

COMBINED STATUTORY-BASIS FINANCIAL  
STATEMENTS

NGM Insurance Company and Insurance Subsidiaries  
As of December 31, 2008 And 2007  
Together With Report of Independent Auditors

# NGM Insurance Company and Insurance Subsidiaries

## Combined Statutory-Basis Financial Statements

Years Ended December 31, 2008 and 2007

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## REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders of NGM Insurance Company:

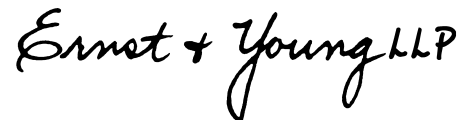
We have audited the accompanying combined statutory-basis balance sheets of NGM Insurance Company and Insurance Subsidiaries (the Group) as of December 31, 2008 and 2007, and the related combined statutory-basis statements of operations and changes in shareholder's surplus and cash flows for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Group's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Group presents its financial statements in conformity with accounting practices prescribed or permitted by the Insurance Departments of the States of South Carolina, Michigan, and Florida, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and U.S. generally accepted accounting principles and the effects on the accompanying financial statements are described in Note 1.

In our opinion, because of the effects of the matter described in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of NGM Insurance Company and Insurance Subsidiaries at December 31, 2008 and 2007, or the results of their operations or their cash flows for the years then ended.

However, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of NGM Insurance Company and Insurance Subsidiaries at December 31, 2008 and 2007 and the results of their operations and their cash flows for the years then ended in conformity with accounting practices prescribed or permitted by the Insurance Departments of the States of South Carolina, Michigan, and Florida.

A handwritten signature in black ink that reads 'Ernst & Young LLP'.

February 27, 2009

# NGM Insurance Company and Insurance Subsidiaries

## Combined Statutory-Basis Balance Sheets

(Dollars in Thousands)

As of December 31,	2008	2007
<b>Assets</b>		
Bonds	\$1,280,524	\$1,085,286
Common Stocks at Fair Values	39,729	279,715
Preferred Stocks at Amortized Cost	8,010	9,751
Preferred Stocks at Fair Values	7,240	4,791
Investment in Uncombined Subsidiaries	38,853	54,638
Real Estate	5,894	5,425
First Mortgage Loans	1,614	1,694
Investment in Limited Partnerships	6,478	1,563
Cash and Short-Term Investments	41,184	20,206
<b>Total Cash and Invested Assets</b>	<b>1,429,526</b>	<b>1,463,069</b>
Premiums Receivable	222,878	235,878
Reinsurance Recoverable on Paid Losses	5,479	4,118
Deferred Tax Asset	44,067	28,984
Accrued Investment Income	13,810	10,965
Federal Taxes Receivable	9,006	5,882
Other Assets	40,186	22,740
<b>Total Assets</b>	<b>1,764,952</b>	<b>\$1,771,636</b>
<b>Liabilities and Shareholder's Surplus</b>		
Unpaid Losses	\$ 558,470	\$ 534,743
Unpaid Loss Adjustment Expenses	102,302	99,573
Unearned Premiums	411,109	417,284
Deposits on Perpetual Policies	5,737	5,866
Other Underwriting Expenses Payable	32,048	38,422
Taxes, Licenses, and Fees Payable	10,552	13,611
Securities Payable and Other Liabilities	37,243	42,569
<b>Total Liabilities</b>	<b>1,157,461</b>	<b>1,152,068</b>
<b>Shareholder's Surplus</b>		
Surplus Notes	30,000	30,000
Common Stock, \$1 par value; 10,000,000 shares authorized; 5,250,000 shares issued and outstanding in 2008 and 2007	5,250	5,250
Additional Paid-In Capital	69,519	35,000
Surplus	502,722	549,318
<b>Total Shareholder's Surplus</b>	<b>607,491</b>	<b>619,568</b>
<b>Total Liabilities and Shareholder's Surplus</b>	<b>\$1,764,952</b>	<b>\$1,771,636</b>

See accompanying notes.

# NGM Insurance Company and Insurance Subsidiaries

## Combined Statutory-Basis Statements of Operations and Changes in Shareholder's Surplus

*(Dollars in Thousands)*

Year Ended December 31,	2008	2007
Net Premiums Written	\$ 805,023	\$ 839,198
Change in Unearned Premiums	7,546	(6,830)
<b>Net Premiums Earned</b>	<b>812,569</b>	<b>832,368</b>
Losses and Loss Adjustment Expenses Incurred	510,027	525,843
Underwriting Expenses Incurred	258,924	274,807
Total Losses and Expenses	768,951	800,650
<b>Net Underwriting Gain</b>	<b>43,618</b>	<b>31,718</b>
Investment Income, Net of Expenses of \$7,028 in 2008 and \$7,711 in 2007	58,265	51,526
Net Realized (Losses)/Gains from Investments	(69,634)	23,525
<b>Net Investment (Loss)/Income</b>	<b>(11,369)</b>	<b>75,051</b>
Other Net Income	976	3,642
Income Before Federal Income Taxes	33,225	110,411
Federal Income Tax Expense	5,775	26,801
<b>Net Income</b>	<b>\$ 27,450</b>	<b>\$ 83,610</b>

### *Combined Statutory-Basis Statements of Changes in Shareholder's Surplus*

<b>Shareholder's Surplus, January 1,</b>	<b>\$ 619,568</b>	<b>\$ 560,310</b>
Additional Paid-In Capital	34,519	-
Net Income	27,450	83,610
Change in Net Deferred Tax Asset	8,828	1,546
Change in Net Unrealized (Losses) and Gains on Investments Carried at Fair Value	(54,219)	1,434
Dividends to Shareholders	(11,318)	(12,465)
Other Changes in Surplus	1,187	(527)
Change in Nonadmitted Assets	(18,524)	(14,340)
<b>Shareholder's Surplus, December 31,</b>	<b>\$ 607,491</b>	<b>\$ 619,568</b>

# NGM Insurance Company and Insurance Subsidiaries

## Combined Statutory-Basis Statements of Cash Flows

*(Dollars in Thousands)*

Year Ended December 31,	2008	2007
<b>Cash Flows from Operating Activities</b>		
Net Premiums Received	\$ 818,677	\$ 826,630
Losses and Loss Adjustment Expenses Paid, net of Salvage and Subrogation	(489,123)	(460,857)
Underwriting Expenses Paid	(268,746)	(277,951)
Miscellaneous (Loss)/Income and Intercompany Activity	(39,148)	36,300
<b>Net Cash Provided by Underwriting Activities</b>	<b>21,660</b>	<b>124,122</b>
<b>Cash Flows from Investing Activities</b>		
Investment Income Received	68,356	65,618
Investment Expenses Paid	(7,028)	(7,712)
Income Taxes Paid	(8,899)	(23,859)
<b>Net Cash Provided by Operating Activities</b>	<b>74,089</b>	<b>158,169</b>
<b>Cash Flows from Investing Activities</b>		
Proceeds from Bonds Sold and Matured	445,462	289,802
Proceeds from Preferred Stock Sold and Matured	2,441	16,126
Proceeds from Common Stock Sold	363,364	156,931
Purchases of Bonds	(642,017)	(378,967)
Purchases of Preferred Stock	(9,723)	(14,866)
Purchases of Common Stock	(233,940)	(192,588)
Net Decrease in Securities Payable and Other Liabilities	(1,899)	(12,556)
<b>Net Cash Used in Investing Activities</b>	<b>(76,312)</b>	<b>(136,118)</b>
<b>Cash Flows from Financing Activities</b>		
Proceeds from Capital Contributions	34,519	10,000
Dividends to Shareholders	(11,318)	(12,465)
<b>Net Cash Provided by (Used in) Financing Activities</b>	<b>23,201</b>	<b>(2,465)</b>
<b>Net Increase in Cash and Short-Term Investments</b>	<b>20,978</b>	<b>19,586</b>
<b>Cash and Short-Term Investments at Beginning of Year</b>	<b>20,206</b>	<b>620</b>
<b>Cash and Short-Term Investments at End of Year</b>	<b>\$ 41,184</b>	<b>\$ 20,206</b>

See accompanying notes.

