21ST CENTURY HOLDING CO
Form 10-K
March 17, 2008

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

x **Annual Report under Section 13 or 15(d) of the Securities Act of 1934**

For the fiscal year ended December 31, 2007

or

o **Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period of _____________to_______________

Commission file number: 0-2500111

21st Century Holding Company
(Exact name of registrant as specified in its Charter)

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

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

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

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

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

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

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

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

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See the definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large accelerated filer o   Accelerated filer x   Non-accelerated filer o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes o No x

The aggregate market value of the Registrant’s common stock held by non-affiliates was $73,482,801 on June 29, 2007, computed on the basis of the closing sale price of the Registrant’s common stock on that date.

As of March 14, 2008, the total number of common shares outstanding of Registrant's common stock was 7,935,619.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2008 Annual Meeting of the Shareholders are incorporated by reference into Part III, of this Form 10K.

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PART I

SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

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

ITEM 1 BUSINESS

GENERAL

21st Century Holding Company ("21st Century," "Company," "we," "us") is an insurance holding company, which, through our subsidiaries and our contractual relationships with our independent agents and general agents, controls substantially all aspects of the insurance underwriting, distribution and claims process. We are authorized to underwrite homeowners' property and casualty insurance, commercial general liability insurance, personal automobile insurance and commercial automobile insurance in various states with various lines of authority through our wholly owned subsidiaries, Federated National Insurance Company ("Federated National") and American Vehicle Insurance Company ("American Vehicle").

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

Federated National is authorized to underwrite homeowners' property and casualty insurance in Florida as an admitted carrier. American Vehicle is authorized in several states to underwrite commercial general liability coverage as either an admitted or surplus lines carrier. An admitted carrier is an insurance company that has received a license from the state department of insurance giving the company the authority to write specific lines of insurance in that state. These companies are also bound by rate and form regulations, and are strictly regulated to protect policy holders from a variety of illegal and unethical practices, including fraud. Admitted carriers are also required to financially contribute to the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders. A non-admitted carrier is not licensed by the state, but is allowed to do business in that state. Sometimes, non-admitted carriers are referred to as "excess and surplus" lines carriers. Non admitted insurers are subject to considerably less regulation with respect to policy rates and forms.

American Vehicle has either ongoing operations or operations expected to commence this year in several states. The table below denotes by state American Vehicle’s authority, status of operations and where new applications are pending. We may not receive authority to write in every state to which we make application due to state specific guidelines.

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States	Admitted carrier	Surplus lines carrier	Ongoing operations	Operations expected to commence this year	Application pending
Alabama	ü		ü		
Arkansas		ü		ü	
California		ü	ü		
Florida	ü		ü		
Georgia		ü	ü		
Kentucky		ü	ü		
Louisiana	ü		ü		
Maryland		ü		ü	
Missouri		ü		ü	
Nevada		ü		ü	
Ohio		ü			ü
Oklahoma		ü			ü
South Carolina		ü	ü		
Tennessee		ü			ü
Texas	ü		ü		
Virginia		ü	ü		

Additionally, both Federated National and American Vehicle are authorized to underwrite personal automobile insurance in Florida as an admitted carrier.

During 2007 American Vehicle applied for and was granted, by the State of Florida in January 2008, licenses to underwrite commercial multiple peril, inland marine and surety lines of business as an admitted carrier. Operations under American Vehicle's newly granted line of authority are expected to begin during 2008.

During the year ended December 31, 2007, 74.5%, 24.1% and 1.4% of the premiums we underwrote were for homeowners' property and casualty insurance, commercial general liability insurance and personal automobile insurance, respectively. During the year ended December 31, 2006, 74.9%, 21.1% and 4.0% of the premiums we underwrote were for homeowners' property and casualty insurance, commercial general liability insurance and personal automobile insurance, respectively. We internally process claims made by our insureds through our wholly owned claims adjusting company, Superior Adjusting, Inc. ("Superior").

