. This has resulted in significant losses, reduced capital to support current and future business, and higher premium rates to meet expected higher claims costs. In 2001, based on publicly available industry information, it is estimated that prices for medical professional liability insurance experienced increases of approximately 15% to 20% over expiring terms. Price increases have varied across the types of insured and geographic region with some states experiencing increases as high as 100%. We believe price increases have continued in 2002 at levels consistent with, or higher than, those reported in 2001, which is consistent with our own experience.

Reduced profitability, reductions in surplus and capacity constraints have led many professional liability carriers focused on medical professional liability coverages to withdraw from, or limit new business in, one or more markets. In December 2001, The St. Paul Companies, Inc., previously the second largest writer of medical professional liability insurance in the United States, announced its immediate intention to exit the market due to poor profitability. In February 2002, Pennsylvania-based PHICO Insurance Company entered into state-ordered liquidation due to financial difficulties. In March 2002, SCPIE Holdings, Inc. announced it terminated its strategic relationship with a national broker to write professional liability insurance for physicians and dentists, and will refocus on its home market of Southern California. In March 2002, The MIIX Group, Inc. announced its intention to stop writing business due to financial difficulties and has sponsored the formation of a new mutual company to write solely in New Jersey. In June 2002, American Physicians Capital, Inc. announced its decision to withdraw from the Florida medical professional liability market. In June 2002, FPIC Insurance Group, Inc. announced that, while it will continue to renew its existing book of business, it will not write new business until it can increase capacity.

Given the continued reduction in capacity and the uncertainty surrounding several writers in the medical professional liability market, we believe the current favorable market environment will continue at least until 2004. The improvements in pricing, however, will be offset to some degree by the impact of loss cost trends and the increased cost of reinsurance.

Table of Contents

Corporate Structure

ProAssurance Corporation was formed as a holding company for Medical Assurance, Inc. in connection with its acquisition of Professionals Group, Inc. in June 2001. The organizational chart below illustrates the corporate relationships among our primary insurance operating subsidiaries. Unless otherwise indicated, we own, directly or indirectly, 100% of the capital stock of each of the companies depicted below. We currently own 83.9% of MEEMIC Holdings, Inc. and have entered into an agreement to increase our ownership to 100%.

Our executive offices are located at 100 Brookwood Place, Birmingham, Alabama 35209, and our telephone number is (205) 877-4400.

Table of Contents

The Offering

Common stock offered hereby	
By ProAssurance	2,650,000 shares
By selling stockholder	100,000 shares
Total	2,750,000 shares
Common stock outstanding before this offering	25,851,178 shares
Common stock outstanding after this offering	28,501,178 shares

Use of proceeds	We estimate that our net proceeds from this offering will be $40.8 million, or $46.7 million if the underwriters over-allotment option is exercised in full. We intend to use the net proceeds from this offering to support the growth of our professional liability business and for general corporate purposes, which may include the acquisition of other companies or books of business and the payment of principal and interest on our outstanding debt. We currently have no agreements or other obligations to acquire any companies or books of business. We will not receive any proceeds from the sale of shares by the selling stockholder.
Dividend policy	We do not currently pay dividends on our common stock and do not intend to pay any dividends in the foreseeable future. We intend to retain earnings to support the future growth of our business.
New York Stock Exchange symbol	PRA

A. Derrill Crowe, M.D., our Chairman and Chief Executive Officer, will sell 100,000 shares of our common stock as part of this offering. This represents approximately 4.0% of the 2,512,492 total shares beneficially held by Dr. Crowe, which includes 188,516 shares issuable under our equity incentive compensation plan. Dr. Crowe has not previously sold any of his shares of common stock since October 1999. Following completion of this offering, Dr. Crowe will continue to beneficially own 2,412,492 shares of our common stock, representing approximately 8.4% of our total outstanding common stock, after giving effect to this offering. In conjunction with this offering Dr. Crowe has agreed not to, directly or indirectly, sell any shares of his remaining common stock for a period of 180 days after the date of this prospectus, except that Dr. Crowe has the right to sell up to 150,000 shares at a price of not less than $16.55 per share. For purposes of estate planning, Dr. Crowe has indicated an intention to engage in the orderly sale of our common stock from time to time over the next five to ten years.

The number of shares of common stock outstanding indicated above excludes 1,103,037 shares issuable upon the exercise of options granted by us under our equity incentive compensation plan at a weighted average exercise price of $19.46 per share, of which approximately 771,037 shares at a weighted average exercise price of $20.60 per share were exercisable as of September 30, 2002. We have an additional 1,005,999 shares reserved for future issuance of options under our equity incentive compensation plan.

Unless otherwise indicated, the information presented in this prospectus assumes the underwriters over-allotment option to purchase up to an additional 375,000 shares from us is not exercised.

Table of Contents

Summary Financial Data

The table below sets forth our summary consolidated financial data and other financial information for each of the three years ended December 31, 2001, and the six months ended June 30, 2001 and 2002. Our historical financial information was prepared in accordance with generally accepted accounting principles (GAAP). Periods prior to June 30, 2001 reflect only the financial results of Medical Assurance which limits the comparability of the financial data and other information set forth below. Our consolidated financial statements and the financial data below for the year ended December 31, 2001 include the financial results of Professionals Group from June 27, 2001, the date of acquisition.

The GAAP statement of income data for the years ended December 31, 1999, 2000 and 2001 and the GAAP balance sheet data as of December 31, 1999, 2000 and 2001 were derived from our audited consolidated financial statements. The GAAP statement of income data for the six months ended June 30, 2001 and 2002 and the GAAP balance sheet data as of June 30, 2002 were derived from our unaudited consolidated financial statements which include all adjustments which, in management s opinion, are normal recurring adjustments necessary for a fair presentation of our financial position and results of operations. The operating results for the six months ended June 30, 2002 are not necessarily indicative of our results of operations for the full year 2002 or any future periods. The statutory data below has been derived from statutory financial statements filed by our insurance operating subsidiaries with the relevant state insurance departments and have been prepared in accordance with statutory accounting principles (SAP), which differ in material respects from GAAP. The summary consolidated financial data presented below should be reviewed in conjunction with our consolidated financial statements, the accompanying notes and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this prospectus.

	Year Ended December 31,			Six Months Ended June 30,	
	2001	2000	1999	2002	2001
	(in thousands, except per share data)				
GAAP Statement of Income Data:					
Gross premiums written	$388,983	$223,871	$201,593	$304,188	$130,428
Net premiums written	310,291	194,279	156,923	255,653	95,112
Net premiums earned	$313,345	$177,596	$164,424	$224,083	$ 96,222
Net investment income	59,782	41,450	39,273	38,954	19,938
Net realized investment gains (losses)	5,441	913	1,787	(3,778)	1,194
Other income	3,987	2,630	2,545	3,624	1,047
Total revenues	382,555	222,589	208,029	262,883	118,401
Net losses and loss adjustment expenses	298,558	155,710	104,657	214,263	90,789
Underwriting, acquisition, and insurance expenses	70,437	38,579	40,212	44,482	23,246
Interest expense	2,591			1,514	84
Total expenses	371,586	194,289	144,869	260,259	114,119
Income before income taxes and minority interest	10,969	28,300	63,160	2,624	4,282
Provision for income taxes	(2,847)	4,000	16,460	(1,866)	(978)
Income before minority interest	13,816	24,300	46,700	4,490	5,260
Minority interest	1,366			1,428	
Income before cumulative effect of accounting change	12,450	24,300	46,700	3,062	5,260
Net income	$ 12,450	$ 24,300	$ 46,700	$ 4,756 (1)	$ 5,260
Income per share before cumulative effect of accounting change (basic and diluted)	$ 0.51	$ 1.04	$ 1.95	$ 0.12	$ 0.23
Net income per share (basic and diluted)	0.51	1.04	1.95	0.18 (1)	0.23

Weighted average number of shares outstanding:					
Basic	24,263	23,291	23,992	25,842	22,705
Diluted	24,267	23,291	24,008	25,864	22,706

Table of Contents

	As of December 31,			As of June 30, 2002	
	2001	2000	1999	Actual	As Adjusted(2)
	(in thousands, except per share data)				
GAAP Balance Sheet Data:					
Total cash and investments	$1,569,628	$ 805,076	$ 781,327	$1,682,523	$1,723,334
Total assets	2,238,325	1,122,836	1,117,668	2,371,885	2,412,696
Reserve for losses and loss adjustment expenses	1,442,341	659,659	665,792	1,507,401	1,507,401
Unearned premiums	188,630	78,495	70,925	224,285	224,285
Debt	82,500			77,500	77,500
Stockholders equity	413,231	345,167	325,724	426,831	467,641
Total cash and investments per share	$ 60.86	$ 35.49	$ 33.39	$ 65.09	$ 60.47
Stockholders equity per share	$ 16.02	$ 15.22	$ 13.92	$ 16.51	$ 16.41
Common stock outstanding	25,789	22,682	23,401	25,851	28,501

	Year Ended December 31,			Six Months Ended June 30,	
	2001	2000	1999	2002	2001
	($ in thousands)				
Selected GAAP Financial Ratios:					
Net loss and loss adjustment expense ratio	95.3%	87.7%	63.7%	95.6%	94.4%
Underwriting expense ratio	22.5	21.7	24.5	19.9	24.2
Combined ratio(3)	117.8%	109.4%	88.2%	115.5%	118.6%
Selected Statutory Combined Data(4):					
Net loss and loss adjustment expense ratio	102.0%	87.4%	63.0%	95.6%	108.4%
Underwriting expense ratio	22.2	22.3	24.0	17.8	22.3
Combined ratio(5)	124.2%	109.7%	87.0%	113.4%	130.7%
Statutory surplus	$359,016	$216,812	$260,885	$356,942	$345,948
Ratio of cash and invested assets to statutory surplus	4.27x	3.42x	3.02x	4.41x	4.12x
Ratio of net premiums written to statutory surplus	1.24x	0.89x	0.62x	1.32x(6)	

(1) Net income for the six months ended June 30, 2002 was increased by $1.7 million due to the adoption of SFAS 141 and 142. See Note 1 to our consolidated financial statements. In accordance with SFAS 142, we wrote off the unamortized balance of deferred credits that related to business combinations completed prior to July 1, 2001. The cumulative effect increased net income per share (basic and diluted) by $0.06 per share.

(2) As adjusted GAAP data reflects our financial information after giving effect to the sale by us of 2.65 million shares of common stock pursuant to this offering at an offering price of $16.55 per share, after deducting the estimated underwriting discounts, commissions, and offering expenses payable by us.

(3) The GAAP combined ratio for the personal lines segment was 91.3% and 91.8% for the six months ended June 30, 2002 and the year ended December 31, 2001, respectively.

(4) For statutory purposes, it is a generally accepted practice to show results following a combination as if it occurred at the beginning of the year the transaction was completed. These figures, therefore, include the results of Professionals Group and MEEMIC since January 1, 2001.

(5) The statutory combined ratio for our personal lines segment was 95.7% and 92.8%, for the year ended December 31, 2001 and the six months ended June 30, 2002, respectively.

(6) The ratio of net premiums written to statutory surplus for the twelve months ended June 30, 2002 was calculated using premiums for the twelve month period then ended.

RISK FACTORS

You should carefully consider the risks described below before making an investment decision. You should also refer to the other information in this prospectus, including our financial statements and accompanying notes appearing elsewhere in this prospectus.

Our results may be affected if actual insured losses differ from our loss reserves.

Significant periods of time often elapse between the occurrence of an insured loss, the reporting of the loss to us and our payment of that loss. To recognize liabilities for unpaid losses, we establish reserves as balance sheet liabilities representing estimates of amounts needed to pay reported and unreported losses and the related loss adjustment expense. The process of estimating loss reserves is a difficult and complex exercise involving many variables and subjective judgments. As part of the reserving process, we review historical data and consider the impact of various factors such as:

- trends in claim frequency and severity;
- changes in operations;
- emerging economic and social trends;
- inflation; and
- changes in the regulatory and litigation environments.

This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate, but not necessarily accurate, basis for predicting future events. There is no precise method for evaluating the impact of any specific factor on the adequacy of reserves, and actual results are likely to differ from original estimates. To the extent loss reserves prove to be inadequate in the future, we would need to increase our loss reserves and incur a charge to earnings in the period the reserves are increased, which could have a material adverse impact on our financial condition and results of operation.

The loss reserves of our insurance subsidiaries also may be affected by court decisions that expand liability on our policies after they have been issued and priced. In addition, a significant jury award, or series of awards, against one or more of our insureds could require us to pay large sums of money in excess of our reserved amounts. Our policy to aggressively litigate claims against our insureds may increase the risk that we may be required to make such payments.

We operate in a highly competitive environment.

The property and casualty insurance business is highly competitive. We compete with large national property and casualty insurance companies as well as specialty insurers and self-insurance entities whose activities are limited to regional and local markets. Our competitors include companies with substantially greater financial resources than we have as well as companies that may have lower return on equity objectives than we have, particularly competitors that are mutual and not owned by stockholders.

Competition in the property and casualty insurance business is based on many factors, including premiums charged and other terms and conditions of coverage, services provided, financial ratings assigned by independent rating agencies, claims services, reputation, perceived financial strength and the experience of the insurance company in the line of insurance to be written. Increased competition could cause us to charge lower premium rates, adversely affect our ability to attract and retain business and reduce the profits that would otherwise arise from operations.

The perceived benefits of the consolidation of our predecessor companies, Medical Assurance and Professionals Group, may not be realized.

We were formed by the consolidation in June 2001 of Medical Assurance and Professionals Group, each of which had previously operated independently. A successful combination will require, among other things: integration of products and services, agency services, sales and marketing, claims adjustment and payment systems, and information and software systems; coordination of employee retention, hiring and training; and coordination of ongoing and future product development efforts. The consolidation of functions, the integration of departments,

systems and procedures and the relocation of staff may present management

challenges. We may not be able to integrate the operations of our predecessor companies without encountering difficulties. The integration may not be completed as rapidly as we expect and the integration may not achieve the benefits we currently anticipate.

Our revenues may fluctuate with insurance business cycles.

The supply of property and casualty insurance and reinsurance, or the industry s underwriting capacity, is determined principally by the industry s level of capitalization, historical underwriting results, returns on investment and perceived premium rate adequacy. Historically, the financial performance of the property and casualty insurance industry has tended to fluctuate in cyclical patterns characterized by periods of greater competition in pricing and underwriting terms and conditions (a soft insurance market) followed by periods of capital shortage and lesser competition (a hard insurance market). In a soft insurance market, competitive conditions could result in premium rates and underwriting terms and conditions which may have an adverse effect on our operating profitability.

We derive a significant portion of our insurance premium revenue from medical malpractice risks. For several years, the medical malpractice insurance industry has faced a soft insurance market that has generally resulted in lower premiums. More recently, loss costs have begun to rise beyond normal inflationary levels. We are endeavoring to compete in this market through premium rate increases and more selective underwriting practices, but these practices may not be successful. Moreover, we cannot predict whether, when or how market conditions will change, or the manner in which, or the extent to which any such changes may adversely impact our results and operations.

Our revenues may fluctuate with interest rates and investment results.

We generally rely on the positive performance of our investment portfolio to offset insurance losses and to contribute to our profitability. As our investment portfolio is primarily comprised of interest-earning assets, prevailing economic conditions, particularly changes in market interest rates, may significantly affect our operating results. Changes in interest rates also can affect the value of our interest-earning assets, which are principally comprised of fixed and adjustable-rate investment securities. Generally, the value of fixed-rate investment securities fluctuate inversely with changes in interest rates. Interest rate fluctuations could adversely affect our GAAP stockholders equity, total comprehensive income and/or our cash flows. As of June 30, 2002, $1,356 million of our $1,599 million investment portfolio was invested in fixed maturities. Unrealized pre-tax net investment gains (losses) on investments in fixed maturities were $10.5 million, $0.1 million and $(14.7) million for the years ended 2001, 2000 and 1999, respectively.

In accordance with our investment policies, the duration of our investment portfolio is intended to be similar to our expectation for the duration of our loss reserves. Changes in the actual duration of our loss reserves from our expectations may affect our results. Our investment portfolio, however, is subject to prepayment risk primarily due to our investments in mortgage-backed and other asset-backed securities. An investment has prepayment risk when there is a risk that the timing of cash flows that result from the repayment of principal might occur earlier than anticipated because of declining interest rates or later than anticipated because of rising interest rates. We are subject to reinvestment risk to the extent that we are not able to reinvest prepayments at rates comparable to the rates on the maturing investments.

At June 30, 2002, 6.9% of our investment portfolio was invested in equity securities, the value of which fluctuates depending on company specific and general market conditions. The broad investment environment in the U.S. has negatively affected the value of certain of these securities and may continue to do so in the future. If the value of our equity investments falls, the value of our investment portfolio will be reduced as a result. Any decline in value may also reduce our net income to the extent that we determine that the decline in market value is other than a temporary decline in value. Any such reduction could cause a decline in the market price of our common stock. At September 30, 2002, as a result of an other than temporary decline in the value of our equity securities, we expect to incur a non-cash pre-tax impairment expense of approximately $13.3 million.