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

December 31, 2008

### 1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying combined statutory–basis financial statements include the combined accounts of NGM Insurance Company (NGM), Main Street America Assurance Company (MSAAC), Old Dominion Insurance Company (ODIC), Main Street America Protection Insurance Company (MSAPIC), all domiciled under Florida State Laws and Regulations, MSA Insurance Company (MSAIC), domiciled under South Carolina Laws and Regulations and Great Lakes Casualty Insurance Company (GLC), domiciled under Michigan Laws and Regulations (collectively referred to as the Group). NGM is a subsidiary of Main Street America Group, Incorporated (MSAG) and MSAG is 94.2% owned by Main Street America Group Mutual Holdings, Incorporated. NGM owns 100% of its subsidiaries.

On October 1, 2008 Main Street America Financial Corporation (MSAFC), a subsidiary of NGM, purchased 100% of the common stock of Great Lakes Casualty Insurance Company. The purchase was accounted for using the statutory purchase method. The purchase price was \$5,977,000 and the amount of goodwill resulting from the acquisition was \$2,181,000. Effective on the date of acquisition the underwriting results began ceding to the Pool.

The Group is primarily involved in the sale of personal and commercial lines of property/casualty insurance. Substantially all net underwriting results are ceded into a pooling arrangement between NGM (NAIC # 14788), ODIC (NAIC # 40231), MSAIC (NAIC # 11066), MSAPIC (NAIC # 13026), MSAAC (NAIC # 29939), and GLC (NAIC # 10787) (the Pool). NGM assumes 100% of the underwriting results of the Pool and all other companies in the Group cede 100% of their net underwriting results to the Pool. The Pool underwrites risks located primarily in New York, Massachusetts, Florida, Connecticut, North Carolina, and Virginia.

The principal lines of business insured by the Group and the percentage of total written premiums for these lines are as follows:

<b>For The Years Ended December 31,</b>	<b>2008</b>	<b>2007</b>
Commercial Multiple Peril (CMP)	31%	32%
Private Passenger Auto	25%	25%
Homeowners	14%	13%
Commercial Automobile	13%	14%

The preparation of financial statements of insurance companies requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future, as more information becomes known, which could impact the amounts reported and disclosed herein.

#### **Basis of Presentation**

The accompanying financial statements of the Group have been prepared in conformity with accounting practices prescribed or permitted by the Florida, Michigan, and South Carolina Insurance Departments. Such practices vary from U.S. generally accepted accounting principles (“GAAP”). The more significant variances from GAAP are as follows:

*Investments:* Investments in bonds and mandatory redeemable preferred stocks are reported at amortized cost or market value based on their National Association of Insurance Commissioners (“NAIC”) rating; for GAAP, such fixed maturity investments would be designated at purchase as held-to-maturity, trading, or available-for-sale. Held-to-maturity fixed investments would be reported at amortized cost, and the remaining fixed maturity investments would be reported at fair value with unrealized holding gains and losses reported in operations for those designated as trading and as a separate component of other comprehensive income, net of the related deferred taxes, for those designated as available-for-sale. Fair value for statutory purposes is based on the price published by the Security Valuation Office of the NAIC (“SVO”) if available, whereas fair value for GAAP is based on quoted market prices.

Investments in real estate are reported net of related obligations rather than on a gross basis as for GAAP. Real estate owned and occupied by the Group is included in investments rather than reported as an operating asset as under GAAP, and investment income and operating expenses for statutory reporting include rent for the Group’s occupancy of those properties.

# NGM Insurance Company and Insurance Subsidiaries

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## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

Embedded derivatives are not accounted for separately from the host contract. Under GAAP, an embedded derivative within a contract that is not clearly and closely related to the economic characteristics and risk of the host contract is accounted for separately from the host contract and valued and reported at fair value. The change in fair value for the embedded derivative is credited or charged directly to income rather than a separate component of shareholders' equity.

*Subsidiaries:* The accounts and operations of the Group's noninsurance subsidiaries are not combined with the accounts and operations of the Group as would be required under GAAP.

*Policy Acquisition Costs:* The costs of acquiring and renewing business are expensed when incurred. Under GAAP, such costs that vary with and are primarily related to the acquisition of new and renewal insurance contracts, to the extent recoverable, would be deferred and amortized over the effective period of the related insurance policies.

*Nonadmitted Assets:* Certain assets designated as "nonadmitted," principally past-due agents' balances, furniture and equipment, taxes, prepaid pension costs, unsecured loans or cash advances to officers or agents, and other assets not specifically identified as an admitted asset within the NAIC Accounting Practices and Procedures Manual, are excluded from the accompanying balance sheets and are charged directly to shareholder's surplus. Under GAAP, such assets are included in the balance sheets.

*Reinsurance:* A liability for reinsurance balances has been provided for unsecured unearned premiums and unpaid losses ceded to reinsurers unauthorized to assume such business and for certain overdue reinsurance balances. Changes to those amounts are credited or charged directly to shareholder's surplus. Under GAAP, an allowance for amounts deemed uncollectible would be established through a charge to earnings.

Reserves for losses and loss adjustment expenses and unearned premiums ceded to reinsurers have been reported as reductions of the related reserves rather than as assets, as would be required under GAAP.

Commissions allowed by reinsurers on business ceded are reported as income when incurred to the extent the amount does not exceed actual acquisition costs, rather than being deferred and amortized with deferred policy acquisition costs, as required under GAAP.

*Employee Benefits:* For purposes of calculating the Group's pension and postretirement benefit obligations, only vested participants and current retirees are included in the valuation. Under GAAP, active participants not currently eligible also would be included.

*Deferred Income Taxes:* Deferred taxes are provided for differences between the tax basis and statutory basis of assets and liabilities. Deferred tax assets are limited to 1) the amount of federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year, plus 2) the lesser of the remaining gross deferred tax assets expected to be realized within one year of the balance sheet date or 10% of capital and surplus excluding any net deferred tax assets, EDP equipment, and operating software, plus 3) the amount of remaining gross deferred tax assets that can be offset against existing gross deferred tax liabilities. The remaining deferred tax assets are nonadmitted. Deferred taxes do not include amounts for state income taxes. Under GAAP, state income taxes are included in the computation of deferred taxes, a deferred tax asset is recorded for the amount of gross deferred tax assets expected to be realized in future years, and a valuation allowance is established for deferred tax assets that may not be realizable. Changes in admitted deferred tax assets are charged directly to shareholder's surplus. Under GAAP, these changes in deferred taxes are charged to income.