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

Our web site is located at www.21centuryholding.com. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to such reports are available, free of charge, through our website as soon as reasonably practicable after we electronically file or furnish such material to the Securities and Exchange Commission ("SEC"). Further, a copy of this annual report on Form 10-K is located at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding our filings at www.sec.gov.

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RECENT DEVELOPMENTS

Proposed Florida Legislation

During February 2008 Florida's House Insurance Committee held a workshop on a proposal and legislation developed by the Florida Department of Financial Services ("DFS") regarding a significant reduction of capacity in the Florida Hurricane Catastrophe Fund ("FHCF"), substantially increasing members' co-insurance participation and the reorganization of the FHCF under the Florida Cabinet. Additionally, the Board of Directors of the Florida Insurance Guaranty Association ("FIGA") held separate meetings to discuss their continued financial challenges in connection with the insolvency of a particular insurance company that was assumed subsequent to the 2005 - 2006 hurricane season. At this time, we do not know if any new laws or regulations will be adopted in Florida which will impact our property and casualty insurance business in fiscal 2008 or any subsequent years.

BUSINESS STRATEGY

We expect that in 2008 we will capitalize on our operational efficiencies and business practices by:

· expanding our lines of business such as our recent approval to write commercial multi-peril, inland marine and surety insurance in the State of Florida. Although operations are not yet ongoing in connection with the new lines of commercial insurance, we expect to commence operations during 2008;

· continued expansion of our commercial general liability insurance product into additional states. In addition to our ongoing operations in nine states, we expect to commence operations in four states where we have obtained licenses to underwrite and sell commercial general liability insurance in 2008. Additionally, we have pending applications for a surplus lines licenses in three more states;

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

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

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

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

· assumption of existing risks from other carriers;

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

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

Additionally, State of Florida legislative initiatives, increased competition, softening general market conditions, an unfolding economic downturn and additional loss development from catastrophic events over two years old suggest that continued financial challenges exist in 2008.

INSURANCE OPERATIONS AND RELATED SERVICES

General

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

Federated National is authorized to underwrite homeowners' property and casualty insurance and personal automobile insurance in Florida as an admitted carrier. American Vehicle is authorized to underwrite personal and commercial automobile insurance and commercial general liability coverage in Florida as an admitted carrier.

In addition, American Vehicle is authorized to underwrite commercial general liability insurance in thirteen states, of which nine states had ongoing operations in 2007. American Vehicle has also recently expanded its domestic authority to include commercial multi peril, inland marine and surety lines of business in the State of Florida and will continue its expansion of commercial general liability insurance into new states.

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

	Years Ended December 31,					
	2007		2006		2005	
	Premium	Percent	Premium	Percent	Premium	Percent
	(Dollars in Thousands)					
Gross written premiums:						
Automobile	$ 1,867	1.4%	$ 6,064	4.0%	$ 20,665	17.3%
Homeowners'	99,502	74.5%	114,388	74.9%	76,182	63.8%
Commercial General Liability	32,222	24.1%	32,213	21.1%	22,593	18.9%
Total gross written premiums	$ 133,591	100.0%	$ 152,665	100.0%	$ 119,440	100.0%
Ceded premiums:						
Automobile	$ -	0.0%	$ -	0.0%	$ (5)	0.0%
Homeowners'	44,551	100.0%	67,520	100.0%	31,419	100.0%
Commercial General Liability	-	0.0%	-	0.0%	-	0.0%
Total ceded premiums	$ 44,551	100.0%	$ 67,520	100.0%	$ 31,414	100.0%
Net written premiums						
Automobile	$ 1,867	2.1%	$ 6,064	7.2%	$ 20,670	23.5%
Homeowners'	54,952	61.7%	46,868	55.0%	44,763	50.9%
Commercial General Liability	32,222	36.2%	32,213	37.8%	22,593	25.6%
Total net written premiums	$ 89,041	100.0%	$ 85,145	100.0%	$ 88,026	100.0%

We marketed our insurance products through our network of independent agents and general agents during fiscal years 2007, 2006 and 2005.