Changes in healthcare could have a material impact on our operations.

We derive substantially all of our medical professional liability insurance premiums from physicians and other individual healthcare providers, physician groups and smaller healthcare facilities. Significant attention has recently been focused on reforming the healthcare industry at both the federal and state levels. A broad range of healthcare reform measures have been suggested, and public discussion of such measures will likely continue in the future. Proposals have included, among others, spending limits, price controls, limiting increases in insurance premiums, limiting the liability of doctors and hospitals for tort claims, imposing liability on institutions rather than physicians and restructuring the healthcare insurance system. We cannot predict which, if any, reform proposals will be adopted, when they may be adopted or what impact they may have on us. The adoption of certain of these proposals could materially adversely affect our financial condition or results of operations.

In addition to regulatory and legislative efforts, there have been significant market driven changes in the healthcare environment. In recent years, a number of factors related to the emergence of managed care have negatively impacted or threatened to impact the medical practice and economic independence of medical professionals. Medical professionals have found it more difficult to conduct a traditional fee-for-service practice and many have been driven to join or contractually affiliate with provider-supported organizations. Such change and consolidation may result in the elimination of, or a significant decrease in, the role of the physician in the medical malpractice insurance purchasing decision. It could also result in greater emphasis on the role of professional managers, who may seek to purchase insurance on a price competitive basis, and who may favor insurance companies that are larger and more highly rated than we are. In addition, such change and consolidation could reduce our medical malpractice premiums as groups of insurance purchasers generally retain more risk.

The movement from traditional fee-for-service practice to the managed care environment may also result in an increase in the liability profile of our insureds. The majority of our insured physicians practice in primary care specialties such as internal medicine, family practice, general practice and pediatrics. In the managed care environment, these primary care physicians are being required to take on the role of gatekeeper and restrain the use of specialty care by controlling access to specialists and by performing certain procedures that would customarily be performed by specialists in a fee-for-service setting. These practice changes are resulting in an increase in the claims frequency and severity experienced by primary care physicians and by us as their insurance carrier.

We are a holding company and are dependent on dividends and other payments from our operating subsidiaries, which are subject to dividend restrictions.

We are a holding company whose principal source of funds is cash dividends and other permitted payments from our operating subsidiaries, principally Medical Assurance Company and ProNational. If our subsidiaries are unable to make payments to us, or are able to pay only limited amounts, we may be unable to pay dividends or make payments on our indebtedness. The payment of dividends by these operating subsidiaries is subject to restrictions set forth in the insurance laws and regulations of Alabama and Michigan. See Insurance Regulatory Matters Regulation of Dividends and Other Payments From Our Operating Subsidiaries.

Regulatory changes and the unpredictability of court decisions could have a material impact on our operations.

Our insurance businesses are subject to extensive regulation by state insurance authorities in each state in which we operate. Regulation is intended for the benefit of policyholders rather than stockholders. In addition to the amount of dividends and other payments that can be made by our insurance subsidiaries, these regulatory authorities have broad administrative and supervisory power relating to:

- licensing requirements;
- trade practices;
- capital and surplus requirements;
- investment practices; and
- rates charged to insurance customers.

Table of Contents

These regulations may impede or impose burdensome conditions on rate increases or other actions that we may want to take to enhance our operating results, and could affect our ability to pay dividends on our common stock. In addition, we may incur significant costs in the course of complying with regulatory requirements. Most states also regulate insurance holding companies like us in a variety of matters such as acquisitions, changes of control and the terms of affiliated transactions. Future legislative or regulatory changes may adversely affect our business operations.

The financial position of our insurance subsidiaries may also be affected by court decisions that expand insurance coverage beyond the intention of the insurer at the time it originally issued an insurance policy. In addition, a significant jury award, or series of awards, against one or more of our insureds could require us to pay large sums of money in excess of our reserve amount.

Our geographic concentration ties our performance to the economic, regulatory and demographic conditions of the midwestern and southern states.

Our revenues and profitability are subject to prevailing economic, regulatory, demographic and other conditions in the states in which we write insurance. We write our professional liability insurance primarily in 19 states located in the midwestern and southern United States with 74.8% written in five states, Alabama, Ohio, Florida, Indiana and Michigan in the six months ended June 30, 2002, and we write our personal lines insurance only in Michigan. Because our business is concentrated in a limited number of markets, adverse developments that are limited to a geographic area in which we do business may have a disproportionately greater affect on us than they would have if we did business in markets outside that particular geographic area.

Our personal lines of property and casualty insurance business provide coverage for personal auto, homeowners, boat and umbrella insurance for residents of Michigan. Property and casualty insurance companies frequently experience losses from both man-made and natural catastrophes. Catastrophes may have a material adverse effect on our operations. Catastrophes include windstorms, hurricanes, earthquakes, tornadoes, hail, severe winter weather, fires and may include terrorist and other unforeseen events. The extent of losses from catastrophes is a function of the total amount of losses incurred, the number of insureds affected, the frequency of the events and the severity of the particular catastrophe. Most catastrophes occur in small geographic areas. The concentration of our personal lines business in Michigan leaves us vulnerable to catastrophes and severe weather specific to that state.

Our business could be adversely affected by the loss of independent agents.

We depend in part on the services of independent agents and brokers in the marketing of our insurance products. We face competition from other insurance companies for the services and allegiance of independent agents and brokers. These agents and brokers may choose to direct business to competing insurance companies or may direct less desirable risks to us.

If we are unable to maintain a favorable financial strength rating, it may be more difficult for us to write new business or renew our existing business.

Third party rating agencies assess and rate the claims-paying ability of insurers based upon criteria established by the agencies. Periodically the rating agencies evaluate us to confirm that we continue to meet the criteria of the ratings previously assigned to us. The financial strength ratings assigned by rating agencies to insurance companies represent independent opinions of financial strength and ability to meet policyholder obligations and are not directed toward the protection of investors. Ratings by rating agencies are not ratings of securities or recommendations to buy, hold or sell any security and are not applicable to the securities being offered by this prospectus.

Our operating subsidiaries hold a financial strength rating of A- (Excellent) by A.M. Best and A- (Strong) with a negative outlook by Standard & Poor s. Financial strength ratings are used by agents and customers as an important means of assessing the financial strength and quality of insurers. If our financial position deteriorates, we may not maintain our favorable financial strength ratings from the rating agencies. A downgrade or withdrawal of any such rating could severely limit or prevent us from writing desirable business.

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

As part of our overall risk and capacity management strategy, we purchase reinsurance for significant amounts of risk underwritten by our insurance company subsidiaries. Market conditions beyond our control determine the availability and cost of the reinsurance we purchase, which may affect the level of our business and profitability. We may be unable to maintain our current reinsurance coverage or to obtain other reinsurance coverage in adequate amounts and at favorable rates. If we are unable to renew our expiring coverage or to obtain new reinsurance coverage, either our net exposure to risk would increase or, if we are unwilling to bear an increase in net risk exposures, we would have to reduce the amount of risk we underwrite.

We cannot guarantee that our reinsurers will pay in a timely fashion, if at all, and, as a result, we could experience losses.

We transfer some of the risk we have assumed to reinsurance companies in exchange for part of the premium we receive in connection with the risk. Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred, it does not relieve us of our liability to our policyholders. If our reinsurers fail to pay us or fail to pay us on a timely basis, our financial results would be adversely affected.

The guaranty fund assessments that we are required to pay to state guarantee associations may increase and our results of operations and financial condition could suffer as a result.

Each state in which we operate has separate insurance guaranty fund laws requiring property and casualty insurance companies doing business within their respective jurisdictions to be members of their guaranty associations. These associations are organized to pay covered claims (as defined and limited by the various guaranty association statutes) under insurance policies issued by insolvent insurance companies. Most guaranty association laws enable the associations to make assessments against member insurers to obtain funds to pay covered claims after a member insurer becomes insolvent. These associations levy assessments (up to prescribed limits) on all member insurers in a particular state on the basis of the proportionate share of the premiums written by member insurers in the covered lines of business in that state. Maximum assessments permitted by law in any one year generally vary between 1% and 2% of annual premiums written by a member in that state. Some states permit member insurers to recover assessments paid through surcharges on policyholders or through full or partial premium tax offsets, while other states permit recovery of assessments through the rate filing process.

Property and casualty guaranty fund assessments incurred by us totaled $1.3 million and $2.0 million for 2001 and 1999, respectively. There were no significant guaranty fund assessments in 2000. Our policy is to accrue the insurance insolvencies when notified of assessments. We are not able to reasonably estimate the insolvent insurer s liabilities or develop a meaningful range of the insolvent insurer s liabilities because of inadequate financial data with respect to the estate of the insolvent company as supplied by the guaranty funds.

Our business could be adversely affected by the loss of one or more employees.

We are heavily dependent upon our senior management and the loss of services of our senior executives could adversely affect our business. Our success has been, and will continue to be, dependent on our ability to retain the services of our existing key employees and to attract and retain additional qualified personnel in the future. The loss of the services of any of our senior management or any other key employee, or the inability to identify, hire and retain other highly qualified personnel in the future, could adversely affect the quality and profitability of our business operations. We currently do not maintain key employee insurance with respect to any of our employees.

Our board of directors is in the process of considering succession planning relating to our Chief Executive Officer and is consulting with outside professional advisors in its planning. Dr. Crowe, our current Chairman and Chief Executive Officer, has indicated to us that he is committed to remaining with ProAssurance for three to five years.

Provisions in our charter documents, Delaware law and state insurance law may impede attempts to replace or remove our management or impede a takeover, which could adversely affect the value of our common stock.

Our certificate of incorporation and by-laws and Delaware law contain provisions that may have the effect of inhibiting a non-negotiated merger or other business combination. Additionally, the board of directors may issue preferred stock, which could be used as an anti-takeover device, without a further vote of our stockholders. No shares of our preferred stock are currently outstanding, and we have no present intention to issue any shares of preferred stock. However, because the rights and preferences of any series of preferred stock may be set by our board of directors in its sole discretion, the rights and preferences of any such preferred stock may be superior to those of our common stock and thus may adversely affect the rights of the holders of our common stock.

The voting structure of our common stock and other provisions of the certificate of incorporation are intended to encourage a person interested in acquiring us to negotiate with, and to obtain the approval of, our board of directors in connection with a transaction. However, certain of these provisions may discourage our future acquisition, including an acquisition in which stockholders might otherwise receive a premium for their shares. As a result, stockholders who might desire to participate in such a transaction may not have the opportunity to do so.

In addition, state insurance laws provide that no person or entity may directly or indirectly acquire control of an insurance company unless that person or entity has received approval from the insurance regulator. An acquisition of control of our insurance operating subsidiaries generally would be presumed if any person or entity acquires 10% (5% in Alabama) or more of our outstanding common stock, unless the applicable insurance regulator determines otherwise. These provisions apply even if the offer may be considered beneficial by some of our stockholders. If a change in management or a change of control is delayed or prevented, the market price of our common stock could decline.

Our acquisition of the minority shares of MEEMIC Holdings is subject to various conditions.

On July 9, 2002, MEEMIC entered into an agreement to acquire all of its outstanding shares not owned by us. The proposed transaction has been approved by the independent board members of MEEMIC and is subject to several other conditions, including without limitation, receipt of a fairness opinion from an independent financial advisor; approval by the stockholders of MEEMIC not affiliated with us; receipt of required regulatory or bank approvals; and no indication from the insurance rating agencies that their current ratings would be impaired by the transaction. The transaction may not be completed if we are unable to satisfy the conditions to the proposed transaction.

If we are unable to access documents stored on our computer systems, our ability to process new policies, revise existing policies and handle reported claims could be impeded.

We use computer-based retention methods to store certain of our information and documentation relating to coverage, policyholder information and the processing of claims. Our computer systems enable us to update and review this information efficiently in order to maintain our records and respond to the needs of our agents and policyholders. Our computer systems are located in our offices in Okemos and Auburn Hills, Michigan and Birmingham, Alabama and can be accessed from certain remote sites via telephone or internet connections. Our ability to access information stored on our computer systems could be negatively affected by numerous factors, including disruptions in electric power, telephone service or the computer systems in each of our main offices. Less than full and immediate access to this information could prevent us from issuing new policies and maintaining an up to date record of existing policies, in addition to hindering our ability to respond to claims. This could damage our reputation for efficiency and could cause us to lose the business of present and future customers.

Table of Contents

FORWARD-LOOKING STATEMENTS

Any written or oral statements made by us or on our behalf may include forward-looking statements that reflect our current views with respect to future events and financial performance. Forward-looking statements (identified by words such as, but not limited to, believe , expect , intend , anticipate , estimate , project and other analogous expressions) include among other things statements concerning: liquidity and capital requirements, return on equity, financial ratios, net income, premiums, losses and loss reserves, premium rates and retention of current business, competition and market conditions, the expansion of product lines, the development or acquisition of business in new geographical areas, the availability of acceptable reinsurance, actions by regulators and rating agencies, the effect of the consolidation of Medical Assurance and Professionals Group into ProAssurance, the purchase of MEEMIC shares, compliance with our credit agreement, payment of dividends, and other matters.

These forward-looking statements are based upon our estimates and anticipation of future events that are subject to certain risks and uncertainties that could cause actual results to vary materially from the expected results described in the forward-looking statements. Due to such risks and uncertainties, you are urged not to place undue reliance on forward-looking statements. All forward-looking statements included in this document are based upon information available to us on the date hereof, and we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Risks which could adversely affect our operations or cause actual results to differ materially from anticipated results include, but are not limited to, the following:

underwriting losses on the risks we insure are higher or lower than expected;

unexpected changes in loss trends and reserving assumptions which might require the reevaluation of the liability for loss and loss adjustment expenses, thus resulting in an increase or decrease in the liability and a corresponding adjustment to earnings;

our ability to retain current business, acquire new business, expand product lines and a variety of other factors affecting daily operations such as, but not limited to, economic, legal, competitive and market conditions which may be beyond our control and are thus difficult or impossible to predict;

changes in the interest rate environment and/or the securities markets that adversely impact the fair value of our investments or our income;

inability on our part to achieve continued growth through expansion into other states or through acquisitions or business combinations;

general economic conditions that are worse than anticipated;

inability on our part to obtain regulatory approval of, or to implement, premium rate increases;

the effects of weather-related events;

changes in the legal system, including retroactively applied decisions that affect the frequency and severity of claims;

significantly increased competition among insurance providers and related pricing weaknesses in some markets;

changes in the availability, cost, quality or collectibility of reinsurance;

changes to our ratings by rating agencies;

regulatory and legislative actions or decisions that adversely affect us; and

our ability to utilize loss carryforwards and other deferred tax assets.

Table of Contents

USE OF PROCEEDS

We estimate that we will receive net proceeds of approximately $40.8 million from this offering, or approximately $46.7 million if the underwriters over-allotment option is exercised in full, based on an offering price of $16.55 per share and after deducting underwriting discounts and commissions and estimated offering expenses payable by us. We will not receive any proceeds from the sale of shares of our common stock by the selling stockholder in this offering.

We intend to use the net proceeds from this offering to support the growth of our professional liability business and for general corporate purposes, which may include the acquisition of other companies or books of business and the payment of principal and interest on our outstanding debt. We currently have no agreements or other obligations to acquire any companies or books of business. Until we use the net proceeds from this offering, we intend to invest such proceeds in U.S. treasury and government agency obligations and investment grade debt securities.

PRICE RANGE OF OUR COMMON STOCK

Our common stock is traded on the New York Stock Exchange under the symbol PRA. The following table sets forth the per share high and low closing sale prices for our common stock as reported on the New York Stock Exchange for the periods presented. Our stock began trading on the New York Stock Exchange on June 28, 2001. Prior to that date, the quotations reflect prices for Medical Assurance (NYSE: MAI) common stock because the New York Stock Exchange treated the consolidation of Professionals Group with Medical Assurance as a name change by Medical Assurance. You can read more about the consolidation and our history under Business Overview.

	High	Low
Fiscal Year Ended December 31, 2000:		
First Quarter	$22.88	$16.88
Second Quarter	20.81	10.19
Third Quarter	12.50	10.56
Fourth Quarter	15.88	12.25
Fiscal Year Ended December 31, 2001:		
First Quarter	$18.06	$12.00
Second Quarter	16.49	12.30
Third Quarter	19.13	14.50
Fourth Quarter	17.99	13.49
Fiscal Year Ended December 31, 2002:		
First Quarter	$18.22	$15.99
Second Quarter	19.70	16.01
Third Quarter	18.00	14.20
Fourth Quarter (through November 7, 2002)	17.25	15.78

Neither Medical Assurance nor ProAssurance paid any cash dividends on its common stock in any of the periods reflected in the table.

As of September 30, 2002, there were 3,763 stockholders of record of our common stock.