*Guaranty Fund and Other Assessments:* A liability for guaranty fund (and other) assessments (net of certain offsets depending on state rules) is accrued after an insolvency has occurred regardless of whether the assessment is based on premiums written before or after the insolvency. Under GAAP, the assessment recognized is typically accrued when premiums are written because the assessment generally is based on prospective premium writings.

*Statements of Cash Flows:* Cash, cash equivalents, and short-term investments in the statements of cash flows represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with initial maturities of three months or less.

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

*Surplus Notes:* Surplus notes represent subordinated debt instruments classified as a component of surplus for statutory accounting purposes. Associated surplus note issuance costs are expensed as incurred. Interest expense on surplus notes is reported as a component of net investment income. Under GAAP, surplus notes are reported as debt, and the associated interest is reported as interest expense. Associated surplus note issuance costs are amortized using the interest method over the period to maturity for GAAP.

A reconciliation of net income and capital and surplus of the Group as determined in accordance with statutory accounting practices to amounts determined in accordance with GAAP is as follows for the years ended December 31, 2008 and 2007:

<i>(In Thousands)</i>	<b>Net Income for the Year Ended December 31, 2008</b>	<b>Capital and Surplus December 31, 2008</b>	<b>Net Income for the Year Ended December 31, 2007</b>	<b>Capital and Surplus December 31, 2007</b>
<b>Statutory-basis amounts</b>	\$ 27,450	\$ 607,491	\$ 83,610	\$ 619,568
Add (deduct) adjustments:				
Policy acquisition costs	1,301	101,204	5,858	99,904
Investments	(14,027)	(54,957)	(6,903)	165
Nonadmitted assets	-	57,747	-	57,317
Deferred income tax	16,578	(5,892)	7,378	(33,455)
Pension liability	(16,160)	(34,359)	(613)	(18,199)
Net (loss)/income of subsidiary	(8,001)	-	5,348	-
Surplus notes	-	(30,000)	-	(30,000)
Other, net	1,684	(2,381)	618	(4,077)
<b>GAAP-basis amounts</b>	<b>\$ 8,825</b>	<b>\$ 638,853</b>	<b>\$ 95,296</b>	<b>\$ 691,223</b>

Other significant accounting practices are as follows:

### Consolidation

The Group's insurance subsidiaries are combined in these financial statements. All significant intercompany transactions have been eliminated. The Group's noninsurance subsidiaries, which have significant ongoing operations other than for the Group and its affiliates, are reported at GAAP equity. The net change in the subsidiaries' equity is included in the change in net unrealized capital gains or losses.

### Investments

Bonds, preferred stocks, common stocks, and short-term investments are stated at values prescribed by the NAIC, as follows:

Bonds not backed by other loans are principally stated at amortized cost using the interest method.

Single class and multi-class mortgage-backed/asset-backed securities are valued at amortized cost using the interest method including anticipated prepayments. Prepayment assumptions are obtained from "The Asset-Backed Securities Group", a third party, and are based on the current interest rate and economic environment. The retrospective adjustment method is used to value all such securities.

Redeemable preferred stocks, which have characteristics of debt securities and are rated as high quality or better, are reported at cost or amortized cost. All other redeemable preferred stocks are reported at the lower of cost, amortized cost, or market value. Nonredeemable preferred stocks are reported at market value or lower of cost or market value as determined by the Securities Valuation Office of the NAIC (SVO), and the related net unrealized capital gains (losses) are reported in shareholder's surplus, along with any adjustment for federal income taxes.

Common stocks are reported at market value as determined by the SVO, and the related net unrealized capital gains (losses) are reported in shareholder's surplus, along with any adjustment for federal income taxes.

There are no restrictions on common or preferred stock.

# NGM Insurance Company and Insurance Subsidiaries

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## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

Short-term investments include investments with remaining maturities of one year or less at the time of acquisition, and are principally stated at amortized cost.

Cash equivalents are short-term highly liquid investments with original maturities of three months or less, and are principally stated at amortized cost.

For repurchase agreements, the Group's policies require a minimum of 102% of the fair value of securities purchased under repurchase agreements to be maintained as collateral. Cash collateral received is invested in short term investments and the offsetting collateral liability is included in miscellaneous liabilities.

Mortgage loans are reported at unpaid principal balances, less allowance for impairment. A mortgage loan is considered to be impaired when, based on current information and events, it is probable that the Group will be unable to collect all principal and interest amounts due according to the contractual terms of the mortgage agreement. When management determines the loan is impaired, the mortgage loan is written down and a realized loss is recognized.

The Group recognized interest expense of \$2,011,000 and \$2,867,000 during the years ended December 31, 2008 and 2007, respectively primarily related to Surplus Notes.

Land is reported at cost. Real estate occupied by the Group and real estate held for the production of income are reported at depreciated cost net of related obligations. Real estate that the Group has the intent to sell is reported at the lower of depreciated cost or fair value, net of related obligations. Depreciation is calculated on a straight-line basis over the estimated useful lives of the properties.

Realized capital gains and losses are determined using the specific identification basis. Changes in admitted asset-carrying amounts of bonds, mortgage loans, common, and nonredeemable preferred stocks are credited or charged directly to shareholder's surplus.

The Group has minor ownership interests in limited partnerships. The Group carries these interests based on their ownership in the underlying GAAP equity of the Investee.

### **Furniture, Equipment, and Software**

The admitted value of the Group's electronic data processing equipment and operating software is limited to three percent of capital and surplus. The admitted portion is reported at cost of \$20,420,000 and \$18,654,000, less accumulated depreciation of \$18,228,000 and \$16,419,000 at December 31, 2008 and 2007, respectively. Electronic data processing equipment and operating software is depreciated using the straight-line method over the lesser of its useful life or three years. Nonoperating software is depreciated using the straight-line method over the lesser of its useful life or five years. Other furniture and equipment is depreciated using the straight-line method over its estimated useful life. Depreciation expense charged to operations in 2008 and 2007 was \$9,196,000 and \$8,171,000, respectively.

### **Premiums**

Premiums are earned pro rata over the terms of the policies. The reserve for unearned premiums is determined on a daily pro rata basis.

### **Loss and Loss Adjustment Expense Reserves**

Loss and loss adjustment expense reserves represent management's best estimate of the ultimate net cost of all reported and unreported losses incurred and unpaid through December 31. The Group does not discount loss and loss adjustment expense reserves, except for certain permanent long-term disability claims related to worker's compensation coverages. The reserves for unpaid losses and loss adjustment expenses are estimated using individual case-basis valuations and statistical analyses. Those estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes the reserves for losses and loss adjustment expenses are adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

Salvage and subrogation recoverables are estimated using the "case basis" method for large recoverables and historical statistics for smaller recoverables. Recoverable amounts deducted from the liability for losses and loss adjustment expense were \$24,925,000 and \$24,483,000 at December 31, 2008 and 2007, respectively.