Homeowners'

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

	As of the years ended December 31					
	In-force policy count					
	2007		2006		2005	
County	Amount	Percentage	Amount	Percentage	Amount	Percentage
Dade	4,587	12.7%	9,151	21.6%	11,201	27.9%
Broward	4,446	12.3%	6,629	15.6%	6,728	16.8%
West Palm Beach	14,969	41.3%	13,539	31.9%	8,079	20.1%

All others	12,239	33.8%	13,099	30.9%	14,117	35.2%
Total	36,241	100.0%	42,418	100.0%	40,125	100.0%

Our property insurance products typically provide maximum coverage in the amount of $750,000, with the aggregate average policy limit being approximately $1,350,000. The approximate average premium on the policies currently in-force is $2,769, as compared to $2,727 for 2006, and the typical deductible is $1,000 for non-hurricane-related claims and generally 2% of the coverage amount for the structure for hurricane-related claims.

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Premium rates charged to our property insurance policyholders are continually evaluated to assure that they meet the expectation, are actuarially sound and produce a reasonable level of profit (neither excessive nor inadequate).

An average rate increase of 38.3% was implemented effective June 1, 2006, followed by three additional filings in March, May and September of 2007. Both the June 2006 and March 2007 rate filings were on a “use and file” basis. The March 2007 rate filing resulted in an average rate reduction of 15.2%. Our May 2007 and September 2007 rate reductions were on a “file and use” basis. Our May 2007 revenue neutral rate filing was approved and made effective for new and renewal policies with policy effective dates of November 1, 2007 and December 1, 2007, respectively. Our September 2007 “file and use” rate filing reflects an additional average rate decrease of 11.4% and is pending approval.

The initial rate increase for policies with an effective date of June 1, 2006 contemplated a 49.9% rate increase, though was ultimately implemented at 38.3%. Policy holders were refunded approximately $6.0 million, and premiums waived totaled and resulted in a charge to operations in 2006 of approximately $1.0 million.

Commercial General Liability

We underwrite commercial general liability insurance for approximately 250 classes of artisan and mercantile trades (excluding home-builders and developers), habitational exposures and certain special events. The limits of liability range from $100,000 per occurrence and $200,000 policy aggregate to $1 million per occurrence and $2 million policy aggregate. We market the commercial general liability insurance products through a limited number of general agencies unaffiliated with the Company. The average annual premium on policies, with deductibles of $250 to $500 per claim, and currently in force is approximately $798, as compared to $826 for the years ended December 31, 2007 and 2006, respectively.

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

	Years Ended December 31,					
	2007		2006		2005	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
	(Dollars in Thousands)					
State						
Alabama	$ 26	0.08%	$ -	0.00%	$ -	0.00%
California	23	0.07%	-	0.00%	-	0.00%
Florida	21,192	65.77%	22,965	71.29%	18,293	80.97%
Georgia	1,023	3.17%	1,805	5.60%	1,258	5.57%
Kentucky	8	0.03%	9	0.03%	-	0.00%
Lousiania	5,595	17.36%	5,743	17.83%	3,042	13.46%
South Carolina	182	0.57%	77	0.24%	-	0.00%
Texas	4,127	12.81%	1,604	4.98%	-	0.00%
Virginia	46	0.14%	10	0.03%	-	0.00%
Total	$ 32,222	100.00%	$ 32,213	100.00%	$ 22,593	100.00%

In order to expand our general liability business, we entered into a 100% quota-share reinsurance treaty with Republic Underwriters Insurance Company ("Republic") on March 28, 2006. This agreement was in place for approximately one year until March 31, 2007, when it was cancelled at the request of Republic. Republic is domiciled in the State of Texas and licensed both directly and on a surplus lines basis in approximately 32 states. Republic has a financial rating of “A-” Excellent with A.M. Best. This arrangement would have facilitated the policyholder who requires their commercial general liability insurance policy to come from an insurance company with an A.M. Best rating.