DIVIDEND POLICY

We do not currently pay dividends on our common stock and do not intend to pay any dividends in the foreseeable future. We intend to retain earnings to support the future growth of our business.

As a holding company with no direct operations, we will rely on cash dividends and other permitted payments from our insurance subsidiaries to pay any future dividends to our stockholders. State insurance laws and restrictions under our credit agreement limit the amounts that may be paid to us by our insurance subsidiaries. See Insurance Regulatory Matters Regulation of Dividends and Other Payments from our Operating Subsidiaries.

Table of Contents

CAPITALIZATION

The following table sets forth our capitalization as of June 30, 2002, and as adjusted to give effect to the sale by us of 2,650,000 shares of our common stock in this offering based on an offering price of $16.55 per share, and after deducting underwriting discounts and commissions and estimated offering expenses payable by us. We will not receive any proceeds from the sale of shares of our common stock by the selling stockholder. This table should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and accompanying notes appearing elsewhere in this prospectus.

	At June 30, 2002	
	Actual	**As Adjusted**
	($ in thousands, **except per share data)**	
Debt	$ 77,500	$ 77,500
Stockholders equity:		
Preferred stock, 50,000,000 shares authorized and none issued and outstanding (actual and as adjusted)		
Common stock, par value $0.01 per share, 100,000,000 shares authorized; 25,972,943 (actual) and 28,622,943 (as adjusted) shares issued(1)	260	286
Additional paid-in capital	261,628	302,412
Accumulated other comprehensive gain (loss), net of deferred tax expense of $4,293	11,536	11,536
Retained earnings	153,463	153,463
Less treasury stock, at cost, 121,765 shares	(56)	(56)
Total stockholders equity	426,831	467,641
Total capitalization	$504,331	$545,141
Book value per common share	$ 16.51	$ 16.41
Ratio of debt to total capitalization	15.4%	14.2%

(1) Excludes 1,103,037 shares issuable upon the exercise of options granted by us under our equity incentive compensation plan, of which approximately 771,037 shares were exercisable at September 30, 2002, and an additional 1,005,999 shares reserved for future issuance of options under our equity incentive compensation plan.

Table of Contents

SELECTED HISTORICAL FINANCIAL DATA

The table shown below presents our selected financial data for the five years ended December 31, 2001. We derived the GAAP statement of operations data and balance sheet data relating to each of the years 1997 through 2001 from our audited consolidated financial statements. Consolidated balance sheets at December 31, 2000 and 2001 and the related consolidated statements of operations and comprehensive income, of stockholders equity and of cash flows for the three years ended December 31, 2001 and accompanying notes, appear in this prospectus beginning at page F-1.

We derived the combined statutory data from annual statutory statements filed with the domiciliary states of our operating subsidiaries and prepared in accordance with SAP, which differ from GAAP.

The financial data as of June 30, 2002 and 2001 and for the six-month periods ended June 30, 2002 and 2001 are derived from our unaudited consolidated financial statements. The unaudited consolidated financial statements include all adjustments, consisting of normal recurring accruals, which we consider necessary for a fair presentation of the financial position and the results of operations for these periods. Operating results for the six-month periods ended June 30, 2002 are not necessarily indicative of the results that may be expected for the entire year ending December 31, 2002.

The selected financial data presented below should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and accompanying notes included elsewhere in this prospectus. The results for the period from January 1, 1997 through June 27, 2001 reflect the historical results of Medical Assurance prior to the consolidation with Professionals Group. The results for the year ended December 31, 2001 include the operations of Professionals Group from June 27, 2001, the date of consolidation.

	Year Ended December 31,					Six Months Ended June 30,	
	2001	2000	1999	1998	1997	2002	2001
	(in thousands, except per share data)						
GAAP Statement of Income Data:							
Gross premiums written	$388,983	$223,871	$201,593	$192,479	$188,195	$304,188	$130,428
Net premiums written	310,291	194,279	156,923	141,787	140,200	255,653	95,112
Net premiums earned	$313,345	$177,596	$164,424	$141,316	$118,967	$224,083	$ 96,222
Net investment income	59,782	41,450	39,273	39,402	38,474	38,954	19,938
Net realized investment gains (losses)	5,441	913	1,787	11,281	1,739	(3,778)	1,194
Other income	3,987	2,630	2,545	1,604	1,562	3,624	1,047
Total revenues	382,555	222,589	208,029	193,603	160,742	262,883	118,401
Net losses and loss adjustment expenses	298,558	155,710	104,657	93,893	77,674	214,263	90,789
Underwriting, acquisition, and insurance expenses	70,437	38,579	40,212	33,508	33,903	44,482	23,246
Interest expense	2,591					1,514	84
Total expenses	371,586	194,289	144,869	127,401	111,577	260,259	114,119
Income before income taxes and minority interest	10,969	28,300	63,160	66,202	49,165	2,624	4,282
Provision for income taxes	(2,847)	4,000	16,460	17,679	11,707	(1,866)	(978)

Income before minority interest	13,816	24,300	46,700	48,523	37,458	4,490	5,260
Minority interest	1,366					1,428	
Income before cumulative effect of accounting change(1)	12,450	24,300	46,700	48,523	37,458	3,062	5,260
Net income(1)	$ 12,450	$ 24,300	$ 46,700	$ 47,400(1)	$ 37,458	$ 4,756(2)	$ 5,260
Income per share before cumulative effect of accounting change (basic and diluted)	$ 0.51	$ 1.04	$ 1.95	$ 1.96	$ 1.51	$ 0.12	$ 0.23
Net income per share (basic and diluted)	0.51	1.04	1.95	1.92(1)	1.51	0.18(2)	0.23
Weighted average number of shares outstanding:							
Basic	24,263	23,291	23,992	24,729	24,844	25,842	22,705
Diluted	24,267	23,291	24,008	24,731	24,844	25,864	22,706

Table of Contents

	As of December 31,					As of June 30,	
	2001	2000	1999	1998	1997	2002	2001
	(in thousands, except per share data)						
GAAP Balance Sheet Data:							
Total cash and investments	$1,569,628	$805,076	$781,327	$800,601	$732,450	$1,682,523	$1,550,139
Total assets	2,238,325	1,122,836	1,117,668	1,132,239	1,063,173	2,371,885	2,260,475
Reserve for losses and loss adjustment expenses	1,442,341	659,659	665,792	660,640	614,729	1,507,401	1,438,667
Unearned premiums	188,630	78,495	70,925	76,229	79,700	224,285	188,414
Debt	82,500					77,500	110,000
Stockholders equity	413,231	345,167	325,724	324,180	287,188	426,831	402,863
Total cash and investments per share	$60.86	$35.49	$33.39	$32.71	$29.50	$65.09	$60.15
Stockholders equity per share	$16.02	$15.22	$13.92	$13.24	$11.57	$16.51	$15.63
Common stock outstanding	25,789	22,682	23,401	24,477	24,829	25,851	25,770

	Year Ended December 31,					Six Months Ended June 30,	
	2001	2000	1999	1998	1997	2002	2001
	($ in thousands)						
Selected GAAP Financial Ratios:							
Net loss and loss adjustment expense ratio	95.3%	87.7%	63.7%	66.4%	65.3%	95.6%	94.4%
Underwriting expense ratio	22.5	21.7	24.5	23.7	28.5	19.9	24.2
Combined ratio(3)	117.8%	109.4%	88.2%	90.1%	93.8%	115.5%	118.6%
Selected Statutory Combined Data(4):							
Net loss and loss adjustment expense ratio	102.0%	87.4%	63.0%	70.5%	68.0%	95.6%	108.4%
Underwriting expense ratio	22.2	22.3	24.0	28.8	26.9	17.8	22.3
Combined ratio(5)	124.2%	109.7%	87.0%	99.3%	94.9%	113.4%	130.7%
Statutory surplus	$359,016	$216,812	$260,885	$239,878	$207,165	$356,942	$345,948
Ratio of cash and invested assets to statutory surplus	4.27x	3.42x	3.02x	3.23x	3.39x	4.41x	4.12x
Ratio of net premiums written to statutory surplus	1.24x	0.89x	0.62x	0.59x	0.68x	1.32x(6)	

(1) Net income for 1998 was reduced by $1.1 million, which represents the cumulative effect (net of tax) of an accounting charge for guaranty fund assessments due to the adoption of the American Institute of Certified Public Accountants Statement of Position 97-3. The cumulative effect decreased net income per share (basic and diluted) by $0.04 per share.

(2) Net income for the six months ended June 30, 2002 was increased by $1.7 million due to the adoption of SFAS 141 and 142. See Note 1 to our consolidated financial statements. In accordance with SFAS 142, we wrote off the unamortized balance of deferred credits that related to business combinations completed prior to July 1, 2001. The cumulative effect increased net income per share (basic and diluted) by $0.06 per share.

(3) The GAAP combined ratio for the personal lines segment was 91.3% and 91.8% for the six months ended June 30, 2002 and the year ended December 31, 2001.

(4) For statutory purposes, it is a generally accepted practice to show results following a combination as if it occurred at the beginning of the year the transaction was completed. These figures, therefore, include the results of Professionals Group and MEEMIC since January 1, 2001.

(5) The statutory combined ratio for our personal lines segment was 95.7% and 92.8%, for the year ended December 31, 2001 and the six months ended June 30, 2002, respectively.

(6) The ratio of net premiums written to statutory surplus for the twelve months ended June 30, 2002 was calculated using premiums for the twelve month period then ended.

Table of Contents

PRO FORMA FINANCIAL DATA

The unaudited pro forma condensed consolidated income statement was derived from and should be read in conjunction with our audited historical consolidated financial statements and related notes for the three years ended December 31, 2001, which are included in this prospectus. The unaudited pro forma condensed consolidated statement of income for the year ended December 31, 2001 gives effect to the acquisition of Professionals Group by Medical Assurance as if it had occurred on January 1, 2001. The statement includes pro forma adjustments as described in the accompanying explanatory notes.

The unaudited pro forma condensed consolidated financial data is presented for illustrative purposes only and does not purport to be indicative of the operating results or financial position that would have actually occurred had the transactions been completed on the dates indicated, nor is it indicative of the future operating results or financial position of the consolidated company. The pro forma adjustments are based on the information and assumptions available at the time of the printing of this prospectus.

Table of Contents

PROASSURANCE CORPORATION

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF INCOME

YEAR ENDED DECEMBER 31, 2001

	ProAssurance Historical	Pro Forma Adjustments(1)	ProAssurance Pro Forma assuming Professional Group Purchase on January 1, 2001
	(in thousands, except per share data)		
Gross written premiums:			
Professional liability:			
Physicians	$228,139	$ 52,995	$281,134
Other	39,080	25,931	65,011
Legal	2,134	1,106	3,240
Other commercial lines	46,345	102	46,447
	315,698	80,134	395,832
Personal lines	73,285	69,027	142,312
	388,983	149,161	538,144
Revenues:			
Net premiums earned	$313,345	$127,600	$440,945
Net investment income	65,223	19,095(2)	84,318
Other income	3,987	1,618	5,605
Total revenues	382,555	148,313	530,868
Expenses:			
Net losses and loss adjustment expenses	298,558	151,718(3)	450,276
Underwriting, acquisition and insurance expenses	70,437	27,121(4)	97,558
Interest expense	2,591	1,642(5)	4,233
Total expenses	371,586	180,481	552,067
Income before income taxes and minority interest	10,969	(32,168)	(21,199)
Income taxes	(2,847)	(14,063)(6)	(16,910)
Income before minority interest	13,816	(18,105)	(4,289)
Minority interest	1,366	786(7)	2,152
Net income	$ 12,450	$ (18,891)	$ (6,441)
Earnings per share (basic and diluted)	$ 0.51		$ (0.25)
Weighted average shares outstanding:			
Basic	24,263	1,594	25,857
Diluted	24,267	1,606	25,873

Table of Contents

PRO FORMA ADJUSTMENT EXPLANATORY NOTES

(1) Except as otherwise indicated in these notes, the pro forma adjustments to each line item reflect results of Professionals Group prior to the acquisition by Medical Assurance on June 27, 2001 (the pro forma period).

(2) We applied approximately $101 million of our internal funds in the consolidation with Professionals Group. The net investment earnings of Professionals Group during the pro forma period have been reduced by the estimated effect that the use of those funds would have had on our net investment income.

(3) The net losses and loss adjustment expenses of Professionals Group for the pro forma period include a $25 million increase to prior year accident reserves.

(4) The pro forma adjustment includes the recurring underwriting, acquisition and insurance expenses of Professionals Group during the pro forma period reduced by the estimated effect of fair value purchase adjustments on the amortization of such expenses.

(5) We increased the interest expense for the estimated interest that would have been incurred on the bank debt used to fund the consolidation.

(6) We decreased Professionals Group tax expense for the tax effect of the pro forma adjustments described in notes (2), (4) and (5), using the statutory rate of 35 percent and taking into consideration that a portion of investment income is tax exempt.

(7) We have estimated the effect of the minority interest of MEEMIC Holdings on the results of operations for Professionals Group during the pro forma period.

Table of Contents

MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following presents our management s discussion and analysis of our financial condition and results of operations as of the dates and for the periods indicated. You should read this discussion in conjunction with the consolidated financial statements and notes thereto included in this prospectus and the information under the caption Risk Factors. This discussion contains forward-looking information that involves risks and uncertainties. Actual results could differ significantly from these forward-looking statements. See Forward-Looking Statements.

Overview

We were organized to serve as a holding company with Medical Assurance and Professionals Group as our wholly owned subsidiaries. Medical Assurance and Professionals Group, through their insurance subsidiaries, are nationally recognized as providers of professional liability insurance and also provide personal lines insurance in Michigan.

Medical Assurance owns all of the capital stock of Medical Assurance Company and Medical Assurance of West Virginia, Inc. These insurance subsidiaries principally Medical Assurance Company provide professional liability insurance to medical and other healthcare providers.

Professionals Group owns all of the capital stock of ProNational and indirectly Red Mountain Casualty Insurance Company, Inc. These insurance subsidiaries principally ProNational also provide professional liability insurance to medical and other healthcare providers and to a lesser extent, providers of legal services.

Professionals Group owns indirectly 83.9% of the outstanding capital stock of MEEMIC. This insurance subsidiary provides personal lines insurance in Michigan primarily to educational employees and their families.

Prior to the completion of the consolidation, we had no assets, liabilities or operations. We commenced operations upon completion of our consolidation with Medical Assurance and Professionals Group on June 27, 2001. On that date:

We distributed one share of our common stock in exchange for each of the approximately 22.6 million outstanding shares of common stock of Medical Assurance in a transaction that was treated as a corporate reorganization of Medical Assurance and accounted for in a manner similar to a pooling of interests.

We distributed both cash and stock in exchange for each of the approximately 8.9 million outstanding shares of common stock of Professionals Group in a transaction that was accounted for as a purchase of Professionals Group. Each holder of a share of Professionals Group common stock, at his election, received either (i) 0.897 of a share of our common stock and $13.47 in cash or (ii) $27.47 in cash.

Upon completion of the consolidation, we distributed approximately 22.6 million newly issued shares of our common stock to the Medical Assurance stockholders and we distributed to the Professionals Group stockholders approximately $196 million in cash and approximately 3.2 million newly issued shares of our common stock valued at $15.59 per share.

We funded the cash requirements of this transaction with the proceeds of a $110 million term loan from a bank syndicate and with internal funds generated from dividends paid to us by Medical Assurance and Professionals Group on completion of the consolidation.

Our financial statements for periods prior to June 30, 2001 reflect the assets, liabilities and operations of Medical Assurance and its subsidiaries. We allocated the total cost of the purchase of Professionals Group to the assets acquired and liabilities assumed based on estimates of their respective fair values at June 27, 2001. We have included Professionals Group s operations in our financial statements since June 27, 2001.

We operate in two insurance segments: professional liability insurance and personal lines insurance. Prior to the consolidation, we operated only in the professional liability segment. Our operations have included a personal lines segment since June 27, 2001, as a result of our ownership of MEEMIC. We allocate our identifiable assets and our revenues and expenses to our operating segments, except that cash and marketable securities owned directly by us, and investment income earned thereon, are allocated to us.

The table below provides a reconciliation of segment information to total consolidated information for the years ended December 31, 2001 and 2000 and for the six month periods ended June 30, 2002 and 2001.