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

### **Premium Deficiency Reserves**

Premium deficiency reserves are established for the amount of the anticipated losses, loss adjustment expenses, commissions, and other acquisition costs and maintenance costs that have not previously been expensed in excess of the recorded unearned premium reserve, future installment premiums, and anticipated investment income on existing policies. The Company did not have a premium reserve deficiency in 2008 or 2007.

### **Reinsurance**

Prospective reinsurance premiums, losses, and loss adjustment expenses are accounted for on a basis consistent with the basis used in accounting for the original policies issued and the terms of the reinsurance contracts. Letters of credit are required from unauthorized reinsurers adequate to fund ceded unearned premiums, ceded unpaid losses, and related receivables.

### **Reinstatement Premiums**

Reinstatement premiums are recognized when the losses creating the additional premiums are incurred.

### **Permitted Statutory Accounting Practices and Changes in Accounting Practices**

The financial statements of the Group are presented on the basis of accounting practices prescribed or permitted by the Florida, Michigan, and South Carolina Insurance Departments. The Florida, Michigan, and South Carolina Insurance Departments recognize only statutory accounting practices prescribed or permitted by the States of Florida, Michigan, and South Carolina for determining and reporting the financial condition and results of operations of an insurance company and for determining its solvency. The NAIC' Accounting Practices and Procedures manual (NAIC SAP) has been adopted as a component of prescribed or permitted practices by the States of Florida, Michigan, and South Carolina. The States of Florida, Michigan, and South Carolina have not prescribed or permitted accounting practices or procedures for the Group that deviate from NAIC SAP.

## **2. Investments**

The Group used the following methods and assumptions in estimating the "fair value" disclosures for financial instruments in the accompanying financial statements and notes thereto:

*Cash, Cash Equivalents, and Short-Term Investments:* The carrying amounts reported in the accompanying balance sheets for these financial instruments approximate their fair values.

*Investment Securities:* Fair values for fixed maturity securities (including redeemable preferred stock) are based on quoted market prices, where available. For fixed maturity securities not actively traded, fair values are estimated using values obtained from independent pricing services, or, in the case of private placements, are estimated by discounting the expected future cash flows using current market rates applicable to the coupon rate, credit, and maturity of the investments. The fair values for equity securities are based on quoted market prices, where available; for equity securities that are not actively traded, estimated fair values are based on values of issues of comparable yield and quality.

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

The amortized cost and the fair value of investments in bonds are summarized as follows:

(In Thousands)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>At December 31, 2008</b>				
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$ 8,003	\$ 580	\$ -	\$ 8,583
Obligations of states and political subdivisions	536,977	16,803	7,724	546,056
Mortgage-backed securities	415,125	4,447	27,135	392,437
Corporate securities	321,662	2,171	38,166	285,667
<b>Total</b>	<b>\$1,281,767</b>	<b>\$ 24,001</b>	<b>\$ 73,025</b>	<b>\$1,232,743</b>

### At December 31, 2007

U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$ 18,162	\$ 562	\$ 1	\$ 18,723
Obligations of states and political subdivisions	327,369	4,180	807	330,742
Mortgage-backed securities	139,349	954	656	139,647
Corporate securities	601,210	7,851	14,341	594,720
<b>Total</b>	<b>\$1,086,090</b>	<b>\$ 13,547</b>	<b>\$ 15,805</b>	<b>\$1,083,832</b>

At December 31, 2008, the Group held unrated or less-than-investment grade corporate bonds of \$14,357,000, with an aggregate fair value of \$14,357,000. Those holdings amounted to less than 1% of the Group's invested assets. The Group performs periodic evaluations of the relative credit standing of the issuers of these bonds.

The amortized cost of bonds at December 31, 2008 and 2007 has been modified by adjustments of \$(1,243,000) and \$(804,000), respectively, to derive the carrying amount of bonds in the balance sheets.

Equity securities are considered "Other-than-temporarily impaired" if their market values (fair values) are below cost for six consecutive months or if their market values are less than fifty percent of cost. Bond securities are considered "Other-than-temporarily impaired" if management does not have the ability to hold them to maturity, if management has the intent to sell the securities, or if management determines them to be at risk of defaulting. Realized losses on Bonds, Convertible Bonds, Preferred Stock, and Common Stock of \$11,957,000 have been recorded for securities that have experienced an "other-than-temporary" decline in value in 2008. Other-than-temporary impairments recorded in 2007 were \$246,000. These impairments are included in Net Realized Gains/ (Losses) from Investments in the Statement of Operations.

A summary of the amortized cost and fair value of the Group's investments in bonds at December 31, 2008, by contractual maturity, is as follows:

(In Thousands)

	<b>December 31, 2008</b>	
	Amortized Cost	Fair Value
Years to maturity:		
One or less	\$ 30,905	\$ 30,587
After one through five	137,768	134,715
After five through ten	267,957	260,662
After ten	430,012	414,342
Mortgage-backed securities	415,125	392,437
<b>Total</b>	<b>\$ 1,281,767</b>	<b>\$ 1,232,743</b>

The expected maturities in the foregoing table may differ from the contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

The Group did not capitalize interest during the years ended December 31, 2008 and 2007, respectively.

Investments in Low Income Housing Tax Credits have holding periods until 2012. None are subject to adverse regulatory actions, exceed 10% of admitted assets, or require additional capital contributions.

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

Proceeds from the sale of investments in bonds during 2008 and 2007 were \$428,087,000 and \$264,392,000; gross gains of \$10,040,000 and \$7,818,000, and gross losses of \$4,419,000 and \$2,841,000 were realized on those sales, respectively.

Proceeds from the sale of investments in stocks during 2008 and 2007 were \$338,887,000 and \$173,057,000; gross gains of \$46,493,000 and \$25,983,000, and gross losses of \$109,516,000 and \$18,718,000 were realized on those sales, respectively.

At December 31, 2008 bonds with an admitted asset value of \$17,212,000 were on deposit with state insurance departments to satisfy regulatory requirements.

Unrealized gains and losses on investments in preferred and common stocks are reported directly in shareholder's surplus and do not affect operations. The cost, gross unrealized gains and losses, and fair value of those investments are summarized as follows:

*(In Thousands)*

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>At December 31, 2008</b>				
Preferred stocks	\$ 17,852	\$ -	\$ 7,356	\$ 10,496
Common stocks	44,554	2,056	6,881	39,729
Total	\$ 62,406	\$ 2,056	\$ 14,237	\$ 50,225
<b>At December 31, 2007</b>				
Preferred stocks	\$ 14,819	\$ 598	\$ 1,256	\$ 14,161
Common stocks	242,925	45,246	8,456	279,715
Total	\$ 257,744	\$ 45,844	\$ 9,712	\$ 293,876

The following table shows gross unrealized losses and fair value of all investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2008:

*(In Thousands)*

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>Description of Securities</b>						
Obligations of states and political subdivisions	\$ 149,904	\$ 5,592	\$ 21,565	\$ 2,132	\$ 171,469	\$ 7,724
Mortgage-backed securities	113,414	11,678	73,197	15,457	186,611	27,135
Corporate securities	134,403	11,230	83,297	26,936	217,700	38,166
Total debt securities	397,721	28,500	178,059	44,525	575,780	73,025
Preferred stock	5,563	2,260	5,050	5,096	10,613	7,356
Common stock	20,904	6,150	1,417	731	22,321	6,881
Total temporarily impaired securities	\$ 424,188	\$ 36,910	\$ 184,526	\$ 50,352	\$ 608,714	\$ 87,262