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

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Personal Automobile

Personal automobile insurance markets can be divided into two categories, standard automobile and nonstandard automobile. Standard personal automobile insurance is principally provided to insureds who present an average risk profile in terms of driving record, vehicle type and other factors. Nonstandard personal automobile insurance is principally provided to insureds that are unable to obtain standard insurance coverage because of their driving record, age, vehicle type or other factors, including market conditions.

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

Both of our insurance subsidiaries currently underwrite nonstandard personal automobile insurance only in Florida, where the minimum limits are $10,000 per individual, $20,000 per accident for bodily injury, $10,000 per accident for property damage, and $50,000 for comprehensive and collision. The average annual premium on policies currently in force is approximately $1,075, as compared to $860 for 2006, and the nonstandard personal automobile insurance lines represents more than 99.5% of our written premiums for personal automobile insurance for both the years ended December 31, 2007 and 2006

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

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

Federated National underwrites standard personal automobile insurance policies providing coverage no higher than $100,000 per individual, $300,000 per accident for bodily injury, $50,000 per accident for property damage and comprehensive and collision up to $50,000 per accident, with deductibles ranging from $200 to $1,000. The average premium on the policies currently in force is approximately $1,346, as compared to $1,599 for 2006, and represents approximately 0.5% of our written premiums for personal automobile insurance as of the year ended December 31, 2007.

Flood

We write flood insurance through the National Flood Insurance Program (“NFIP”). We write the policy for the NFIP, which assumes 100% of the flood risk while we retain a commission for our service. The average flood policy premium is approximately $400 with limits up to $250,000. Commissions in connection with this program totaled $0.3 million, $0.3 million and $0.2 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Assurance Managing General Agents, Inc. (“Assurance MGA”)

Assurance MGA, a wholly owned subsidiary, acts as Federated National's and American Vehicle's exclusive managing general agent in the state of Florida. As American Vehicle continues its expansion into other states we will continue to contract with general agents to market our commercial general liability insurance product outside the state of Florida. Assurance MGA currently provides underwriting policy administration, marketing, accounting and financial services to Federated National and American Vehicle, and participates in the negotiation of reinsurance contracts. Assurance MGA generates revenue through a 6% commission fee from the insurance companies' gross written premium, policy fee income of $25 per policy and other administrative fees from the marketing of company products through the Company's distribution network. The 6% commission fee from Federated National and American Vehicle became effective January 1, 2005. Assurance MGA plans to establish relationships with additional carriers and servicing additional insurance products in the future.

Superior Adjusting, Inc.

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

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

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

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

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

	Years Ended December 31,					
	2007		2006		2005	
	Premium	Percent	Premium	Percent	Premium	Percent
	(Dollars in Thousands)					
Federated National	$ 2,547	62.7%	$ 6,279	56.2%	$ 6,893	21.5%
American Vehicle	169	4.2%	1,981	17.7%	14,946	46.7%
Other insurers	1,346	33.1%	2,917	26.1%	10,186	31.8%
Total	$ 4,062	100.00%	$ 11,177	100.00%	$ 32,025	100.00%

Federated Premium's operations were funded by a revolving loan agreement ("Revolving Agreement") with FlatIron Funding Company LLC ("Flatiron"). The Revolving Agreement is structured as a sale of contracts receivable under a sale and assignment agreement with Westchester Premium Acceptance Corporation ("WPAC") (a wholly-owned subsidiary of FlatIron), which gives WPAC the right to sell or assign these contracts receivable. Federated Premium, which services these contracts, has recorded transactions under the Revolving Agreement as secured borrowings. There were no outstanding borrowings under the Revolving Agreement as of December 31, 2007. Outstanding borrowings under the Revolving Agreement as of December 31, 2006 and 2005 were approximately $0.01 million and $0.20 million, respectively. This credit facility terminated, at our request, during 2007.