	Year Ended December 31,		Six Months Ended June 30,	
	2001	2000	2002	2001
	($ in thousands)			
Revenues:				
Professional liability lines	$306,825	$222,589	$185,351	$118,401
Personal lines	75,290		77,532	
Corporate and other	440			
Total revenues	$382,555	$222,589	$262,883	$118,401
Income (loss) before cumulative effect of accounting change:				
Professional liability lines	$ 6,759	$ 24,300	$ (3,503)	$ 5,260
Personal lines	7,088		7,549	
Corporate and other	(1,397)		(984)	
Total	$ 12,450	$ 24,300	$ 3,062	$ 5,260
Net Income:				
Professional liability lines	$ 6,759	$ 24,300	$ (1,809)	$ 5,260
Personal lines	7,088		7,549	
Corporate and other	(1,397)		(984)	
Total net income	$ 12,450	$ 24,300	$ 4,756	$ 5,260

	December 31,		June 30,
	2001	2000	2002
	($ in thousands)		
Identifiable Assets:			
Professional liability lines	$1,913,558	$1,122,836	$2,025,051
Personal lines	324,719		346,824
Corporate and other	48		10
Total assets	$2,238,325	$1,122,836	$2,371,885

Critical Accounting Policies

We are required to make estimates and assumptions in certain circumstances that affect amounts reported in our consolidated financial statements and related footnotes. We evaluate these estimates and assumptions on an on-going basis based on historical developments, market conditions, industry trends and other information that we believe to be reasonable under the circumstances. There can be no assurance that actual results will conform to our estimates and assumptions, and that reported results of operations will not be materially adversely affected by the need to make accounting adjustments to reflect changes in these estimates and

assumptions from time to time. We believe the following policies are the most sensitive to estimates and judgments.

Revenue Recognition. We recognize insurance premium income on a monthly pro rata basis over the respective terms of the policies in force. Unearned premiums represent the portion of premiums written applicable to the unexpired terms of the policies in force. Reinsurance arrangements are prospective contracts for which prepaid reinsurance premiums are amortized ratably over the related policy terms based on the estimated ultimate amounts to be paid. Changes in estimated outcomes are recognized currently.

Reserves for Losses and Loss Adjustment Expense. Our reserves for losses and LAE represent our estimate of the future amounts necessary to pay claims and expenses associated with investigation and settlement of claims. These estimates consist of case reserves and bulk reserves. Case reserves are estimates of future losses and LAE for reported claims and are established by our claims department. Bulk reserves, which include a provision for losses that have occurred but have not been reported to us as well as development on reported claims, are the difference between (i) the sum of case reserves and paid losses and (ii) an actuarially determined estimate of the total losses and LAE necessary for the ultimate settlement of all reported claims and incurred but not reported claims, including amounts already paid. The estimates take into consideration our past loss experience, available industry data and projections as to future claims frequency, severity, inflationary trends and settlement patterns. Estimating reserves, especially professional liability reserves, is a complex process which is heavily dependent on judgment and involves many uncertainties. As a result, reserve estimates may vary significantly from the eventual outcome. The assumptions used in establishing our reserves are regularly reviewed and updated by management as new data becomes available. Any adjustments necessary are reflected in current operations.

Investments. At December 31, 2001 and 2000, we classified all of our securities as available-for-sale, which means they are available to be sold in response to our liquidity needs, changes in market interest rates and investment management strategies, among others. Available-for-sale securities are recorded at fair value, with unrealized gains and losses, net of the related income tax effect, excluded from income and reported as a separate component of stockholders equity. A decline in the fair value of an available-for-sale security below cost that we judge not to be temporary is charged against income in the current period.

Results Of Operations

Six Months Ended June 30, 2002 Compared to Six Months Ended June 30, 2001

Our consolidated income before cumulative effect is $3.1 million or $0.12 per share for the six months ended June 30, 2002 compared to $5.3 million or $0.23 per share for the six months ended June 30, 2001. The operating results of each of our reportable industry segments are discussed separately in the following sections.

Interest expense during both 2002 and 2001 relates entirely to the bank loan that provided financing for the consolidation with Professionals Group. The debt bears interest at a variable rate based on the London Interbank Offered Rate (LIBOR), or at our election, the bank s base rate. The interest rate was 3.4% on June 30, 2002.

We recognized a tax benefit of $1.9 million for the six months ended June 30, 2002, as compared to a tax benefit of $1.0 million for the six months ended June 30, 2001. Our tax-exempt investment income is the primary reason that our effective rates for both years are significantly lower than the expected statutory rate of 35%. We earn a significant portion of our investment income from tax-exempt sources. After adjustment for tax-exempt income, we experienced a taxable loss for the six months ended June 30, 2002 and 2001.

We currently have available approximately $40.3 million in federal tax loss carryforwards. These carryforwards begin to expire in the year 2018. Approximately $28.7 million of the carryforwards relate to our consolidation with Professionals Group; because of this, approximately $10.1 million of the carryforwards are not available to us until 2003 or after.

Table of Contents

Professional Liability Segment

Operating results for our professional liability segment for the six months ended June 30, 2002 and 2001 are summarized in the table below.

	Six Months Ended June 30,		
	2002	2001	Increase (Decrease)
		($ in thousands)	
Gross premiums written	$220,341	$130,428	$ 89,913
Revenues:			
Premiums earned	$191,567	$123,145	$ 68,422
Premiums ceded	38,403	26,923	11,480
Net premiums earned	153,164	96,222	56,942
Net investment income	33,895	19,938	13,957
Net realized investment gains (losses)	(4,422)	1,194	(5,616)
Other income	2,714	1,047	1,667
Total revenues	185,351	118,401	66,950
Expenses:			
Net losses and loss adjustment expenses	165,674	90,789	74,885
Underwriting, acquisition and insurance expenses	28,329	23,246	5,083
Total expenses	194,003	114,035	79,968
Income (loss) before income taxes	$ (8,652)	$ 4,366	$(13,018)
Net loss and LAE ratio	108.2%	94.4%	13.8%
Underwriting expense ratio	18.5	24.2	(5.7)
Combined ratio	126.7%	118.6%	8.1%

Premiums

Gross Premiums Written. Our professional liability segment principally provides professional liability insurance for providers of medical and other healthcare services, and to a limited extent providers of legal services, and insignificant amounts of general liability insurance products that are offered to such providers as accommodation products (Professional Coverages). The professional liability segment also includes accident and health, workers compensation and multi-line insurance (Other Coverages).

Gross premiums written for the six months ended June 30, 2002 increased by $89.9 million as compared to the same period of 2001. This increase is comprised of a $119.1 million increase related to Professional Coverages offset by a $29.2 million decrease related to Other Coverages. The increase in Professional Coverages gross premiums written is primarily attributable to an increase in coverage of physicians versus hospitals.

The Professional Coverages increase is primarily attributable to the consolidation with Professionals Group but also includes the effect of rate increases implemented during 2002 and 2001. We have implemented, and we plan to continue to implement, rate increases based on loss trends, subject to our receipt of regulatory approval. To date, premiums renewed at the higher rates coupled with new business have more than offset the effect of premiums we lost due to our decreased retention of insureds. However, our higher rates may cause a greater loss of insureds in future periods.

28

We have historically written Other Coverages premiums as favorable opportunities arose to utilize capital. We significantly decreased our commitment to these programs during the latter half of 2000 and have since allowed existing contractual relationships to expire. This resulted in substantial declines in premium volumes related to this business during 2002 and the latter half of 2001. Gross premiums written for Other Coverages were $2.7 million for the six months ended June 30, 2002, as compared to $31.9 million for the same period in 2001.

Premiums Earned. Premiums earned for the six months ended June 30, 2002 increased by $68.4 million as compared to the same period of 2001. As in gross premiums written, this increase is comprised of a $94.5 million increase related to Professional Coverages offset by a $26.1 million decrease related to Other Coverages. The increase in Professional Coverages premiums earned is primarily attributable to the consolidation. The beneficial impact of rate increases will be reflected in our financial results over time. Therefore, rate increases implemented after July 1, 2001 have not yet been fully reflected in premiums earned since premiums are earned over the entire policy period (usually one year) after the policy is written. The decrease in Other Coverages premiums earned is primarily attributable to our decreased commitment to these programs, as previously discussed.

Premiums ceded are estimated based on the terms of the respective reinsurance agreements. We continually review our estimated expense and we include in current operations any adjustments that we believe are necessary.

Premiums ceded for the six months ended June 30, 2002 increased by $11.5 million as compared to the same period of 2001. This increase is comprised of a $16.2 million increase related to Professional Coverages offset by a $4.7 million decrease related to Other Coverages. Reinsurance premiums ceded related to Professional Coverages increased due to several factors. The most significant factor was the increase in the volume of premiums earned during those periods that resulted from our consolidation with Professionals Group. However, reinsurance premiums ceded related to Professional Coverages also increased in 2002 because more premiums were earned in markets where we rely more heavily on reinsurance. Reinsurance premiums ceded related to Other Coverages decreased due to the previously discussed decline in premiums earned related to Other Coverages during those periods.

Losses and Loss Adjustment Expenses

Net losses and loss adjustment expenses (net losses) includes three components: (a) actuarial evaluation of incurred loss levels for the current accident year; (b) actuarial re-evaluation of incurred loss levels for prior accident years and (c) actuarial re-evaluation of the reserve for the death, disability and retirement provision. These components take into consideration prior loss experience, loss trends, changes in the frequency and severity of claims, premium rate loads and the retention of insureds. We include in current operations any changes to previously established estimates of net losses. We increased our estimates of prior accident year net losses by $2.4 million during the second quarter of 2002. We did not change our estimates of prior accident year net losses during the first quarter of 2002 nor during the first or second quarters of 2001. Accident year refers to the accounting period in which the insured event is incurred as a liability of the insurer. This may be when the event occurs or when a claim arising from the event is first reported to the insurer, depending on the policy terms. We believe that measuring losses on an accident year basis is the most indicative measure of the underlying profitability of the premiums earned in that period, since it associates losses with the premiums earned for the policies covering the losses.

Professional liability claims are resolved over an extended number of years and many of these claims are litigated. We use methods we believe to be reasonable and appropriate in establishing our loss reserves, but during the extended period in which claims are resolved, the legal environment and other factors may change. Consequently, ultimate losses are inherently difficult to estimate and actual results may vary from the estimated amounts. Given the large volume of loss reserves at any balance sheet date, a small change in the estimate of those reserves can have a significant effect on current operations.

The following table summarizes current accident year net losses and LAE incurred and current accident year net loss ratios for 2002 and 2001 by type of coverage. We calculated the current accident year net loss ratios by dividing current accident year net losses and LAE incurred by the net premiums earned.

	Six Months Ended June 30,	
	2002	**2001**
	($ in thousands)	
Incurred losses and LAE related to:		
Current accident year	$163,274	$90,789
Prior accident year	2,400	
Change in death, disability and retirement reserves		
Net incurred losses and LAE	$165,674	$90,789
Current accident year net incurred losses and LAE allocated to:		
Professional coverages	$161,847	$74,515
Other coverages	1,427	16,274
Current accident year net incurred losses and LAE	$163,274	$90,789
Net loss and LAE ratio:		
Current accident year ratio	106.6%	94.4%
Prior accident year ratio	1.6	
Total calendar year net loss and LAE ratio	108.2%	94.4%
Current accident year net loss and LAE ratio:		
Professional liability coverages ratio	106.9%	102.0%
Other coverages ratio	82.6%	70.3%

Professional Coverages. Current accident year net losses related to Professional Coverages increased by $87.3 million for six months ended June 30, 2002, as compared to the same period of 2001. Our consolidation with Professionals Group and the resultant increase in the number of insureds is the primary reason for the increase in Professional Coverage net losses.

Current accident year net loss and LAE ratio for Professional Coverages also increased during 2002. This is primarily because net premiums earned included an increased proportion of business from states that had a higher loss ratio. This increased proportion is the result of our consolidation with Professionals Group. We have also experienced a small increase in the loss costs per unit of risk associated with the premiums written by Medical Assurance due to rising loss costs. The premium increases that we have implemented are expected to contribute to a decrease in our loss ratio.

Other Coverages. As discussed under gross premiums written, we have discontinued most of the underwriting arrangements that generated Other Coverages premiums. As a result of this decline in premiums earned, current accident year net losses related to Other Coverages decreased by $14.8 million for the six months ended June 30, 2002, as compared to the same period of 2001. As we have exited this business, the losses associated with the remaining premiums are such that the average 2002 current accident year net loss ratio for Other Coverages increased as compared to the average 2001 ratio.

All Coverages. Our 2002 current accident year net loss and LAE ratio for all coverages is greater than the same ratio for 2001 primarily because of an increased amount of workers compensation insurance premiums. Net losses related to Other Coverages premiums are historically lower than the net losses expected for Professional Coverages while other expenses are higher. In 2002, our premiums related to Other Coverages decreased in significance as a component of total net premiums earned. As this portion of the business decreased, our average net loss ratio has increased.

Net Investment Income and Net Realized Investment Gains (Losses)

Our investment portfolio is principally comprised of fixed maturities, equity securities, short-term investments and cash and cash equivalents. At June 30, 2002 and December 31, 2001 the fair value of our professional liability segment investment portfolio was $1,387 million and $1,313 million, respectively; the amortized cost of our professional liability segment investment portfolio was $1,374 million and $1,309 million, respectively. Our net investment income is comprised of earnings on our professional liability segment investment portfolio.

Earnings on our investment portfolio increased by approximately $14.0 million for the six month period ended June 30, 2002 as compared to the same period in 2001. The primary reason for this increase is the additional investment income earned as a result of our consolidation with Professionals Group.

We have experienced decline in the overall yields on our portfolio as a result of lower market interest rates, both short and long-term. As our investment securities have matured and we have generated additional cash from operations, our available long-term investment opportunities have been at rates that are less favorable than the rates available in 2001. In addition, our average investment in lower yielding short-term and overnight cash investments increased during 2002 due to a lack of available long-term investment opportunities. At June 30, 2002 approximately $122.2 million of our professional liability segment investment portfolio was invested in short-term securities. At June 30, 2002, the average yield of our professional liability segment fixed maturity investments was 6.1%.

Although we purchase fixed maturity securities with the initial intent to hold such securities until their maturity, we may dispose of these securities prior to their respective maturities if we believe such disposals are consistent with our overall investment objectives, including maximizing after-tax yields and disposals of securities that no longer meet our risk management criteria.

We recognized net capital losses for the six months ended June 30, 2002, principally due to losses of $5.1 million realized on the disposal of WorldCom, Inc. securities. We also recognized a loss of $1.6 million during the first quarter of 2002 related to equity securities that we consider to have an other-than-temporary decline in fair value.

Net realized investment gains (losses) for the six months ended June 30, 2001 included a loss of $94,000 recognized during the second quarter related to one security that we considered to have an other-than-temporary decline in fair value.

Other Income

Other income is comprised primarily of fee and commission income. Our consolidation with Professionals Group is the primary reason for the increase in other income for the six months ended June 30, 2002 as compared to the same period in 2001.

Underwriting, Acquisition and Insurance Expenses

We defer costs that vary with and are directly related to the production of new and renewal premiums (primarily premium taxes, commissions and underwriting salaries) to the extent they are recoverable against unearned premiums, and we amortize the deferred costs as related premiums are earned. We treat commissions earned on ceded reinsurance as a reduction of our acquisition costs. Amortization of deferred acquisition costs, net of ceding commissions earned, amounted to approximately $20.0 million and $15.2 million for the six months ended June 30, 2002 and 2001, respectively.

Underwriting, acquisition and insurance expenses for the six months ended June 30, 2002 increased by $5.1 million as compared to the same period in 2001. The increase included both higher overall expenses related to the consolidation with Professionals Group and higher commission costs and guaranty fund assessments of $13.4 million. Offsetting this increase was an expense reduction of approximately $8.3 million that resulted from a reduction in commissions paid on the earned premiums for Other Coverages.

The underwriting expense ratio decreased for the six months ended June 30, 2002 as compared to the same period in 2001. The ratio for the six months ended June 30, 2002 was 18.5% as compared to 24.2% for the same period in 2001.

The primary reason for the lower ratio in the six month period was the decrease in Other Coverages acquisition costs. Excluding the effects of acquisition costs related to Other Coverages and guaranty fund assessments, the underwriting expense ratio related to Professional Coverage premiums has been reduced by approximately 2.5% for the six months ended June 30, 2002, as compared to the same period in 2001.

Guaranty fund assessments for the six months ended June 30, 2002 were approximately $1.4 million. Guaranty fund assessments totaled $15,000 for the six months ended June 30, 2001. We are required by most states to be a member of the state s insolvency or guaranty fund association and, as such, must make payments to the association when so assessed by the state. Such assessments can and do vary from year to year.

Personal Lines Segment

Our personal lines segment is comprised of the operations of MEEMIC. Operating results for our personal lines insurance segment for the six months ended June 30, 2002 are summarized in the table below.

	Six Months Ended June 30, 2002
	($ in thousands)
Gross premiums written:	
Auto	$72,294
Homeowners	11,190
Other	363
Total	$83,847
Revenues:	
Premiums earned	$76,965
Premiums ceded	6,046
Net premiums earned	70,919
Net investment income	5,059
Net realized investment gains (losses)	644
Other income	910
Total revenues	77,532
Expenses:	
Net losses and loss adjustment expenses	48,589
Underwriting, acquisition and insurance expenses	16,153
Total expenses	64,742
Income before income taxes and minority interest	$12,790
Net loss and LAE ratio	68.5%
Underwriting expense ratio	22.8
Combined ratio	91.3%

Premiums

Gross premiums written included premiums for automobile coverages of $72.3 million and premiums for homeowners coverages of $11.2 million for the six months ended June 30, 2002. From June 27, 2001 to June 30, 2002, the number of our insured vehicles increased by approximately 4.5% and the number of our homeowners policies increased by approximately 15.6%.