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

The following table shows gross unrealized losses and fair value of all investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2007:

<i>(In Thousands)</i> <b>Description of Securities</b>	<b>Less Than 12 Months</b>		<b>12 Months or More</b>		<b>Total</b>	
	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$ -	\$ -	\$ 1,554	\$ 1	\$ 1,554	\$ 1
Obligations of states and political subdivisions	28,697	227	17,051	580	45,748	807
Mortgage-backed securities	24,002	278	30,051	378	54,053	656
Corporate securities	217,186	10,782	107,855	3,559	325,041	14,341
Total debt securities	269,885	11,287	156,511	4,518	426,396	15,805
Preferred stock	8,552	1,256	-	-	8,552	1,256
Common stock	63,920	8,223	906	233	64,826	8,456
Total temporarily impaired securities	<b>\$ 342,357</b>	<b>\$ 20,766</b>	<b>\$ 157,417</b>	<b>\$ 4,751</b>	<b>\$ 499,774</b>	<b>\$ 25,517</b>

The Company considers relevant facts and circumstances in evaluating whether the impairment of the security is other-than-temporary. Relevant facts and circumstances include (1) the length of time the fair value has been below cost; (2) the financial position of the issuer; (3) the Company's ability and intent to hold the security to maturity or until it recovers in value. To the extent the Company determines that a security is deemed to be other-than-temporarily impaired, the difference between amortized cost and fair value would be charged to operations.

With respect to the common stocks, the unrealized losses are due to temporary fluctuations in market values. The Group will continue to examine its portfolio and closely watch the value of these stocks; the Group will record an "other-than-temporary" impairment if the amounts do not recover.

With respect to the bonds, the unrealized losses are principally due to an increase in interest rates since the investments were acquired. These unrealized losses will reverse as these investments near maturity. The Group has the intent and ability to hold these investments until maturity or until fair value recovers above cost or amortized cost.

At December 31, 2008 the lending rate for mortgage loans was 5.6%. At the issuance of a loan, the percentage of any one loan to value of security was 80%. At December 31, 2008 and 2007, the Group held no mortgages with interest overdue beyond 180 days. No amounts were advanced on loans for taxes or assessments. At December 31, 2008 and 2007, no loans were impaired.

The Group's investments in mortgage loans involve commercial real estate. At December 31, 2008, all such mortgages (\$1,614,000) were represented by one property located in New Hampshire. This investment includes a first mortgage lien on this completed income-producing property.

The Group has no investments in restructured loans at December 31, 2008 and 2007.

### 3. Reinsurance

During the normal course of business, the Group places reinsurance with various reinsurance companies and state reinsurance facilities. No material balances are past due or in dispute. Certain premiums and benefits are assumed from and ceded to other insurance companies under various reinsurance agreements. The ceded reinsurance agreements provide the Group with increased capacity to write larger risks and maintain its exposure to loss within its capital resources. The Group remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations.

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

The effects of reinsurance on premiums written and earned are as follows:

<i>(In Thousands)</i>	<b>2008</b>		<b>2007</b>	
	<b>Written</b>	<b>Earned</b>	<b>Written</b>	<b>Earned</b>
Direct premiums	\$ 810,876	\$ 825,645	\$ 851,563	\$ 845,495
Assumed premiums – Nonaffiliates	55,380	49,303	54,793	52,834
Ceded premiums – Nonaffiliates	61,233	62,379	67,158	65,961
Net premiums	<u>\$ 805,023</u>	<u>\$ 812,569</u>	<u>\$ 839,198</u>	<u>\$ 832,368</u>

Amounts payable or recoverable for reinsurance on paid or unpaid losses are not subject to periodic or maximum limits. The Group's ceded reinsurance arrangements reduced certain other items in the accompanying financial statements as follows for the years ending December 31:

<i>(In Thousands)</i>	<b>2008</b>	<b>2007</b>
Losses and loss adjustment expenses	\$ 20,789	\$ 14,170
Loss and loss adjustment expense reserves	\$ 40,204	\$ 38,718
Unearned premium reserves	\$ 9,784	\$ 10,580

At December 31, 2008, no individual reinsurer owed the Group an amount that was equal to or greater than 3% of the Group's surplus.

The net amount of return commissions recoverable (payable) at December 31, 2008, if all assumed and ceded reinsurance treaties were canceled, is summarized as follows:

<i>(In Thousands)</i>	<b>Assumed Reinsurance</b>		<b>Ceded Reinsurance</b>		<b>Net</b>	
	<b>Unearned Premium Reserve</b>	<b>Commission Recoverable/ (Payable)</b>	<b>Unearned Premium Reserve</b>	<b>Commission Recoverable/ (Payable)</b>	<b>Unearned Premium Reserve</b>	<b>Commission Recoverable/ (Payable)</b>
Total Nonaffiliates	\$ 22,692	\$ 6,104	\$ (9,784)	\$ (793)	\$ 12,908	\$ 5,311

In 2008 and 2007, the Group did not commute any ceded reinsurance, nor did it enter into or engage in any loss portfolio transfer for any lines of business.

#### 4. Intercompany Pooling Arrangements

NGM is the lead company in an intercompany pooling arrangement for the Group. NGM assumes 100% of the underwriting results of the Pool and all other companies in the Group cede 100% of their net underwriting results to the Pool.

#### 5. Federal Income Taxes

The Group is included in a consolidated federal income tax return with its ultimate parent company, Main Street America Group Mutual Holdings, Incorporated (MSAGMH) and all of its subsidiaries. The entities included in this consolidated tax return have tax sharing agreements that allocate the consolidated tax provision among the companies. The method of allocation among the companies is subject to the tax sharing agreements, approved by the Board of Directors. Allocations are based upon separate tax return calculations with tax benefits recognized for net losses currently recoverable on a consolidated basis. No amounts were due from the subsidiaries for federal income taxes at December 31, 2008 and 2007. Federal Income taxes receivable were \$9,006,000 and \$5,882,000 at December 31, 2008 and 2007, respectively.

Income before taxes differs from taxable income principally due to differences between statutory and tax reserves, advanced commissions, pension expense, capitalization of policy acquisition costs for tax purposes, and other differences prescribed by the Internal Revenue Code. When determining its consolidated federal income tax expense, the Company uses estimates when actual amounts can not be calculated, which may change when the actual tax return is complete.

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

As of December 31, 2008, the Company has net operating loss carryforwards available of \$5,056,000 that expire in 2025 through 2028, and net capital loss carryforwards of \$18,269,000, that expire in 2013. The operating loss was obtained as part of the Great Lakes Casualty Insurance Company acquisition and is subject to an annual limitation on its use of \$471,000 for the first five years after purchase and \$295,000 thereafter. The amount of federal income taxes incurred that will be available for recoupment in the event of future net losses are \$17,408,000, and \$13,813,000, from 2008, and 2007, respectively.