Finance contracts receivable decreased $1.4 million, or 77.0%, to $0.4 million as of December 31, 2007, compared to $1.8 million as of December 31, 2006. We anticipate a continued decline in the short-term in connection with premiums financed contracts. The Company anticipates continued use of the direct bill feature associated with Federated National and American Vehicle and their automobile lines of business.

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

MARKETING AND DISTRIBUTION

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

Our independent agents and general agents have the authority to sell and bind insurance coverage in accordance with procedures established by Assurance MGA. There were no other agency relationships with affiliated captive or franchised agents for the years ended December 31, 2007, 2006 and 2005. Assurance MGA reviews all coverage bound by the agents promptly and generally accepts all coverage that falls within stated underwriting criteria. For automobile and commercial general liability policies, Assurance MGA also has the right, within a period of 60 days from a policy's inception, to cancel any policy, upon 45 days' notice, even if the risk falls within our underwriting criteria.

During periods under emergency order as defined by the Florida Office of Insurance Regulation ("OIR"), there typically exists a moratorium on cancellations and non-renewals of various types of insurance coverage. Our homeowners' and mobile home policies provide Assurance MGA the right to cancel any policy within a period of 90 days from the policy's inception with 25 days' notice, or after 90 days from policy inception with 95 days' notice, even if the risk falls within our underwriting criteria.

We believe that our integrated computer system, which allows for rapid automated premium quotation and policy issuance by our agents, is a key element in providing quality service to both our agents and insureds. For example, upon entering a customer's basic personal information, the customer's driving record is accessed and a premium rate is quoted. If the customer chooses to purchase the insurance, the system can generate the policy on-site.

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

REINSURANCE

We follow industry practice of reinsuring a portion of our risks and paying for that protection based primarily upon total insured values of all policies in effect and subject to such reinsurance. Reinsurance involves an insurance company transferring or "ceding" all or a portion of its exposure on insurance underwritten by it to another insurer, known as a "reinsurer." The ceding of insurance does not legally discharge the insurer from its primary liability for the full amount of the policies. If the reinsurer fails to meet its obligations under the reinsurance agreement, the ceding company is still required to pay the insured for the loss. Our reinsurance agreements are designed to coincide with the seasonality of Florida's hurricane season.

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

For the 2007-2008 hurricane season, the excess of loss and FHCF treaties will insure us for approximately $403.0 million of aggregate loss and loss adjustment expenses ("loss and LAE") with a maximum single event coverage totaling approximately $320.0 million, with the Company retaining the first $3.0 million of loss and LAE. Our reinsurance program included coverage purchased from the private market, which afforded optional Reinstatement Premium Protection that provides coverage beyond the first event, along with coverage from the FHCF.

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The FHCF affords coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event. The cost to the Company for these reinsurance products for the 2007-2008 hurricane season, including the prepaid automatic premium reinstatement protection will be approximately $46.5 million. The reinsurance companies and their respective A. M. Best rating are listed in the table as follows:

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

To date, there have been no claims asserted against any of the 2007-2008 hurricane season excess of loss and FHCF treaties

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

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For the 2006-2007 hurricane season, we assembled a range of reinsurance products designed to insure the Company for an aggregate of approximately $414.5 million for a minimum of two catastrophic events. The reinsurance treaties contained several complex features and through a series of fluid retentions, attachment points and limitations, additional coverage may have been afforded Federated National for events beyond the first two catastrophic events. Our retention would have varied depending on the severity and frequency of each catastrophic event. The reinsurance companies and their respective participation in the season's program are noted in the table as follows:

		First Event Participation			Reinstated Premium Protection	
Current AM Best Rating	Reinsurer	$20m in excess of $15m	$40m in excess of $35m	$72m in excess of $75m and FHCF participation	$20m in excess of $15m	$40m in excess of $35m
A+	Ace Tempest Reinsurance Ltd		7.5%	7.5%		
A	Amlin 2001 Syndicate	5.0%	5.0%	5.0%	5.0%	
A-	Amlin Bermuda Ltd	2.5%	4.0%	4.0%	2.5%	
A	American Reinsurance Company			3.5%		
A	Ascot 1414 Syndicate			6.5%		
A++	National Liability and Fire Company		33.8%	6.6%		77.6%
B++	Converium AG		5.0%			
A+	Everest Reinsurance Company		22.0%	4.3%		12.0%
NR	Wentworth Insurance Company Ltd	5.0%		.	5.0%	
A-	Flagstone Reinsurance Ltd		4.3%	4.0%		
A	MAP 2791 Syndicate	2.5%	2.5%	2.5%	2.5%	
A-	New Castle Reinsurance Company Ltd	2.0%	2.0%	2.0%	2.0%	
A	QBE Reinsurance Corporation		1.5%	1.0%		
A	Renaissance Reinsurance, Ltd		12.5%	12.5%		
A+	XL Re Limited			2.5%		
A	Odyssey			3.5%		
A	Catlin Insurance Company Ltd	25.0%			25.0%	
NR	Allianz Risk Transfer (Bermuda) Ltd	33.0%			33.0%	
A	Liberty Mutual Insurance Company			34.7%		

NR4	American Vehicle Insurance Company (Affiliated)	25.0%	25.0%

In the discussion that follows it should be noted that all amounts of reinsurance were based on management's analysis of Federated National's exposure levels to catastrophic risk. Our data was subjected to exposure level data analysis at various dates through December 31, 2006.

Our overall reinsurance structure was divided into four major layers of financial impact in connection with any single catastrophic event. The bottom layer was considered the first $15 million of losses. The next layer was considered to be greater than $15 million and less than $35 million. The next layer was considered to be greater than $35 million and less than $233.3 million. The fourth layer was considered losses greater than $233.3 million and less than 305.3 million.

For the first and second catastrophic events equal to or less than $15 million, the bottom layer, Federated National would have retained 100% of the first $4.3 million and the last $0.7 million of this bottom layer. The FHCF would have participated 100% for the $10 million in excess of Federated National's first $4.3 million.

For the first and second catastrophic events with aggregate losses in excess of the first $15.0 million discussed above and less than $35 million, Federated National acquired 100% reinsurance protection with a single automatic premium reinstatement protection provision. The $20 million of coverage afforded in this layer was by way of 42% traditional, single season, excess of loss ("Traditional") treaties and 58% structured multi-year, excess of loss ("Structured") treaties. As noted in the chart above, American Vehicle reinsured Federated National via a traditional treaty for 25% of this $20 million layer. Relative to the structured excess of loss reinsurance treaties, terms contained in these treaties afford capacity in this layer beyond the 2006 - 2007 season for two additional hurricane seasons. The structured treaties offered respective coverage for a single event in each of the three hurricane seasons and one additional respective coverage that could be applied as needed in any one of the three hurricane seasons. One of the structured treaties, representing 25% of this layer, contained a provision that prevented the Company from recovery if any single event resulted in damages that exceed $20 billion in the United States and its territories.

For the first and second catastrophic events where aggregate losses exceeded $35 million, but were less than $233.3 million, Federated National acquired 100% reinsurance protection through a combination of private market reinsurers and the FHCF program. The private market reinsurers afforded coverage to insure us for $40 million against covered losses in excess of $35 million. The FHCF afforded coverage to insure us for 90% of loss greater than $55.6 million and less than $231.5 million. The private treaties "wrapped around" the FHCF treaty afforded coverage, in aggregate, for losses in excess of $35 million but less than $233.3 million. The FHCF treaty was an aggregate "for the entire season" treaty while the private market treaties afforded respective per event coverage. As to reinstatement of coverage for the private market treaties, Federated National purchased a single automatic premium reinstatement protection provision that would have provided for an automatic reinstatement for 89% of the $40 million coverage. Federated National would have been responsible for the remaining premium reinstatement protection and the cost in connection with that reinstatement was estimated to be approximately $2.1 million. Federated National would also have been responsible for seasonal losses beyond what was afforded through this part of the FHCF coverage.