Losses and Loss Adjustment Expenses

Net losses and LAE for the personal lines segment were $48.6 million for the six months ended June 30, 2002. The net loss ratio was 68.5% during the six months ended June 30, 2002.

Net Investment Income and Net Realized Investment Gains (Losses)

Our personal lines investment portfolio is comprised of fixed maturities and equity securities at amortized cost, short-term investments and cash and cash equivalents. At June 30, 2002 and December 31,

Table of Contents

2001 the fair value of the personal lines investment portfolio was $193.5 million and $190.4 million, respectively; the amortized cost of the personal lines investment portfolio was $188.4 million and $187.6 million, respectively. Most of the cash generated by operating and investing activities of our personal lines segment during the six months ended June 30, 2002 continues to be held as cash in order to provide funds for the purchase of the minority interest in MEEMIC as discussed under Liquidity and Capital Resources.

Our net investment income is comprised of the earnings on our personal lines investment portfolio. Earnings totaled $5.1 million for the six months ended June 30, 2002. Net realized investment gains of approximately $644,000 were recognized during the six months ended June 30, 2002.

At June 30, 2002, the average yield of the personal lines segment fixed maturity investments was 5.2%.

Underwriting, Acquisition and Insurance Expenses

Underwriting, acquisition and insurance expenses related to the personal lines segment were $16.2 million for the six months ended June 30, 2002, consisting of normal, recurring expenses such as commissions, salaries and other expenses. The underwriting expense ratio was 22.8% for the same period. No guaranty fund assessments were included in underwriting, acquisition and insurance expenses in 2002.

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Our consolidated income before cumulative effect was $12.5 million, or $0.51 per share, for the year ended December 31, 2001. The operating results of our reportable industry segments are discussed separately in the following discussion.

Interest expense for the year ended December 31, 2001 of $2.6 million relates entirely to the term loan obtained in order to finance our consolidation with Professionals Group. The debt bears interest at a variable rate based on LIBOR or the bank s base rate. At December 31, 2001 the interest rate was 3.4%.

We recognized a tax benefit of $2.8 million for the year ended December 31, 2001 as compared to a tax expense of $4.0 million for the year ended December 31, 2000. Our tax-exempt investment income is the primary reason that our effective rates for both years are significantly lower than the expected statutory rate of 35%. We earned tax-exempt investment income of approximately $18.7 million in 2001 and $17.4 million in 2000. Because tax-exempt income is not included as taxable income, we experienced a taxable loss for the year ended December 31, 2001 as compared to taxable income for the year ended December 31, 2000.

Professional Liability Segment

We have summarized the operating results for our professional liability segment for the years ended December 31, 2001 and 2000 in the table below.

	Year Ended December 31,		
	2001	2000	Increase (Decrease)
		($ in thousands)	
Gross premiums written	$315,698	$223,871	$ 91,827
Revenues:			
Premiums earned	$310,222	$216,297	$ 93,925
Premiums ceded	(66,307)	(38,701)	(27,606)
Net premiums earned	243,915	177,596	66,319
Net investment income	54,339	41,450	12,889
Net realized investments gains (losses)	5,441	913	4,528
Other income	3,130	2,630	500
Total revenues	306,825	222,589	84,236
Expenses:			
Net losses and loss adjustment expenses	250,257	155,710	94,547
Underwriting, acquisition and insurance expenses	55,021	38,579	16,442
Total expenses	305,278	194,289	110,989
Income before income taxes	$ 1,547	$ 28,300	$ (26,753)
Net loss and LAE ratio	102.6%	87.7%	14.9%
Underwriting expense ratio	22.6	21.7	0.9
Combined ratio	125.2%	109.4%	15.8%

Premiums

Gross Premiums Written. Professional liability segment gross premiums written for the year ended December 31, 2001 increased by $91.8 million as compared to 2000. Our consolidation with Professionals Group is the primary reason that our gross premiums written increased. Our rate increases implemented during 2001 also contributed to the increase.

We implemented rate increases on our Professional Coverages averaging approximately 23% on 2001 renewals weighted by premium volume. Our retention of insureds averaged approximately 84% during 2001. We plan to continue to implement rate increases based on loss trends, subject to regulatory approval. To date, premiums renewed at the higher rates coupled with new business have more than offset the effect of premiums lost due to decreased retention of insureds. However, the higher rates may result in a greater loss of insureds in future periods.

Premiums Earned. As with gross premiums written, the increase in premiums earned for the year ended December 31, 2001 as compared to 2000 is primarily attributable to our consolidation with Professionals Group. The beneficial impact of rate increases will be reflected in our financial results over time. Rate increases implemented after January 1, 2001 have not yet been fully reflected in premiums earned since premiums are earned over the entire policy period (usually one year) after the policy is written.

Reinsurance premiums ceded are estimated based on the terms of the respective reinsurance agreements. We continually review the estimated expense and any adjustments that we believe necessary are included in

current operations. Several factors contributed to the increase in reinsurance premiums ceded for 2001 as compared to 2000. The increase in premiums earned as a result of the consolidation accounted for approximately 30% of the increase. During the fourth quarter of 2000, we increased the amount of reinsurance coverage in certain markets which resulted in more of our premiums earned being ceded to reinsurers in 2001. Also, in 2001 more premiums were earned in markets where we rely more heavily on reinsurance.

Net premiums earned for the years ended December 31, 2001, and 2000 include Other Coverages of approximately $38.8 million and $34.8 million, respectively. We have historically written accident and health, workers compensation and multi-line premiums from time to time as favorable opportunities arose to utilize capital. During 2000 we decided to decrease our commitment to these programs. However, we continued to write and earn premiums for Other Coverages during 2001 and 2000 to honor existing contractual relationships. Our premiums during 2001 reflect both volume increases and higher rates charged on Other Coverages.

Losses and Loss Adjustment Expenses

Professional liability segment losses and loss adjustment expenses and the related current accident year net loss and LAE ratio are summarized in the following table.

	Year Ended December 31,	
	2001	**2000**
	($ in thousands)	
Incurred losses and LAE related to:		
Current accident year	$255,086	$178,210
Prior accident years	13,818	(12,500)
Change in death, disability and retirement reserves	(18,647)	(10,000)
Net incurred losses and LAE	$250,257	$155,710
Net loss and LAE ratio:		
Current accident year ratio	104.6%	100.3%
Prior accident years ratio	5.7	(7.0)
Change in death, disability and retirement reserves ratio	(7.6)	(5.6)
Total calendar year net loss and LAE ratio	102.6%	87.7%

During 2001, we recognized $13.8 million of additional net losses related to prior accident years. This represented approximately 1.4% of our December 31, 2001 professional liability segment net reserves of $1.0 billion. In 2001, the $18.6 million decrease in our reserve for death, disability and retirement is principally the result of an increase in premium rate loads and a decrease in the number of insureds primarily related to the ProNational book of business.

The current accident year net loss and LAE ratio in the table above is calculated by dividing current accident year incurred losses by net premiums earned. The principal reason for the increase in that ratio in 2001 is the effect of the inclusion of Professionals Group s premiums and losses.

Net Investment Income and Net Realized Investment Gains (Losses)

The investment portfolio of our professional liability segment is comprised of fixed maturities and equity securities at amortized cost, short-term investments and cash and cash equivalents. Our net investment income is comprised of earnings on the investment portfolio.

Earnings on our professional liability segment investment portfolio increased by $12.9 million as compared to the year ended December 31, 2000. The increase is primarily due to the net increase in the investment portfolio as a result of the consolidation with Professionals Group.

At December 31, 2001, our professional liability segment investment portfolio of approximately $1.3 billion consisted of 78% taxable securities and 22% tax-exempt securities. At December 31, 2001, the average yield of our professional liability segment fixed maturity investments was 5.9%.

Net realized investment gains increased from approximately $900,000 in 2000 to $5.4 million in 2001. This increase primarily resulted from additional sales of investment securities related to our efforts to restructure our professional liability segment investment portfolio.

Underwriting, Acquisition and Insurance Expenses

Underwriting, acquisition and insurance expenses increased approximately $16.4 million for the year ended December 31, 2001 as compared to 2000 due to our consolidation with Professionals Group. The underwriting expense ratio also increased to 22.6% for 2001 as compared to 21.7% for 2000. The increase in the ratio is primarily due to an increase in guaranty fund assessments. The remaining increase is due to normal fluctuations in acquisition expenses between years.

Guaranty fund assessments for the year ended December 31, 2001 were $1.3 million. There were no significant guaranty fund charges in 2000. We are required by most states to be a member of the state s insolvency or guaranty fund association and, as such, we must make payments to the association when so assessed by the state.

Table of Contents

Personal Lines Segment

Our personal lines segment is comprised of the operations of a single insurance company, MEEMIC Insurance Company, acquired on June 27, 2001. Operating results for our personal lines segment for the six months ended December 31, 2001 are summarized in the table below.

	Six Months Ended December 31, 2001
	($ in thousands)
Gross premiums written	$73,285
Revenues:	
Premiums earned	$71,288
Premiums ceded	(1,858)
Net premiums earned	69,430
Net investment income	5,003
Net realized investment gains (losses)	
Other income	857
Total revenues	75,290
Expenses:	
Net losses and LAE	48,301
Underwriting, acquisition and insurance expenses	15,416
Total expenses	63,717
Income before income taxes and minority interest	$11,573
Net loss and LAE ratio	69.6%
Underwriting expense ratio	22.2
Combined ratio	91.8%

Premiums

Gross premiums written were $73.3 million and net premiums earned were $69.4 million related to our personal lines segment for the six months ended December 31, 2001. Gross premiums written for personal automobile coverage represent approximately 85.2% of the total, and premiums from homeowners coverage represent approximately 14.5% of the total.

Losses and Loss Adjustment Expenses

Net losses and LAE incurred related to our personal lines segment were $48.3 million for the six months ended December 31, 2001. The incurred loss and LAE ratio was 69.6% during the six months ended December 31, 2001.

Net Investment Income and Net Realized Investment Gains (Losses)

Our personal lines segment investment portfolio is comprised of fixed maturities and equity securities at amortized cost, short-term investments and cash and cash equivalents.

Our net investment income is comprised of the earnings on our personal lines segment investment portfolio and totaled $5.1 million for the six months ended December 31, 2001. We did not consider any securities within the portfolio to have permanently declined in market value during the six months ended December 31, 2001.

Table of Contents

At December 31, 2001, our personal lines segment investment portfolio consisted of 48% taxable securities and 52% tax-exempt securities. At December 31, 2001, the average yield of our personal lines segment fixed maturity investments was 5.0%.

Net realized investment gains (losses) are insignificant during the six months ended December 31, 2001.

Underwriting, Acquisition and Insurance Expenses

Underwriting, acquisition and insurance expenses related to our personal lines segment were $15.4 million for the period ended December 31, 2001, consisting of normal, recurring expenses such as commissions, salaries and other expenses. The underwriting expense ratio was 22.2% for the six months ended December 31, 2001. No guaranty fund assessments were included in underwriting, acquisition and insurance expenses in 2001.

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999

During the years ended December 31, 2000 and December 31, 1999, we operated in the United States in only one reportable insurance industry segment, professional liability insurance, which was principally made up of our two operating insurance subsidiaries: Medical Assurance Company and Medical Assurance of West Virginia. Effective December 29, 2000, we consolidated our organizational structure and merged two of our formerly separate insurance subsidiaries, Medical Assurance of Missouri, Inc. and Medical Assurance of Indiana, Inc., into Medical Assurance Company.

Table of Contents

Professional Liability Segment

We have summarized the operating results for our professional liability segment for the twelve months ended December 31, 2000 and 1999 in the table below.

	Year Ended December 31,		
	2000	1999	Increase (Decrease)
		($ in thousands)	
Gross premiums written	$223,871	$201,593	$ 22,278
Revenues:			
Premiums earned	$216,297	$207,492	$ 8,805
Premiums ceded	(38,701)	(43,068)	4,367
Net premiums earned	177,596	164,424	13,172
Net investment income	41,450	39,273	2,177
Net realized investment gains (losses)	913	1,787	(874)
Other income	2,630	2,545	85
Total revenues	222,589	208,029	14,560
Expenses:			
Net losses and LAE	155,710	104,657	51,053
Underwriting, acquisition and insurance expenses	38,579	40,212	(1,633)
Total expenses	194,289	144,869	49,420
Income before income taxes	$ 28,300	$ 63,160	$(34,860)
Net loss and LAE ratio	87.7%	63.7%	24.0%
Underwriting expense ratio	21.7	24.5	(2.7)
Combined ratio	109.4%	88.2%	21.3%

Premiums

Gross Premiums Written. Gross premiums written from our Professional Coverages during the year ended December 31, 2000 increased to $180.0 million from $178.6 million for 1999. After giving effect to insureds that did not renew, a net increase of approximately $5.3 million resulted from rate increases and writing premiums at approved higher rates. Partially offsetting this $5.3 million increase was a decrease of $3.9 million resulting from one-time additional premiums written in January 1999 related to the purchase of a book of business.

For the year ended December 31, 2000 as compared to 1999, gross premiums written from Other Coverages increased by $20.9 million to $43.9 million.

Premiums Earned. Premiums earned on Professional Coverages decreased $4.9 million for the year ended December 31, 2000 as compared to 1999. As with gross premiums written, $3.9 million of this decrease was due to one-time additional premiums earned in 1999 related to the purchase of a book of business. Premiums earned on Other Coverages increased by $13.7 million during the year ended December 31, 2000 as compared to 1999.

Premiums ceded decreased by approximately $4.4 million for the year ended December 31, 2000 as compared to the year ended December 31, 1999, primarily related to premiums earned on Other Coverages.

Table of Contents

While the total earned amount of these premiums increased during 2000, the proportion of the premiums that were ceded decreased. As a result, ceded premiums were lower for the year ended December 31, 2000.

Net premiums earned included premiums on Other Coverages of approximately $34.8 million in 2000 and $14.1 million in 1999. We have disclosed our commitment to discontinue participation in the underwriting programs that generated most of these premiums and expect substantially decreased premiums in future periods.

Losses and Loss Adjustment Expense

Consolidated losses and loss adjustment expenses and the related current year loss ratio are summarized in the following table.

	Year Ended December 31,	
	2000	**1999**
	($ in thousands)	
Incurred losses and LAE related to:		
Current accident year	$ 178,210	$ 158,303
Prior accident years	(12,500)	(53,646)
Change in death, disability and retirement reserves	(10,000)	
Net incurred losses and LAE	$ 155,710	$ 104,657
Net loss and LAE ratio:		
Current accident year ratio	100.3%	96.3%
Prior accident years ratio	(7.0)	(32.6)
Change in death, disability and retirement reserves ratio	(5.6)	
Total calendar year net loss and LAE ratio	87.7%	63.7%

The current accident year net loss ratio increased to 100% from 96%. This change is due to increasing trends in severity and frequency of professional liability claims that we recognized during the year 2000. As a result of these same trends, the average ultimate payment of indemnity and loss adjustment expenses per exposure unit for recent accident years appears likely to exceed comparable averages for previous years. Although such per claim average remains within the level contemplated by the previously established reserves, the effect was favorable loss development during the year ended December 31, 2000 of $12.5 million versus $53.6 million during the year ended December 31, 1999. In 2000, the $10.0 million decrease in the reserve for death, disability and retirement is principally the result of an increase in premium rate loads and a decrease in the number of insureds.

Net Investment Income and Net Realized Investment Gains (Losses)

The investment portfolio of our professional liability segment is comprised of fixed maturities and equity securities at amortized cost and short-term investments. Our net investment income is comprised of earnings on the investment portfolio.

Our consolidated net investment income was $41.5 million in 2000 compared to $39.3 million in 1999. The $2.2 million increase is due both to an increase in the amount of invested assets and an increase in the average yield of those assets.

At December 31, 2000, our professional liability segment investment portfolio consisted of 51% taxable securities and 49% tax-exempt securities. At December 31, 2000, the average yield of fixed maturity investments was 5.5%.

Net realized investment gains from the investment portfolio were $1.0 million in 2000 and $1.8 million in 1999.

Underwriting, Acquisition and Insurance Expenses

Underwriting, acquisition and insurance expenses decreased by approximately $1.6 million for the year ended December 31, 2000 as compared to 1999 primarily because of a $2 million decrease in guaranty fund assessments. The underwriting expense ratio for 2000 was 21.7% as compared to 24.5% for the same period in 1999. The decrease in the ratio was due both to the reduction in guaranty fund assessments and to the cost control measures implemented by us during 2000.

Liquidity and Capital Resources

We need liquid funds to pay losses and LAE and operating expenses in the ordinary course of business and to meet our debt service requirements. Cash provided by our operating activities was sufficient to meet those needs in 2001 and during the first six months of 2002. We believe that our operating activities will provide sufficient cash to meet our liquidity needs for the twelve months following June 30, 2002.