The components of the net deferred tax asset are as follows:

*(In Thousands)*

	<b>Year Ended December 31</b>		
	<b>2008</b>	<b>2007</b>	<b>Change</b>
Gross deferred tax assets	\$ 73,832	\$ 59,908	\$ 13,924
Gross deferred tax liabilities	8,802	28,664	(19,862)
Net deferred tax asset	<u>65,030</u>	<u>31,244</u>	<u>33,786</u>
Deferred tax assets nonadmitted	20,963	2,260	18,703
Deferred tax assets admitted	<u>\$ 44,067</u>	<u>\$ 28,984</u>	<u>\$ 15,083</u>

The components of gross deferred tax assets and deferred tax liabilities for the year ended December 31 are as follows:

*(In Thousands)*

	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
Deferred tax assets resulting from book/tax differences in:		
Reserves	\$ 19,779	\$ 20,095
Unearned premium	29,245	29,721
Deferred compensation	2,506	3,553
Capital loss carryforward	6,394	-
Investment tax basis greater than book basis	4,058	-
Net unrealized losses	2,970	-
Other deferred assets	8,880	6,539
Total deferred tax assets	<u>\$ 73,832</u>	<u>\$ 59,908</u>
Deferred tax liabilities resulting from book/tax differences in:		
Unrealized capital gains	\$ 805	\$ 22,793
Partnership deferred adjustments	3,212	2,919
Other deferred liabilities	4,785	2,952
Total deferred tax liabilities	<u>\$ 8,802</u>	<u>\$ 28,664</u>

The change in net deferred income taxes is comprised of the following as of December 31:

*(In Thousands)*

	<b>2008</b>	<b>2007</b>	<b>Change</b>
Total gross deferred tax assets	\$ 73,832	\$ 59,908	\$ 13,924
Total gross deferred tax liabilities	<u>8,802</u>	<u>28,664</u>	<u>(19,862)</u>
Net deferred tax assets	<u>\$ 65,030</u>	<u>\$ 31,244</u>	<u>33,786</u>
Tax effected of unrealized			<u>(24,958)</u>
Change in net deferred income taxes			<u>\$ 8,828</u>

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

The Company's provision for federal income taxes incurred is different from that which would be obtained by applying the statutory federal income tax rate of 35% to net gain from operations before taxes. The significant items causing these differences at December 31 are as follows:

<i>(In Thousands)</i>	<b>2008</b>	<b>2007</b>
Statutory Gain Provision computed at statutory rate	\$ 11,629	\$ 38,644
Tax exempt income	(3,852)	(2,444)
Dividends received deductions	(1,216)	(1,175)
Federal historic tax credit	(2,721)	-
Change in non-admitted assets	(6,067)	(8,747)
Gross deferred tax assets of GLC at acquisition	(1,844)	-
Other	1,018	(1,023)
Total incurred Federal income tax expense	<u>\$ (3,053)</u>	<u>\$ 25,255</u>
Federal income taxes incurred	\$ 5,775	\$ 26,801
Change in deferred income taxes	(8,828)	(1,546)
Total statutory taxes	<u>\$ (3,053)</u>	<u>\$ 25,255</u>

### 6. Losses and Loss Adjustment Expenses

The following table provides a reconciliation of the beginning and ending reserve balances for losses and loss adjustment expenses (LAE), net of reinsurance recoverables, for 2008 and 2007:

<i>(In Thousands)</i>	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
Unpaid losses and LAE, at beginning of year	\$ 634,316	\$ 573,188
Add provision for claims, net of reinsurance, occurring in:		
The current year	526,860	536,617
Prior years	(16,833)	(10,774)
Net incurred losses during the current year	<u>510,027</u>	<u>525,843</u>
Deduct payments for claims, net of reinsurance, occurring in:		
The current year	248,155	230,840
Prior years	235,416	233,875
Net claim payments during the current year	<u>483,571</u>	<u>464,715</u>
Unpaid losses and LAE, at end of year	<u>\$ 660,772</u>	<u>\$ 634,316</u>

The Group's liabilities for unpaid losses and LAE, net of related reinsurance recoverables, increased 4.2% during 2008. This increase is a continuation of a pattern of growth due to a gradual shift in our mix of business toward policies with a larger percentage of liability coverage. The growth rate in our unpaid losses and LAE has moderated due to an overall flattening in our policies-in-force growth during the calendar year. Incurred losses related to prior years developed favorably by \$16,833,000 and \$10,774,000 for the years ending December 31, 2008 and 2007 respectively, as a result of actual experience developing more favorably than the Group's initial expectations.

The indemnity portion of reserves for workers' compensation claims have been discounted on a tabular basis using the NCCI Table III-A, at 3.5%. The December 31, 2008 and 2007 loss reserves include \$5,688,000 and \$7,694,000 respectively, of such discounted reserves. The amount of discount for case reserves is \$1,846,000 and \$3,297,000, respectively, and none for IBNR reserves, at December 31, 2008 and 2007, respectively.

The anticipated effect of inflation is implicitly considered in the actuarial methodologies used to estimate our liabilities for losses and LAE. The increase in average severities of claims is caused by a number of factors that vary with the individual type of policy written. Future average severities are projected based on historical trends adjusted for implemented changes in underwriting standards, policy provisions, and general economic trends. Those anticipated trends are monitored based on actual development and are modified if necessary.

The Group has reduced reserves by \$1,788,000 and \$7,300,000 at December 31, 2008 and 2007 respectively, for annuities purchased where the claimant is the payee. The Group is contingently liable for such amounts should the

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

issuers of the annuities fail to perform under the terms of the annuities.

### 7. Asbestos-Related and Environmental Loss Reserve

The Group has minimal exposure to asbestos-related and environmental claims relative to its size due to the nature of the risks it insures. Exposure arises primarily from the Homeowners and CMP Property lines of business and the majority of these claims arise from heating oil spills at residences or places of business. The Group estimates the full impact of the exposure by establishing full case basis reserves on all known losses and computing IBNR based on previous experience. In establishing liabilities for claims for asbestos-related illnesses and for toxic waste cleanup claims, the Group's management considers facts currently known and the current state of the law and coverage litigation. However, given the expansion of coverage and liability by the courts and the legislatures in the past and the possibilities of similar interpretations in the future, there is significant uncertainty regarding the extent of the Group's ultimate liability. Accordingly, a significant amount of additional liability could develop. The Group's environmental related losses (including coverage dispute costs), for years ended December 31, were as follows:

#### Asbestos Loss Reserves

Gross of Reinsurance:

*(In Thousands)*

	2004	2005	2006	2007	2008
Beginning reserves	\$ 720	\$ 507	\$ 523	\$ 502	\$ 406
Incurred losses and LAE	(142)	111	205	30	89
Payments	71	95	226	126	79
Ending reserves	<u>\$ 507</u>	<u>\$ 523</u>	<u>\$ 502</u>	<u>\$ 406</u>	<u>\$ 416</u>

Net of Reinsurance:

*(In Thousands)*

	2004	2005	2006	2007	2008
Beginning reserves	\$ 720	\$ 507	\$ 523	\$ 502	\$ 406
Incurred losses and LAE	(142)	111	205	30	89
Payments	71	95	226	126	79
Ending reserves	<u>\$ 507</u>	<u>\$ 523</u>	<u>\$ 502</u>	<u>\$ 406</u>	<u>\$ 416</u>

At December 31, 2008, the Group held IBNR and LAE reserves related to asbestos coverage in the amount of \$235,000 on a gross and net basis.