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If an event had occurred where aggregate losses exceed $233.3 million, but were less than $305.3 million, Federated National had acquired traditional reinsurance treaties representing 65.3% of this layer without a provision for premium reinstatement protection. Premium reinstatement coverage would have been prorated as to amount and if the first event exhausted this coverage, then Federated National would have been responsible for approximately $10.4 million for reinstatement protection. Additional coverage was afforded to Federated National via Industry Loss Warrants ("ILW"). The ILW policies provided for payments to Federated National based solely on industry wide losses to private and commercial property only in the State of Florida. A payment to Federated National would only have been considered under the terms of these contracts, if insured wind damages incurred in the State of Florida had exceeded amounts varying between $20 billion and $25 billion excluding public property and certain other named exclusions.

The Company would have been responsible for single catastrophic events, with incurred losses in excess of approximately $305 million subject to the terms of the ILW's above.

The estimated cost to the Company in connection with this reinsurance structure was approximately $73.0 million, which for the most part was payable in quarterly installments that began July 1, 2006 and were amortized through earned premium in accordance with the provisions and terms contained in the respective treaties.

As a result of the loss and LAE incurred in connection with the hurricane activity that occurred in 2004 and 2005, the Company has reflected in its operations the effects of each storm as follows:

2004 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
		(Dollars in millions)		
Charley (August 13)	2,572	$ 65.3	$ 55.3	$ 10.0
Frances (September 3)	3,809	54.2	44.1	10.1
Ivan (September 14)	1,062	26.5	-	26.5
Jeanne (September 25)	1,563	14.0	-	14.0
Total Loss Estimate	9,006	$ 160.0	$ 99.4	$ 60.6

2005 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
		(Dollars in millions)		
Dennis (July 10)	322	$ 2.7	$ -	$ 2.7
Katrina (August 25)	2,117	14.6	11.6	3.0
Rita (September 20)	19	0.1	-	0.1
Wilma (October 24)	11,761	184.5	181.5	3.0
Total Loss Estimate	14,219	$ 201.9	$ 193.1	$ 8.8

Our automobile quota-share reinsurance treaties for 2003 included loss corridors with varying layers of coverage based on ultimate incurred loss ratio results whereby the two insurance companies will retain 100% of the losses between incurred loss ratios of 66% and 86% for policies with an effective date of 2003. Despite the loss corridor, the reinsurer assumes significant insurance risk under the reinsured portions of the underlying insurance contracts and it is reasonably possible that the reinsurer will realize a significant loss from the transaction. Our ultimate incurred loss ratios for these treaties as of December 31, 2007 are estimated to be 67.7% and 79.9% for Federated National and American Vehicle, respectively.

Effective March 28, 2006, American Vehicle entered into a 100% quota-share reinsurance treaty with Republic. Republic is domiciled in the State of Texas and licensed both directly and on a surplus lines basis in approximately 32 states. This agreement was in place for approximately one year until March 31, 2007, when it was cancelled at the request of Republic. Republic has a financial rating of “A-” Excellent with A.M. Best. This arrangement would have facilitated the policyholder who requires their commercial general liability insurance policy to come from an insurance company with an A.M. Best rating. Our arrangement with Republic allowed for a 4.75% commission on net written premium and reimbursement for all other costs in connection with the treaty such as premium taxes and assessments. We also remit a 1% commission to the intermediary broker on the same net written premium. Under this agreement, the Company assumed approximately $348,000 in premiums in connection with its operations in the State of Texas. Our operations in Texas began in December 2006. During the three months ended March 31, 2007, this 100% quota-sharing reinsurance treaty with Republic was cancelled, on a run-off basis, at their request, effective June 30, 2007.

LIABILITY FOR UNPAID LOSSES AND LAE

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

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

All newly reported claims received with respect to personal automobile policies are set