We believe that our reserves for losses and LAE and unearned premiums are adequate to discharge outstanding contractual liabilities. We establish our reserves for losses and LAE based on our estimates of the future amounts necessary to pay claims and expenses associated with the investigation and settlement of claims. Although we believe our methods to establish reserves are reasonable and appropriate, the estimation of reserves for losses and LAE, especially professional liability reserves, is a complex process heavily dependent on judgment with many uncertainties. As a result, our estimates of reserves may vary significantly from the actual outcome. We anticipate these variances by regularly reviewing and updating the assumptions used in establishing our reserves. Any adjustments resulting from the review and update of our reserves are reflected in current operations.

State insurance regulators utilize the Risk-Based Capital tests developed by the National Association of Insurance Commissioners (NAIC) to evaluate the financial condition of insurance companies. Third party rating agencies such as A.M. Best and Standard & Poor s have developed their own set of evaluations based on similar ratios. The tests and ratios measure our surplus in relation to the premiums we write, the losses we reserve and the quality of our assets. We believe that our surplus is adequate to meet the requirements of our current operations and immediate growth plans. However, we may need additional surplus to take advantage of anticipated opportunities for further growth and acquisition.

We borrowed $110 million under a term loan facility in order to fund the cash requirements of the consolidation. We are required to pay quarterly principal repayments of $2.5 million, and beginning in 2003, an additional annual principal payment equal to the greater of either 50% of our parent-company-only cash flow for the preceding year or $15 million. We have made all quarterly payments on the loan, and we also made a $22.5 million optional prepayment in September 2001. The loan had an outstanding principal balance of $77.5 million on June 30, 2002.

The term loan bears interest at a variable rate based on LIBOR or the bank s base rate at our election. At June 30, 2002 the interest rate was 3.4%.

The credit agreement for the term loan, as is customary for credit agreements of this size and nature, requires that we maintain certain financial standards, otherwise known as loan covenants, including:

- a consolidated debt coverage ratio of 3.0 to 1;
- minimum consolidated tangible net worth equal to the sum of (i) 90% of our consolidated net worth as of June 30, 2001, and (ii) 75% of cumulative consolidated net income after June 30, 2001;
- a consolidated fixed charge coverage ratio of 1.5 to 1;
- a funded debt to adjusted statutory capital ratio of 0.35 to 1; and

maintenance of statutory Risk-Based Capital ratios (as defined by the NAIC and measured annually on December 31) of 3.5 to 1 by Medical Assurance and ProNational.

As of June 30, 2002, we were in compliance with all loan covenants.

The borrowings under the credit agreement are secured by a pledge of the outstanding stock of our subsidiaries other than MEEMIC and its subsidiaries.

The credit agreement also provides for a revolving line of credit in the amount of $40 million. Borrowings under the line of credit are repayable in full in two years, subject to renewal. The revolving line of credit is available for our operating and working capital requirements. We have not borrowed any funds under the revolving line of credit.

We currently have sufficient funds in our direct non-insurance subsidiaries to meet our debt service requirements for the twelve months following June 30, 2002. Our future cash requirements for debt service will be provided principally from dividends of our direct and indirect insurance subsidiaries, which may require regulatory approval.

We did not repurchase any shares of our common stock during the six months ended June 30, 2002. Our board has authorized stock repurchases of up to approximately 1.02 million shares.

On July 9, 2002, MEEMIC agreed to acquire all of the outstanding shares of its common stock not owned by us. If certain conditions are satisfied, MEEMIC will make a tender offer to purchase a total of approximately 1.2 million shares of its common stock at a price of $29.00 per share, and any shares not tendered will be acquired in a subsequent merger at the same price. The transaction is subject to several conditions, including without limitation, approval by the stockholders other than us and our affiliates, the receipt of all required regulatory and bank approvals, receipt of a fairness opinion from an independent financial advisor, and no indication from the rating agencies that the transaction will result in a reduction of the current ratings of MEEMIC and our other insurance subsidiaries. MEEMIC intends to use primarily its own cash and investment resources to fund the purchase of the shares. There can be no assurance that the transaction will be completed.

Market Sensitive Instruments

We believe that we are principally exposed to three types of market risk related to our investment operations. These risks are interest rate risk, credit risk and equity price risk.

The term market risk refers to the risk of loss arising from adverse changes in market rates and prices, such as interest rates, equity prices and foreign currency exchange rates.

All market sensitive instruments discussed here relate to our investment assets which are classified as available-for-sale.

As of June 30, 2002, our $1,599 million investment portfolio was comprised of $1,356 million of fixed income securities that are subject primarily to interest rate risk and credit risk. We have not and currently do not intend to enter into derivative transactions.

Interest Rate Risk

Our fixed maturities portfolio is exposed to interest rate risk. Fluctuations in interest rates have a direct impact on the market valuation of these securities. As interest rates rise, market values of fixed income portfolios fall and vice versa. We believe we are in a position to keep our fixed income investments until maturity as we do not invest in fixed maturity securities for trading purposes. Our investment policies implement an asset allocation that uses length to maturity as a means to maximize the long term rate of return.

Table of Contents

The table below displays the potential impact of market value fluctuations on the fixed income portfolio as of June 30, 2002 and December 31, 2001 based on parallel 200 basis point shifts in interest rates up and down in basis points increments. It also shows the anticipated changes to the weighted average modified duration due to fluctuations in market interest rates.

Interest Rates	As of June 30, 2002		
	Portfolio Value	Change in Value	Modified Duration
	($ in millions)		(Years)
200 basis point rise	$1,243	$(113)	4.37
100 basis point rise	1,299	(57)	4.31
Current rate*	1,356		4.08
100 basis point decline	1,411	55	3.80
200 basis point decline	1,455	99	3.70

* Current rates are as of June 30, 2002.

Interest Rates	As of December 31, 2001		
	Portfolio Value	Change in Value	Modified Duration
	($ in millions)		(Years)
200 basis point rise	$1,165	$(105)	4.29
100 basis point rise	1,216	(54)	4.29
Current rate*	1,270		4.14
100 basis point decline	1,323	53	3.89
200 basis point decline	1,375	105	3.78

* Current rates are as of December 31, 2001.

At June 30, 2002 and December 31, 2001, the fair value of our investment in preferred stocks was $52.2 million and $52.6 million, respectively, which included net unrealized gains of $2.3 million and $2.2 million. Preferred stocks are primarily subject to interest rate risk because they bear a fixed rate of return. The investments in the above tables do not include preferred stocks.

Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including the maintenance of the existing level and composition of fixed income security assets, and should not be relied on as indicative of future results.

Certain shortcomings are inherent in the method of analysis presented in the computation of the fair value of fixed rate instruments. Actual values may differ from those projections presented should market conditions vary from assumptions used in the calculation of the fair value of individual securities, including non-parallel shifts in the term structure of interest rates and changing individual issuer credit spreads.

Credit Risk

We have exposure to credit risk primarily as a holder of fixed income securities. We control this exposure by emphasizing investment grade credit quality in the fixed income securities we purchase.

As of June 30, 2002 and December 31, 2001, 98.4% and 98.6%, respectively, of our fixed income portfolio consisted of securities rated investment grade. We believe that this concentration in investment grade securities reduces our exposure to credit risk on these fixed income investments to an acceptable level. However, in the current environment even investment grade securities can rapidly deteriorate and result in significant losses as was the case with respect to our investment in WorldCom bonds.

Table of Contents

Equity Price Risk

At June 30, 2002 and December 31, 2001, the fair value of our investment in common stock was $47.6 million and $44.5 million, respectively, which included net unrealized losses of $11.3 million and $6.4 million, respectively. These investments are exposed to equity price risk, which is defined as the potential for loss in market value due to a decline in equity prices. A 10% decline in the price of each of these marketable securities would result in a decrease of our total investment portfolio of $4.8 million and $4.5 million at June 30, 2002 and December 31, 2001, respectively.

Table of Contents

BUSINESS

Overview

We are a holding company for specialty property and casualty insurance companies focused on the professional liability and the personal automobile insurance markets. We have a regional orientation, applying a focused underwriting strategy to local markets where we have built a strong reputation among our customers and producers. We are the fourth largest writer of medical professional liability insurance in the United States based on direct premiums written in 2001. We are the tenth largest writer of personal automobile insurance in Michigan based on direct premiums written in 2001. We were formed to effect the consolidation of Medical Assurance and Professionals Group in June 2001, but our predecessor company, Medical Assurance, has been in operation since 1977.

We conduct our business through two operating segments, each of which maintains a strong position in its local markets:

Our *professional liability* segment, which represents our commercial lines business, primarily focuses on providing medical professional liability insurance. We provide protection against claims arising out of the death, injury or disablement of a person resulting from the negligence or other misconduct of medical and other healthcare professionals.

Our *personal lines* segment primarily offers personal automobile, and to a lesser extent, homeowners, boat and umbrella insurance to teachers, administrators, college professors and other members of the educational community and their families in Michigan.

Our professional liability segment represented 72.4% of our gross premiums written for the six months ended June 30, 2002 while our personal lines represented 27.6% for the same period. Approximately 96.2% of our business related to casualty coverages, including automobile coverages, and 3.8% to property coverages primarily through homeowners insurance, as measured by gross premiums written for the six months ended June 30, 2002. We believe we do not have any exposure to asbestos claims which are currently prevalent in the insurance industry.

By concentrating on specialty markets where customers have specialized needs, we seek to provide value added solutions through our underwriting expertise and our emphasis on strong customer service. Our regional presence allows us to maintain active relationships with our customers and be more responsive to their needs. We seek to maintain a strong financial position to protect our customers. We believe these factors have allowed us to establish a leading position in our markets, enabling us to compete on a basis other than just price.

Professional liability insurance is generally referred to as a long tail line of business. This means there is typically a long period of time between collecting the premium for insuring a risk and the ultimate payment of losses, typically exceeding five years. This allows us to invest the premiums we collect until we pay losses which results in a higher level of invested assets and investment income as compared to other lines of property and casualty business. This is in contrast to personal lines insurance, which is generally referred to as short tail , due to shorter time periods between insuring the risk and the ultimate payment of claims. As a result, there is less time to invest premiums collected, which makes it necessary to achieve an underwriting profit in order to generate a satisfactory return on equity.

Professional Liability. Our customers include physicians, hospitals, dentists and other healthcare providers. We distinguish ourselves through individual risk selection by applying a rigorous and analytical underwriting process. We focus on physicians who are sole practitioners or who practice in small groups, who we believe exhibit greater customer loyalty and provide us a better opportunity to achieve an underwriting profit. We estimate that at least 90% of our policies in force on June 30, 2002 cover physicians and dentists who are sole practitioners or who practice in small groups of less than 20 professionals. On a limited basis, we provide coverage for hospitals, primarily in Alabama and Indiana where we have a strong understanding of the liability and operating environment. While we are licensed in 48 states, we primarily write insurance in

19 states, mainly in the southeast and midwest, with Alabama, Florida, Ohio, Indiana and Michigan representing our five largest states based on direct premiums written in 2001.

We operate through our home office and 12 regional offices, allowing us to better control our underwriting and claims process, respond to local market conditions and more effectively serve our customers and producers. In Alabama, we rely solely on direct marketing, and in Florida and Missouri, direct marketing accounts for a majority of our business. We use independent agents to market our professional liability insurance products in other states. We believe our size, financial strength and flexibility of distribution differentiates us from our competitors.

Given the long tail nature of our professional liability business, we focus on our operating ratio, which combines the ratio of underwriting income or loss to net premiums earned, referred to as the combined ratio, offset by the benefit of investment income generated from our cash and invested assets, also expressed as a percentage of net premiums earned. Our average statutory operating ratio for the five year period ended December 31, 2001 was 78.5%. This compares favorably to an average statutory operating ratio of 94.4% for the property and casualty industry over the same period, according to data published by A.M. Best. The long tail nature also results in a higher level of invested assets and investment income as compared to other property and casualty lines of business. At December 31, 2001, our ratio of cash and invested assets (including personal lines), which totaled $59.49 per share, to statutory surplus was 4.3x as compared to 2.7x for the property and casualty industry according to information reported by A.M. Best. For the five years ended December 31, 2001, our net investment income averaged 24.6% of net premiums earned compared to 14.0% for the property and casualty industry over the same period according to information reported by A.M. Best, in each case determined on a statutory basis.

Personal Lines. We conduct our personal lines business through our publicly-traded subsidiary, MEEMIC. We believe our focus on the educational community provides better than average risk-selection, which contributes to our historically profitable underwriting results. We distribute our products directly to insureds through a network of 93 captive agents who are primarily current and former teachers, administrators and other educational employees.

For the year ended December 31, 2001, MEEMIC reported a statutory combined ratio of 95.8% as compared to 110.9% for the personal lines insurance industry over the same period, according to data published by A.M. Best. For the five years ended December 31, 2001, MEEMIC reported an average statutory combined ratio of 92.9% versus an average of 105.6% for the personal lines insurance industry over the same period according to information reported by A.M. Best. For the year ended December 31, 2001 MEEMIC reported gross premiums written of $142.3 million, which represented a compounded annual growth rate of 7.6% for the five years then ended.

Our senior management team is led by A. Derrill Crowe, M.D., our Chairman and Chief Executive Officer, and Victor T. Adamo, Esq., our President and Chief Operating Officer. Dr. Crowe has acted as the Chief Executive Officer of Medical Assurance since its founding in 1977. He has applied a hands-on management style in developing our underwriting and claims strategies and was instrumental in establishing us as a leading professional liability specialist. Mr. Adamo has held various positions with Professionals Group since 1985 and as its president was largely responsible for building it into a successful regional professional liability company. Dr. Crowe practiced medicine as his principal occupation for more than 25 years and Mr. Adamo was in the private practice of law for 10 years, providing them with knowledge of medical and legal issues that are critical to our insurance operations. We also have a knowledgeable and experienced management team with established track records in building and managing successful insurance operations. In total, our senior management team has average experience in the insurance industry of 22 years.

For the year ended December 31, 2001, we generated $389.0 million of gross premiums written, $313.3 million of net premiums earned and $382.6 million of total revenues. For the six months ended June 30, 2002, we generated gross premiums written of $304.2 million. As of June 30, 2002, we had cash and invested assets of $1.7 billion, total assets of $2.4 billion and stockholders equity of $426.8 million. Following completion of this offering, we expect to have total capitalization, including debt, of approximately

Table of Contents

$545.1 million. Each of our insurance subsidiaries is rated A- (Excellent) by A.M. Best and A- (Strong) with a negative outlook by Standard and Poor s.

Corporate Strategy

Our objective is to build value for our stockholders through superior underwriting of classes of business in which we have a comprehensive understanding and which offer us the opportunity to generate competitive returns on capital. We target an operating return on equity, which includes investment income but excludes realized gains and losses, of 12% to 14% over the long term. Over the five years ending December 31, 2001, however, we achieved an average operating return on equity of 10.1%, with a high of 14.0% in 1999 and a low of 2.4% in 2001. The major elements of our strategy are:

Adhere to a Strict Underwriting Philosophy. We emphasize disciplined underwriting and do not manage our business to achieve a certain level of premium growth or market share. In our professional liability business, we apply our local knowledge to individual risk selection to determine the appropriate price based on our assessment of the specific characteristics of each risk. We seek to achieve our principal objective of attracting and retaining high quality business by focusing on small groups and sole practitioners who we believe are more receptive to our service-intensive approach and are more likely to remain with us in times of price based competition. In our personal lines business, we target the educational community, which we believe provides a stable and predictable group of risks. We apply our underwriting expertise through our regional offices while adhering to a centrally controlled underwriting philosophy. We continually monitor market conditions to identify potentially negative trends that may require corrective actions in our prices and underwriting criteria.

Aggressively Manage Policyholder Claims. In addition to prudent risk selection, we seek to control our underwriting results through effective claims management. We investigate each professional liability claim and have fostered a strong culture of aggressively defending those claims that we believe have no merit. We manage these claims at the local level, tailoring claims handling to the legal climate of each state, which we believe differentiates us from national writers. Through the first nine months in 2002, we defended our insureds in 250 jury trials resulting in a verdict, of which 192 resulted in a favorable verdict for our insureds. Although this approach contributes to higher expenses in managing our claims compared to other insurers, we believe it contributes to lower overall loss costs, and results in greater customer loyalty. In our personal lines business, we seek to quickly and efficiently settle claims through an established network of auto repair shops and other repair facilities, focusing on minimizing the cost of handling each claim.

Operate Through Regional Offices in Local Markets. We believe that our business is most effectively managed at the local level. We operate our professional liability business through 12 regional offices in 9 states and our personal lines business through 93 agents in Michigan. Through our regional underwriting and claims office structure, we are able to gain a strong understanding of local market conditions and efficiently adapt our underwriting and claims strategies to regional conditions. This allows us to maintain a comprehensive understanding of the legal environment and skills of the attorneys in each region, allowing us to better pursue our aggressive claims handling philosophy. Our local offices increase our visibility within the community and among our customers and producers, enhancing our ability to make better risk selection through informed underwriting.