#### Environmental Loss Reserves

Gross of Reinsurance:

*(In Thousands)*

	2004	2005	2006	2007	2008
Beginning reserves	\$ 4,263	\$ 3,219	\$ 3,153	\$ 1,993	\$ 2,273
Incurred losses and LAE	(811)	359	(600)	763	160
Payments	233	425	560	483	260
Ending reserves	<u>\$ 3,219</u>	<u>\$ 3,153</u>	<u>\$ 1,993</u>	<u>\$ 2,273</u>	<u>\$ 2,173</u>

Net of Reinsurance:

*(In Thousands)*

	2004	2005	2006	2007	2008
Beginning reserves	\$ 4,263	\$ 3,219	\$ 3,153	\$ 1,993	\$ 2,273
Incurred losses and LAE	(811)	359	(600)	763	160
Payments	233	425	560	483	260
Ending reserves	<u>\$ 3,219</u>	<u>\$ 3,153</u>	<u>\$ 1,993</u>	<u>\$ 2,273</u>	<u>\$ 2,173</u>

At December 31, 2008, the Group held IBNR and LAE reserves related to environmental coverage of \$1,365,000 on a gross and net basis.

### 8. Capital and Surplus

Property/casualty insurance companies are subject to certain Risk-Based Capital (RBC) requirements as specified by the NAIC. Under those requirements, the amount of capital and surplus maintained by a property/casualty insurance company is to be determined based on the various risk factors related to it. At December 31, 2008, the Group meets the RBC requirements.

During 2008 the parent of NGM, MSAG, provided additional paid in capital of \$34,519,000.

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

The payment of dividends by the Group to shareholders is limited and can only be made from earned profits unless prior approval is received from the Insurance Commissioner of the state of domicile. The maximum amount of dividends that may be paid by property-casualty insurance companies without prior approval of the Insurance Commissioner also is subject to restrictions relating to statutory surplus and net income. In 2008, NGM and MSAAC can pay dividends of \$60,749,000 and \$9,839,000 respectively, without the prior approval of the Florida Insurance Commissioner.

The Board of Directors approved a dividend of \$170 million from MSAAC to its parent MSAFC and a dividend of \$130 million from MSAFC to its parent NGM during 2007. Additionally, the board of directors approved dividend payments by NGM to its parent MSAG of \$11,318,000 and \$12,465,000 during 2008 and 2007, respectively.

### 9. Related Party Transactions

The Group shares office facilities and personnel with its subsidiaries. Such shared costs and expenses are allocated to the Group and its subsidiaries based on time and usage studies and those allocations would vary depending on the assumptions underlying those studies. The Group's allocated expenses to uncombined subsidiaries were \$584,000 and \$1,438,000 in 2008 and 2007, respectively. Accounts payable due to uncombined subsidiaries were \$12,484,000 and \$30,686,000 in 2008 and 2007, respectively.

### 10. Leases

The Group leases office space and equipment under lease agreements that expire at various intervals over the next five years and are subject to renewal options at market rates prevailing at the time of renewal. Rental expense for all leases was \$5,556,000 and \$5,216,000 for the years ended 2008 and 2007, respectively.

The Group entered into sale-leaseback transactions with unrelated parties as of December 30, 2008 for the sale of software and fixed assets in the amount of \$20,905,000. The assets were sold at book value and no gains or losses were recognized. The lease terms are for three years; annual lease payments are \$7,562,000. Leased assets may be repurchased for a nominal amount at the end of the lease term.

At December 31, 2008, future minimum payments under noncancellable leases are as follows:

2009	2010	2011	2012	2013	Thereafter	Total
\$ 13,005,000	\$ 12,485,000	\$ 10,815,000	\$ 722,000	\$ 131,000	-	\$ 37,158,000

### 11. Commitments and Contingencies

The Group is named as a defendant in various legal actions arising principally from claims made under insurance policies and contracts. The Group considers these actions when estimating the loss and loss adjustment expense reserves. The Group's management believes the resolution of these actions will not have a material effect on the Group's financial position or results of operations.

The Group has guaranteed a third party loan of \$5,000,000. If this third party defaults on their loan obligations, the Group will be responsible for the balance of the outstanding loan. The Group has not had to, and does not expect to, fund any amounts related to its guarantee.

The Group is assessed amounts by state guaranty funds to cover losses to policyholders of insolvent insurance companies. Those mandatory assessments may be partially recovered through a reduction in future premium taxes in certain states and from recoveries from the estates of insolvent insurance companies. At December 31, 2008 and 2007, the Group has accrued \$925,000 and \$1,015,000, respectively, for guaranty fund assessments. A receivable for future premium tax deductions related to these assessments of \$610,000 and \$912,000 was recorded at December 31, 2008 and 2007, respectively. The period over which the assessments are expected to be paid and the recorded premium tax offsets and/or policy surcharges are expected to be realized is up to 10 years. Expenses incurred for guaranty fund assessments were \$(100,000) and \$653,000 in 2008 and 2007, respectively.

The Group has little exposure to the risks and uncertainties related to the credit crisis.

The Group has a line of credit agreement with Wachovia Bank for \$10,000,000, with an interest rate of LIBOR plus 1.5%; no amount is currently outstanding.

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

### 12. Surplus Notes

The Group has issued the following surplus notes:

Date Issued	Interest Rate at December 31, 2008	Par Value	Carrying Value	Total Principal and/or Interest Paid Current Year	Total Principal and/or Interest Paid Cumulative	Unapproved Principal and/or Interest	Date of Maturity
12/4/2002	6.21%	\$15,000,000	\$15,000,000	\$ 1,131,000	\$ 6,641,000	None	12/4/2032
5/15/2003	6.25%	\$15,000,000	\$15,000,000	\$ 1,137,000	\$ 6,274,000	None	5/15/2033

The interest rate on the 12/4/2002 Surplus Note varies (3-Month LIBOR plus 4%) on a quarterly basis provided, however, that prior to December 4, 2008, the interest rate shall not exceed 12.5%. This Surplus Note was sold for cash to I-Preferred Term Securities I, Ltd., an unaffiliated Company, and is callable at par on or after December 4, 2008.

The interest rate on the 5/15/2003 surplus note varies (3-Month LIBOR plus 4.1%) on a quarterly basis provided, however, that prior to May 15, 2008, the interest rate shall not exceed 12.5%. This surplus note was sold for cash to I-Preferred Term Securities II, Ltd., an unaffiliated Company, and is callable at par on or after May 15, 2008. The Florida Insurance Commissioner must approve in advance, interest, and principal payments on these surplus notes. The payment by the Group of the principal and interest of both surplus notes are subordinated and junior in right of payment to the prior payment in full of all policy claims and senior indebtedness of the Group.

### 13. Transferable State Tax Credits

The carrying value and the amount of unused transferable state tax credits available are as follows:

State	Carrying Value	Unused Credits
Connecticut	\$ 896,000	\$ 1,120,000
Massachusetts	1,275,000	1,459,000
North Carolina	636,000	859,000
South Carolina	273,000	355,000
Virginia	880,000	1,170,000
Total	\$ 3,960,000	\$ 4,963,000

Utilization of tax credits is based on projected State tax liabilities; the Group expects to fully utilize these credits during 2009.

### 14. Employee Benefits

The Group sponsors a noncontributory defined benefit retirement plan, which provides benefits to substantially all employees based upon compensation and length of service. Contributions to the plan are at least equal to the ERISA minimum funding requirements. Plan assets consist primarily of common stock, investment-grade corporate bonds, and U.S. government obligations.

The Group has a Profit Sharing Retirement Plan in which substantially all employees are eligible to participate and a deferred compensation plan for senior management. The Group contributed \$1,951,000 and \$1,921,000 in 2008 and 2007, respectively, to the Profit Sharing Retirement Plan.

Certain health care and life insurance benefits are provided for retired employees. Substantially all employees become eligible for those benefits if they reach age 55, with 15 years of service. Plan benefits terminate at age 65. The cost of postretirement benefits is initially recognized when the employee becomes vested and the remainder is recognized over the employees working life. The health care cost trend was 10.00% during 2008, decreasing to 5.00% in 2013 and future years. The health care cost trend was 8.75% during 2007, decreasing to 4.75% in 2011 and future years.

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

The Group uses a December 31 measurement date for its pension and postretirement benefit plans. The Group expects to make a \$4,000,000 contribution to the defined benefit pension plan in 2009; however, the Group monitors changes in interest rates and the return on pension plan assets and will make adjustments to contributions as needed.

The Groups pension plan weighted-average asset allocations by asset category are as follows:

	<b>Year Ended December 31</b>		
	<b>Target</b>	<b>2008</b>	<b>2007</b>
Equity securities	55% - 65%	54.0%	54.5%
Debt securities	35% - 45%	41.2%	40.7%
Other	0% - 1.5%	4.80%	4.8%
Total		100.0%	100.0%

The expected return on plan assets of 8.5% is based on the Group's allocation of assets of 60% to equities and 40% to bonds, plus or minus 5%, and the 10-year historical returns of the S&P 500 and the U.S. Lehman Aggregate.

Expected benefit payments for years ended December 31, are as follows:

*(In Thousands)*

	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014 through 2018</b>
Pension plan	\$ 6,221	\$ 6,920	\$ 6,707	\$ 7,173	\$ 7,558	\$ 40,692
Postretirement plan	\$ 274	\$ 314	\$ 374	\$ 359	\$ 444	\$ 3,099

Health care cost trend rate assumptions have a significant effect on the amounts reported for health care plans. A 1% change in the assumed health care cost trend rates, for years ended December 31, would have the following effects:

*(In Thousands)*

	<b>Postretirement Benefits</b>			
	<b>1% Increase</b>		<b>1% Decrease</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Effect on the benefit obligation	\$ 92	\$ 86	\$ (87)	\$ (82)
Effect on total of service and interest cost components	\$ 34	\$ 24	\$ (32)	\$ (22)

### **Excess Employee Retirement Plan**

The Group has entered into excess retirement income agreements with certain employees. Benefits under those agreements vest at normal retirement or disability. The Group accrues the liability for each agreement over the period from inception to retirement. The expense for those agreements amounted to \$(323,000) and \$148,000 in 2008 and 2007, respectively. The Projected Benefit Obligation was \$897,000 and the Accumulated Benefit Obligation was \$572,000 as of December 31, 2008. The liability recognized in the statement of financial position as of December 31, 2008 is \$572,000.

# NGM Insurance Company and Insurance Subsidiaries

## NOTES TO COMBINED STATUTORY-BASIS FINANCIAL STATEMENTS

A summary of assets, obligations and assumptions of the Pension and Postretirement Benefit Plans, for years ended December 31, are as follows:

(In Thousands)

	Pension Benefits		Postretirement Benefits	
	2008	2007	2008	2007
<b>Change in Projected Benefit Obligation (PBO):</b>				
PBO at beginning of year	\$ 77,380	\$ 72,341	\$ 2,465	\$ 2,091
Service cost	4,530	4,453	400	272
Interest cost	4,474	4,223	141	120
Plan change	-	2,616	-	-
Actuarial (gain)/loss (excluding assumption change)	(312)	596	83	(136)
Actuarial (gain)/loss (due to assumption change)	(11,087)	(1,575)	(365)	318
Benefits paid to participants	(4,883)	(5,274)	(191)	(200)
PBO at end of year	<u>\$ 70,102</u>	<u>\$ 77,380</u>	<u>\$ 2,533</u>	<u>\$ 2,465</u>
<b>Change in plan assets:</b>				
Fair value of plan assets at beginning of year	\$ 79,661	\$ 73,674	\$ -	\$ -
Actual return on plan assets	(21,887)	5,261	-	-
Employer contribution	12,500	6,000	-	-
Benefits paid	(4,883)	(5,274)	-	-
Fair value of plan assets at end of year	<u>\$ 65,391</u>	<u>\$ 79,661</u>	<u>\$ -</u>	<u>\$ -</u>
<b>Funded status:</b>				
Excess of the PBO over plan assets	\$ (4,711)	\$ 2,281	\$ (2,533)	\$ (2,465)
Unamortized prior service cost	188	231	-	-
Unrecognized net actuarial (gain)/loss	33,566	17,525	(376)	(94)
Prepaid asset/(accrued liability)	<u>\$ 29,043</u>	<u>\$ 20,037</u>	<u>(2,909)</u>	<u>\$ (2,559)</u>
<b>Amount recognized in the financial statements:</b>				
Prepaid asset/(accrued liability)	\$ 29,373	\$ 20,037	\$ (2,533)	\$ (2,396)
Nonadmitted asset	(29,373)	(20,037)	-	-
Net accrued benefit cost	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (2,533)</u>	<u>\$ (2,396)</u>
<b>PBO for non-vested employees</b>	\$ 275	\$ 443	\$ 2,168	\$ 2,512
<b>Accumulated Benefit Obligation (ABO)</b>	\$ 63,763	\$ 70,306	\$ 2,533	\$ 2,465
<b>ABO for nonvested employees</b>	\$ 210	\$ 357	\$ 2,168	\$ 2,512
<b>Weighted-average assumptions used to determine benefit obligations:</b>				
Discount rate	7.75%	6.00%	7.75%	6.00%
Expected return on plan assets	8.50%	8.50%	N/A	N/A
Expected compensation increase (Age Graded Rates)	3% to 6%	3% to 6%	N/A	N/A
<b>Components of net periodic benefit cost:</b>				
Service cost	\$ 4,530	\$ 4,453	\$ 400	\$ 272
Interest cost	4,474	4,223	141	120
Expected return on plan assets	(6,532)	(6,096)	-	-
Amount of recognized losses	978	887	-	(18)
Amount of prior service cost recognized	43	(225)	-	-
Total net periodic benefit cost	<u>\$ 3,493</u>	<u>\$ 3,242</u>	<u>\$ 541</u>	<u>\$ 374</u>
<b>Weighted-average assumptions used to determine net periodic benefit cost:</b>				
Discount rate	6.00%	6.00%	6.00%	6.00%
Expected return on plan assets	8.50%	8.50%	N/A	N/A
Expected compensation increase (Age Graded Rates)	3% to 6%	4.00%	N/A	N/A