Expand Our Position in Regional Markets. Our goal is to build upon our position as a leading writer of professional liability and personal lines insurance and expand within a defined geographic area, while maintaining our commitment to disciplined underwriting and aggressive claims management. The withdrawal and reduced capacity of several competitors in the medical professional liability market has led to significant increases in the number of new policy applications received over the past 12 months. We believe that our strong reputation in our regional markets, combined with our financial strength, strong customer service and proven ability to manage claims, should enable us to profitably expand our position in select states. We will only move into markets where we believe we can use local knowledge and services to allow effective management of claims and underwriting. In our personal lines business, we estimate that we currently insure approximately 20% of educational professionals in Michigan. Through the appointment of additional agents

and broadening our relationships with educational institutions, we intend to increase our penetration of the educational community.

Pursue Consolidating Acquisitions. We have successfully acquired and integrated companies and books of business in the past and believe our financial size and strength make us an attractive acquiror. We continually evaluate opportunities to acquire professional liability companies or books of business that leverage our core underwriting and claims expertise. We believe that higher claim costs on historical business and capacity constraints may create disruption among other professional liability writers, thereby providing acquisition opportunities.

Maintain Our Financial Strength and Security. We have sustained our financial stability during difficult market conditions through responsible pricing and loss reserving practices. We are committed to maintaining prudent operating and financial leverage and conservatively investing our assets. We recognize the importance of our A- (Excellent) A.M. Best rating to our customers and producers and intend to manage our business to protect our financial security.

Growth Opportunities and Outlook

We believe our current market position and reputation allows us to take advantage of improving marketing conditions and opportunities in the market. Based on improving market conditions and our assessment of our ability to effectively compete, we expect to achieve gross premiums written of at least $500 million in 2002. We expect to achieve our growth primarily through the (i) increased prices in our professional liability business and (ii) expansion of our personal automobile business in Michigan.

We expect the growth of our professional liability business will be primarily generated through increased pricing across our portfolio. Through June 2002, we achieved average gross price increases of approximately 25% on renewal business across our professional liability business (weighted by premium volume). These increases are in addition to average gross price increases achieved during 2001 of approximately 23% on renewal business across our professional liability business (weighted by premium volume).

We expect our future growth will also be supported by controlled expansion in states where we have recently commenced writing business but have little or no presence. These states include Arkansas and Virginia, where The St. Paul Companies was a leading writer prior to its departure from the market and which we believe have favorable medical and legal climates. We anticipate there will be additional opportunities for profitable expansion as a number of insurers are experiencing financial difficulties, requiring them to reduce their business or completely exit the marketplace.

We believe we can achieve our growth while improving our combined ratio. Based on price increases achieved to date, we expect the ultimate combined ratio on our professional liability business currently written to be reduced to 102% or lower, as premiums are earned. This takes into account expected increases in the cost of claims and reinsurance protection purchased. As with all property and casualty companies, we expect the beneficial impact of price increases and any development of losses to be fully reflected in our financial results over time. We recognize the impact of higher prices as the associated premiums are earned which generally occurs over the course of the year after the policy is written.

In September 2002, we started offering professional liability insurance to medical and other healthcare professionals who generally do not qualify for standard coverage because of their claim history or other factors. We write this business on an excess and surplus lines basis, which provides us with greater flexibility in establishing prices and terms of coverage. While we do not expect this class of insured to become a major portion of our business, we believe this provides profitable opportunities to expand our business.

We continually evaluate opportunities to acquire other professional liability companies or books of business. While there are no acquisitions planned or expected at this time, we believe this can be an attractive incremental source of profitable expansion.

In our personal lines business our objective is to achieve an underwriting profit, targeting a combined ratio of 96% or lower, which is in line with our historical financial results. To expand our personal lines

business, we have increased the number of our sales representatives to 93 agents. Consistent with our focus on the educational community, we are increasing our marketing efforts to colleges and universities in Michigan, where we currently have little penetration. Growth of our personal lines business will be supported by the expansion of our recently introduced boat and umbrella coverages, which currently account for less than 1% of our personal lines net premiums written for the six months ended June 30, 2002. In addition, the productivity of our agents has increased, having increased average gross premiums per sales agent from $1.3 million in 1999 to $1.5 million in 2001, an increase of 15.4%. Through June 2002, we achieved average gross price increases of approximately 13.5% on renewal business across our personal lines business (weighted by premium volume).

We have demonstrated our willingness to reduce or terminate business where there is unacceptable pricing. We may later return to a given market based on improved market conditions. Our ability to achieve future growth is contingent on several factors, including the amount of competition, availability of capital, availability and price of reinsurance, whether or not we can identify attractive markets, the regulatory and legal environment in which we operate, and rating agency considerations.

Recent Events

Financial Outlook. We estimate our net operating income per share will be between $0.13 and $0.16 for the three months ended September 30, 2002, and between $0.30 and $0.35 for the last six months of 2002. We calculate net operating income excluding the effects of guaranty fund assessments, as well as net realized investment gains (losses), net of applicable income taxes. These estimates reflect our current views as of the date of this prospectus. As such, they are subject to uncertainty and may change as a result of a number of factors, many of which are beyond our control. See Forward-Looking Statements.

At September 30, 2002, our investment portfolio of fixed maturity and equity securities had a market value of $1,557 million which, after giving effect to the expected impairment expense discussed below, includes an unrealized pre-tax net gain of $64.5 million. This compares to an unrealized pre-tax net gain of $18.6 million at June 30, 2002. We regularly review our investment portfolio to evaluate our securities for any meaningful decline in market value below amortized cost. We expect to incur a non-cash pre-tax expense associated with the impairment of equity securities in our investment portfolio of approximately $13.3 million for the three months ended September 30, 2002. This impairment expense will reduce our net income but will not affect our book value at September 30, 2002 or our previously estimated net operating income for the three months ended September 30, 2002 or the six months ended December 31, 2002.

Purchase of MEEMIC Shares. We currently own 83.9% of the issued and outstanding common stock of MEEMIC. On March 18, 2002, we announced our intention to purchase the remaining 16.1% of the common stock of MEEMIC that we did not already own. The purchase price of $29.00 per share in cash, representing an aggregate purchase price of $34.4 million, will be financed through existing cash and investment resources of MEEMIC. The acquisition of these minority shares is subject to regulatory approval, a vote of minority stockholders and other conditions. The proposed transaction, including the financial terms, have been unanimously approved by the board of directors of MEEMIC, including its independent directors not affiliated with us. We expect to complete the acquisition of the remaining shares that we do not already own by January 2003, but there can be no assurances that we will be successful.

On March 18, 2002, a complaint was filed against MEEMIC, its directors, and ourselves on behalf of the minority stockholders of MEEMIC alleging, among other things, that the acquisition we have proposed is unfair to the minority stockholders of MEEMIC. The plaintiff agreed to dismiss the lawsuit with prejudice, and the court approved the dismissal on September 11, 2002. No payments of any kind were made by MEEMIC, its directors or us to the plaintiff or his counsel to obtain the dismissal of the case.

Industry Trends

Throughout the 1990s and into 2000, the overall property and casualty insurance and reinsurance industry was overcapitalized, which resulted in highly competitive market conditions as evidenced by

Table of Contents

declining premium rates and poor underwriting results. By mid-2000, capacity was reduced by significant losses experienced throughout the industry, which led companies to tighten underwriting guidelines, cease writing selected lines of business or withdraw from the market completely. In response to these market conditions, insurers began to seek and achieve significant price increases, in addition to improved terms and conditions. This has affected all major lines of business with a more significant impact in selected lines, particularly medical professional liability insurance.

Professional Liability Industry Trends. The medical malpractice, or medical professional liability, market totaled $7.3 billion in direct premiums written for the year ended December 31, 2001, which represented 3.9% of the total commercial premiums in the property and casualty industry, according to data published by A.M. Best. Since 1999, insurance companies focused on medical professional liability coverage have experienced higher claim costs on business written in prior years than they had reserved for initially. This has resulted in significant losses, reduced capital to support current and future business, and higher premium rates to meet expected higher claims costs. In 2001, based on publicly available industry information, it is estimated that prices for medical professional liability insurance experienced increases of approximately 15% to 20% over expiring terms. Price increases have varied across the types of insured and geographic region with some states experiencing increases as high as 100%. We believe price increases have continued in 2002 at levels consistent with, or higher than, those reported in 2001, which is consistent with our own experience.

Reduced profitability, reductions in surplus and capacity constraints have led many professional liability carriers focused on medical professional liability coverages to withdraw from, or limit new business in, one or more markets. In December 2001, The St. Paul Companies, Inc., previously the second largest writer of medical professional liability insurance in the United States, announced its immediate intention to exit the market due to poor profitability. In February 2002, Pennsylvania-based PHICO Insurance Company entered into state-ordered liquidation due to financial difficulties. In March 2002, SCPIE Holdings, Inc. announced it terminated its strategic relationship with a national broker to write professional liability insurance for physicians and dentists, and will refocus on its home market of Southern California. In March 2002, The MIIX Group, Inc. announced its intention to stop writing business due to financial difficulties and has sponsored the formation of a new mutual company to write solely in New Jersey. In June 2002, American Physicians Capital Inc. announced its decision to withdraw from the Florida medical professional liability market. In June 2002, FPIC Insurance Group, Inc. announced that, while it will continue to renew its existing book of business, it will not write new business until it can increase capacity.

This reduction in capacity comes at a time when many medical professional liability insurers are raising prices, eliminating policy credits and discounts and tightening policy terms. We believe the effect of lower capacity and higher pricing is to focus buying decisions on more traditional insurance factors such as balance sheet strength, ratings and long-term commitment to a particular market. We also believe that concern over the long-term viability of some insurers is also forcing independent agents to focus more on these traditional factors.

Given the continued reduction in capacity and the uncertainty surrounding several writers in the medical professional liability market, we believe the current favorable market environment will continue at least until 2004. The improvements in pricing to some degree, however, will be offset by the impact of loss cost trends and the increased cost of reinsurance.

Personal Lines Industry Trends. After a number of years of competitive pricing, underwriting discipline has returned to the personal lines market. In the late 1990s and 2000, strong investment returns created excess surplus in the personal lines industry. This buildup of capital led to a declining rate environment for both automobile and homeowners lines of business as personal lines competitors sought to grow market share. A combination of poor underwriting and investments have helped to reverse the declining pricing trends in the industry. According to A.M. Best, direct premiums written for automobile policies increased 8.1% nationally in 2001 and 7.5% in Michigan.

Corporate Organization and History

We were incorporated in Delaware to serve as the holding company for Medical Assurance in connection with its acquisition of Professionals Group in June 2001. Our three principal operating subsidiaries are Medical Assurance Company, ProNational and MEEMIC Insurance.

We are the successor to 11 insurance organizations and books of business. In each acquisition we have retained key personnel to further our goal of having a local presence for underwriting and managing our claims. Our successful integration of each organization demonstrates our ability to grow effectively through acquisitions.

Our predecessor company, Medical Assurance, was founded by physicians as a mutual company in Alabama in 1977 and demutualized into a public company in 1991. Medical Assurance has expanded through internal growth and the acquisition of professional liability insurance companies with strong regional identities in West Virginia, Indiana and Missouri, along with books of business in Ohio and Missouri.

Professionals Group traces its roots to the Brown-McNeeley Fund, which was founded by the State of Michigan in 1975 to provide medical professional liability insurance to physicians. Physicians Insurance Company of Michigan, which ultimately became ProNational, was founded in 1980 to assume the business of the fund. That company also grew through internal growth and the acquisition of books of business in Illinois and Indiana and the acquisition of a professional liability insurer in Florida.

MEEMIC Insurance was founded as a mutual company by Michigan teachers and has provided personal lines insurance to the education community in that state since 1950. Professionals Group became affiliated with MEEMIC in 1997 and acquired majority ownership in transactions related to MEEMIC s demutualization in 1999.

Lines of Business

We operate across two primary segments of the insurance market: (i) professional liability insurance, which represents our commercial lines activity, and (ii) personal lines insurance. The following table illustrates our gross premiums written for our two primary segments for each of the periods indicated:

	Year Ended December 31,						Six Months Ended June 30,			
	2001		2000		1999		2002		2001	
	$	%	$	%	$	%	$	%	$	%
	($ in thousands)									
Professional Liability Segment	$315,698	81.2%	$223,871	100.0%	$201,593	100.0%	$220,341	72.4%	$130,428	100.0%
Personal Lines Segment	73,285	18.8					83,847	27.6		
Total	$388,983	100.0%	$223,871	100.0%	$201,593	100.0%	$304,188	100.0%	$130,428	100.0%

Professional Liability Segment. We offer professional liability insurance for providers of medical and other healthcare services. Medical professional liability insurance provides protection against claims arising out of the death, injury or disablement of a person as the result of covered negligence or other misconduct in rendering professional service. Although we generate a majority of our premiums from individual and small group practices, we also insure several major physician groups as well as several hospitals. We also offer professional liability insurance for providers of legal services, and we offer professional office package and workers compensation insurance products, primarily in connection with our professional liability products.

Table of Contents

The following table illustrates the distribution of our gross premiums written of our professional liability segment by type of coverage for the periods indicated.

	Year Ended December 31, 2001		Six Months Ended June 30, 2002	
	$	%	$	%
	($ in thousands)			
Professional Liability Physicians	$228,139	72.3%	$194,720	88.4%
Professional Liability Other(1)	39,080	12.4	18,996	8.6
Total Medical Professional Liability	267,219	84.6	213,716	97.0
Professional Liability Legal	2,134	0.7	2,667	1.2
Other Commercial Lines(2)	46,345	14.7	3,958	1.8
Total Professional Liability Segment	$315,698	100.0%	$220,341	100.0%

(1) Primarily includes hospitals, other health care facilities and dentists.

(2) Primarily includes workers compensation and commercial multi-peril coverages.

We have offered accident and health and workers compensation insurance and reinsurance through various programs to entities and individuals other than healthcare providers. We ceased our marketing of these programs in order to focus on our core professional liability products. We expect these accident and health and workers compensation programs to terminate completely by the end of 2002.

There are two types of liability insurance policies, occurrence and claims-made. Under occurrence coverage, insurance is provided against claims of liability arising from incidents that occur during the policy period, regardless of when claims arising out of such incidents may be reported. Claims-made coverage provides protection against only those claims that arise out of incidents occurring and of which notice to the insurer is given while coverage is effective. Claims-made policies enable the insurer to estimate its loss reserves with more certainty as reserves for losses are accrued in the year that a claim is reported instead of in the year of occurrence as is the case with occurrence policies. Approximately 85.4% of our direct premiums written for the six months ended June 30, 2002 were issued on a claims-made basis.

Personal Lines Segment. Our personal lines business is written through our subsidiary, MEEMIC, which primarily serves educational employees and their immediate families in Michigan. Private passenger automobile insurance is our primary line of business, representing approximately 85% of our personal lines gross premiums written. MEEMIC s personal automobile policy provides policyholders with protection against claims resulting from bodily injury and property damage liability and automobile physical damage. To provide for the other insurance needs of our auto customers, we also offer homeowners, boat and umbrella policies.

The following table illustrates our gross premiums written for each of our personal lines classes of business for each of the periods indicated.

	Year Ended December 31, 2001		Six Months Ended June 30, 2002	
	$(1)	%	$	%
		($ in thousands)		
Personal Automobile	$62,422	85.2%	$72,294	86.2%
Homeowners	10,637	14.5	11,190	13.3
Boat	163	0.2	276	0.3
Umbrella	63	0.1	87	0.1
Total	$73,285	100.0%	$83,847	100.0%

(1) The year ended December 31, 2001 includes gross premiums written since June 27, 2001, the date of consolidation of Professionals Group and Medical Assurance.

When measured by number of policies, personal automobile represented 63.3% of our personal lines policies in force as of June 30, 2002. The following table illustrates our number of policies in force for each of our personal lines of business at each of the dates indicated.

	December 31, 2001		June 30, 2002	
	Number	%	Number	%
Personal Automobile	92,709	64.5%	94,765	63.3%
Homeowners	48,461	33.7	52,070	34.8
Boat	1,776	1.2	2,116	1.4
Umbrella	717	0.5	804	0.5
Total	143,663	100.0%	149,755	100.0%

Table of Contents

Geographic Distribution

We are licensed to write business in 48 states, and currently operate primarily in 19 states. For the six months ended June 30, 2002, our top five states represented 81.8% of direct premiums written with Michigan accounting for 36.6%. The following table displays distribution of our gross premiums written by state.

	Year Ended December 31,						Six Months Ended June 30,			
	2001		2000		1999		2002		2001	
	$	%	$	%	$	%	$	%	$	%
					($ in thousands)					
Alabama	$ 74,917	19.3%	$ 66,123	29.5%	$ 69,903	34.7%	$ 46,937	15.4%	$ 44,416	34.1%
MEEMIC (Michigan)	73,286	18.8					83,847	27.6		
Ohio	51,520	13.2	30,357	13.6	29,943	14.9	42,092	13.9	20,288	15.6
Florida	29,519	7.6	7,636	3.4	4,078	2.0	31,971	10.5	3,269	2.5
Indiana	25,130	6.5	13,667	6.1	12,913	6.4	16,495	5.4	7,464	5.7
Michigan	22,404	5.8					27,408	9.0		
All other states(1)	112,207	28.8%	106,088	47.4%	84,756	42.0%	55,438	18.2%	54,991	42.1%
Total	$388,983	100.0%	$223,872	100.0%	$201,593	100.0%	$304,188	100.0%	$130,428	100.0%

(1) No other state comprises more than 5.8% of our 2001 gross premiums written.

Underwriting

Professional Liability Segment. Our underwriting process is driven by individual risk selections, and our pricing decisions are focused on achieving rate adequacy. We assess the quality and pricing of the risk, primarily emphasizing loss history, practice specialty and location of practice in making our underwriting decision. Our underwriters work with our claims, risk management and marketing departments to build a base of knowledge from which they make these decisions.

Our underwriting focuses on knowledge of local market conditions and legal environment. Through our five local underwriting offices located in Alabama, Florida, Indiana, Missouri and Michigan, we have established a local presence within our targeted markets to obtain better information more quickly. These offices are staffed by 30 underwriting professionals who report to the branch vice presidents of their respective local office. The five underwriting offices each report to one of two regional vice presidents who are ultimately responsible for the pricing and underwriting decisions in their respective regions.

Our underwriting department establishes guidelines to classify risks by practice specialty and by location. Our underwriters work with our field marketing force to identify business that meets these established underwriting standards and to develop specific strategies to write the desired business. In performing this assessment, our underwriters may also consult with internal actuaries regarding loss trends and pricing and utilize loss rating models to assess the projected underwriting results of accounts. Our agents are authorized to bind professional liability coverage within our underwriting guidelines, but binding authority is exercised only after authorization from our underwriting staff.

Our underwriters work closely with our local claims departments. This includes consulting with claims investigators on patterns of practice in a particular locale and monitoring claims activity. Our underwriters are also assisted by our local advisory committees that we have established in our key states. These committees are comprised of doctors, hospital administrators and other medical professionals and help us maintain close ties to the medical communities in key locations, provide information on the practice of medicine in each state and provide guidance on critical underwriting and claims issues. As these committees examine claims, they are able to identify potentially troubling practice patterns and can make recommendations to our risk underwriting staff.

55

Personal Lines Segment. We rely to a significant degree on information provided by our sales representatives in underwriting risks. Our sales representatives have the authority to bind coverage for a thirty-day period. The majority of our sales representatives are or were teachers. This enhances the sales representatives ability to act as field underwriters since they have a general understanding of lifestyles and insurance needs within the educational community to effectively pre-screen applicants. We believe that the educational community in Michigan provides better than average risk-selection, which contributes to our historically profitable underwriting results.

We evaluate and accept applications for insurance based on consistently applied underwriting guidelines. Our processing system provides modifications for some of these guidelines and underwriting supervisors regularly audit the work of individual underwriters to ensure adherence to our guidelines. Our 24 underwriters monitor policyholder deviations from the underwriting guidelines to assist in decisions related to cancellation and non-renewal.

Claims Management

Professional Liability Segment. We have claims offices throughout the states in which we write business in order to provide localized and timely attention to claims. Our claims department investigates the circumstances surrounding a medical incident from which a covered claim arises against an insured. Upon investigation, and in consultation with the insured and appropriate experts, we evaluate the claim and either seek reasonable settlement or aggressively defend against the claim. If the claim is defended, our claims department manages the case, including planning the defense, coordinating and managing defense attorneys and obtaining medical and/or other professional experts to assist in the analysis and defense of the claim.

Our claims department consists of 94 claims professionals, including claims specialists, senior claims specialists, directors and vice presidents. Our claims department establishes the appropriate case reserves for each claim and monitors the level of each case reserve as circumstances require. The department also decides when and if to settle all but the most significant claims, which are currently reviewed by an internal committee made up of our Chairman and Chief Executive Officer, our Senior Vice President Claims, and our outside legal counsel. In each of the states in which we operate, we meet regularly with local medical advisory committees, which are principally comprised of local physicians, dentists and representatives of hospitals and healthcare entities.

We aggressively defend claims against our insureds that we believe have no merit or that we believe cannot be reasonably settled. As a result of this policy, many of our claims are litigated, and we engage experienced trial attorneys in each venue to handle the litigation in defense of our policyholders.

Our aggressive claims management approach generally results in increased loss adjustment expenses compared to those of other property and casualty lines or others specializing in professional liability insurance. However, we believe that our approach contributes to lower overall loss costs and results in greater customer loyalty. The success of this claims philosophy is based on our ability to develop relationships with attorneys who have significant experience in the defense of professional liability claims and who are able to defend claims in an aggressive, cost-efficient manner.

Personal Lines Segment. In responding to claims, we emphasize timely investigation, evaluation and fair settlement while controlling claims expense and maintaining adequate reserves.

We have a claims staff of 66 people. Our claims operation is centralized in Auburn Hills, Michigan, but we also employ four resident adjusters located in cities throughout Michigan. These employee adjusters settle a majority of our claims, though independent multi-line adjusters are used when claim volume rises. We have also established a network of auto repair shops and other repair facilities that provide damage appraisals and repairs according to established company guidelines. A reinspection audit program ensures that repairs are completed timely, economically and to the satisfaction of the customer.

Audits of liability claim files are conducted regularly by claims department managers and reinsurers. Our claims department decides which claims we seek to settle and which claims we defend. We believe that less than 1% of all claims result in litigation. Claims we choose to litigate are initially reviewed by our in-house

legal counsel to determine whether the file should be outsourced to an outside specialist or handled internally. Our claims department actively monitors all litigation including planning the defense, coordinating and managing defense attorneys and obtaining professional experts to assist in the analysis and defense of the claim.

We have a 24 hour claim reporting telephone service for insureds and third-party claimants. This service allows customers to report their first notice of a loss at anytime of the night or day, 365 days a year. This reporting methodology enables us to more quickly complete initial claim handling and ultimately reduce indemnity payments such as rental and storage.

Marketing

Professional Liability Segment. We utilize direct marketing and independent agents to write business in the eastern portion of the United States, with concentrations in Alabama, Florida, Illinois, Indiana, Michigan, Missouri, Ohio and West Virginia. We are currently licensed in 48 states, allowing us to respond outside this region when an opportunity arises.

In Alabama, we rely solely on direct marketing, and in Florida and Missouri, direct marketing accounts for a majority of our business. We currently employ 10 producers to handle direct sales of our professional liability insurance.

We use independent agents to market our professional liability insurance products in other markets. For the year ended December 31, 2001, approximately 62% of our professional liability direct premiums written were produced through independent insurance agencies. We define direct premiums written as our gross premiums written minus our premiums assumed from other insurance carriers. We primarily rely on local agencies usually having one to three producers who specialize in professional liability insurance and who we believe are able to appreciate the factors that differentiate our professional liability insurance product. No single agent or agency accounts for more than 5% of our total direct premiums written.

We focus our marketing efforts on sole practitioners and small groups of physicians. We generally do not solicit large accounts because of the difficulty in underwriting the individual risks and because their purchasing decision is usually based primarily on price. Our marketing efforts differentiate our professional liability insurance products by emphasizing claims service and other services and communications we provide to our customers including:

- risk management consultation, loss prevention seminars and other educational programs;
- legislative oversight and active support or opposition of proposed legislation relating to liability issues affecting the healthcare industry;
- the preparation and dissemination of newsletters and other printed material with information of interest to the healthcare industry;
- endorsements by, and attendance at meetings of, the state and local medical societies and related organizations; and
- the sponsorship of risk management education seminars as an accredited provider of continuing medical education.

These communications and services have helped us gain exposure among potential insureds and demonstrate our understanding of the insurance needs of the healthcare industry and promote a commonality of interest among us and our insureds.

Personal Lines Segment. We market our personal lines insurance products to members of the educational community and their families in Michigan exclusively through approximately 93 sales representatives. Our representatives typically are current or former teachers, school administrators or other education professionals. We currently are licensed in Minnesota, Michigan, and Ohio, but write insurance only in Michigan.

Approximately 92% of the premiums sold by our sales representatives are for our own insurance products. The remaining 8% of the premium volume is for products underwritten by other carriers in Michigan who pay us commissions for such sales. In general, these carriers offer products that we do not currently offer, or insure a class of business that does not meet our underwriting guidelines. By offering complementary insurance products, our sales representatives provide our customers with the convenience of being able to purchase a full range of insurance products through a single agent. We benefit by having potential customers for products we may offer in the future.

We conduct quarterly meetings with our sales representatives, establish benchmarks and goals, conduct technical training and sponsor continuing education programs. Our representatives provide us with important information about market conditions and feedback from our customers regarding their insurance requirements and our level of service provided. This information is used to develop new products and new product features. We recruit and train new sales representatives to work in underserviced areas of the state. Sales representatives are paid a fixed base commission with some opportunity for contingent bonuses, based upon the representative s production and loss ratios.

For the year ended December 31, 2001, one sales representative accounted for 4.9% of our direct premiums written within our personal lines segment. No other sales representative accounted for more than 4.2% of our direct premiums written in 2001. The top 10 sales representatives accounted for 32.3% of our direct premiums written in 2001.

We provide personal computer software that allows sales representatives to quote rates for auto, homeowners and boat insurance. In addition, we have a web site on the internet for the public that is periodically updated with pertinent information on MEEMIC, its products, and how to locate a sales representative.

Reserves for Losses and Loss Adjustment Expenses

All of our reserves are considered property and casualty reserves. At December 31, 2001, approximately 94% of our loss and loss adjustment expense reserves were associated with professional liability coverage and the balance was associated with personal lines coverage. We did not operate in the personal lines segment prior to our consolidation with Professionals Group on June 27, 2001.

Our consolidation with Professionals Group increased professional liability net loss reserves by approximately $499 million bringing consolidated professional liability net loss reserves to approximately $1.0 billion. Professionals Group s reserves for losses and LAE and related reinsurance recoverables were included at their fair value based on the present value of the expected underlying cash flows of the loss reserves and reinsurance recoverables and a risk premium and a profit margin. The value of Professionals Group s loss reserves included a $25 million increase made to ProNational s loss reserves in the second quarter of 2001. This reserve increase is not reflected in our historical results of operations for 2001 because it occurred prior to the consolidation.

We establish our reserves based on our estimates of the future amounts necessary to pay claims and expenses associated with the investigation and settlement of claims. These estimates consist of case reserves and bulk reserves. Case reserves are estimates of future losses and LAE for claims that have already been reported and are established by our claims department upon receiving a notice of claim. Bulk reserves (which include a provision for losses that have occurred but have not been reported to us as well as development on reported claims) are the difference between (i) the sum of case reserves and paid losses and (ii) an actuarially determined estimate of the total losses and LAE necessary for the ultimate settlement of all reported claims and incurred but not reported claims, including amounts already paid. Losses and LAE reserves are determined on the basis of individual claims and actuarially determined estimates of future losses based on our past loss experience, available industry data and projections as to future claims frequency, severity, inflationary trends, judicial trends, legislative changes and settlement patterns. Many of these items are not definitively quantifiable. Additionally, there may be significant reporting lags between the occurrence of an insurable event and the time it is reported to us. The assumptions used in establishing our reserves are regularly reviewed and updated by management as new data becomes available. The reserves for losses and

LAE of each of our insurance subsidiaries are reviewed by its independent actuaries for each year. The independent actuaries prepare reports that include recommendations as to the level of reserves. We consider these recommendations as well as other factors, such as known, anticipated or estimated changes in frequency and severity of claims and loss retention levels and premium rates, in establishing the amount of our reserves for losses and loss adjustment expenses. The statutory filings of each insurance company with the insurance regulators must be accompanied by an actuary s certification as to its reserves in accordance with the requirements of the NAIC.

We believe the methods we use to establish our reserves for losses and LAE are reasonable and appropriate. Estimating reserves, especially professional liability reserves, is a complex process heavily dependent on judgment. We believe that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate, but not necessarily accurate, basis for evaluating the adequacy of our loss reserves. There is no precise method for evaluating the adequacy of reserves and changes are made to the amount of the reserves as estimates change based on current information. Changes in the amount of reserves for losses and LAE are reflected in current earnings. Because of the size of our reserves, a small percentage change in the amount of the reserves can have a material impact on our results of operations.

The following table reconciles beginning and ending reserves for losses and LAE as shown in our consolidated financial statements for the years indicated. As of December 31, 2001, our insurance subsidiaries had consolidated reserves for losses and LAE on a GAAP basis that exceeded those on a statutory basis by approximately $24.8 million, which is principally due to the portion of GAAP reserves that are reflected for statutory accounting purposes as unearned premiums. These unearned premiums are applicable to extended reporting endorsements issued without a premium charge upon death, disability, or retirement of an insured.

	Years Ended December 31,		
	2001	**2000**	**1999**
		($ in thousands)	
Balance, beginning of year	$ 659,659	$ 665,792	$ 660,640
Less reinsurance balances recoverable	(166,202)	(179,508)	(179,890)
Net balance, beginning of year	493,457	486,284	480,750
Losses and LAE net reserves acquired from Professionals Group	557,284		
Incurred related to:			
Current year	303,387	178,210	158,303
Prior years	13,818	(12,500)	(53,646)
Change in death, disability and retirement reserve	(18,647)	(10,000)	
Total incurred	298,558	155,710	104,657
Paid related to:			
Current year	(137,121)	(14,909)	(10,297)
Prior years	(143,893)	(133,628)	(88,826)
Total paid	(281,014)	(148,537)	(99,123)
Net balance, end of year	1,068,285	493,457	486,284
Plus reinsurance balances recoverable	374,056	166,202	179,508
Balance, end of year	$1,442,341	$ 659,659	$ 665,792

Loss Reserve Development Table. The following table includes information regarding the development of our liability for unpaid losses and LAE for the years ended December 31, 1991 through 2001. The table

includes losses and LAE on both a direct and an assumed basis and is net of reinsurance recoverables in the table below:

- the line entitled Losses and LAE Reserves, undiscounted and net of reinsurance recoverables reflects the amount recorded as the reserve for liability for unpaid losses and LAE in the consolidated balance sheet at the end of each year (the Balance Sheet Reserves);

- the section entitled Cumulative net paid, as of reflects the cumulative amounts paid as of the end of each succeeding year with respect to the previously recorded Balance Sheet Reserves;

- the section entitled Re-estimated net liability as of reflects the re-estimated amount of the liability previously recorded as Balance Sheet Reserves that includes the cumulative amounts paid and an estimate of additional liability based upon claims experience as of the end of each succeeding year (the Net Re-estimated Liability); and

- the line entitled Net cumulative redundancy, (deficiency) reflects the difference between the previously recorded Balance Sheet Reserve for each applicable year and the Net Re-estimated Liability relating thereto as of the end of the most recent fiscal year.

The gross liability for losses and LAE before reinsurance, as shown on the balance sheet, and the reconciliation of that gross liability to amounts net of reinsurance are reflected below the table. We do not discount our reserves.

Information presented in the following table is cumulative and, accordingly, each amount includes the effects of all changes in amounts for prior years. The table presents the development of our balance sheet reserves; it does not present accident year or policy year development data. Conditions and trends that have affected the development of liabilities in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on this table.

In each year reflected in the table, we have utilized actuarial methodologies, including incurred loss development, paid loss development and frequency-severity projections, to estimate reserves. These techniques are applied to the data and the resulting projections are evaluated by management to establish the estimate of reserves.

Table of Contents

Analysis of Losses and Loss Adjustment Expense Reserve Development

	Years ended December 31,										
	1991(1)	**1992(1)**	**1993(1)**	**1994(1)**	**1995(1)**	**1996(1)**	**1997(1)**	**1998(1)**	**1999(1)**	**2000(1)**	**2001(2)**
	($ in thousands)										
Losses and LAE reserves, undiscounted and net of reinsurance recoverables	$228,119	$252,739	$272,392	$295,541	$352,521	$440,040	$464,122	$480,741	$486,279	$493,457	$1,068,285
Cumulative net paid as of:											
One year later	19,560	19,752	21,296	24,102	27,532	48,390	67,383	89,864	133,832	143,892	
Two years later	35,461	36,185	40,988	42,115	58,769	98,864	128,758	192,716	239,872		
Three years later	46,417	52,550	53,186	58,793	80,061	136,992	194,139	257,913			
Four years later	58,124	58,526	61,153	65,520	107,005	173,352	227,597				
Five years later	62,573	63,325	66,419	76,291	120,592	191,974					
Six years later	65,090	68,021	73,308	81,722	129,043						
Seven years later	68,719	71,466	76,716	82,605							
Eight years later	71,305	72,352	76,821								