Employers Holdings, Inc.
Form 10-Q
November 05, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from ____ to ____
Commission file number: 001-33245

EMPLOYERS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Nevada	**04-3850065**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

10375 Professional Circle, Reno, Nevada 89521
(Address of principal executive offices and zip code)

(888) 682-6671
(Registrant s telephone number, including area code)

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes o No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o

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

Class	October 30, 2009
Common Stock, $0.01 par value per share	44,004,442 shares outstanding

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Employers Holdings, Inc. and Subsidiaries

Consolidated Balance Sheets
(in thousands, except share data)

	As of September 30, 2009	As of December 31, 2008
	(unaudited)	
Assets		
Available for sale:		
Fixed maturity securities at fair value (amortized cost $1,915,852 at September 30, 2009 and $1,870,227 at December 31, 2008)	$ 2,046,116	$ 1,909,391
Equity securities at fair value (cost $40,252 at September 30, 2009 and $43,014 at December 31, 2008)	65,746	58,526
Short-term investments at fair value (amortized cost $2,998 at September 30, 2009 and $74,952 at December 31, 2008)	3,000	75,024
Total investments	2,114,862	2,042,941
Cash and cash equivalents	212,621	202,893
Accrued investment income	22,874	24,201
Premiums receivable, less bad debt allowance of $9,812 at September 30, 2009 and $7,911 at December 31, 2008	129,842	150,502
Reinsurance recoverable for:		
Paid losses	12,841	12,723
Unpaid losses, less allowance of $1,335 at each period	1,045,804	1,075,015
Funds held by or deposited with reinsureds	84,064	88,163
Deferred policy acquisition costs	36,764	41,521
Federal income taxes recoverable	6,312	11,042
Deferred income taxes, net	36,366	80,968
Property and equipment, net	12,509	14,098
Intangible assets, net	16,093	18,218
Goodwill	36,192	36,192
Other assets	22,369	26,621
Total assets	$ 3,789,513	$ 3,825,098
Liabilities and stockholders equity		
Claims and policy liabilities:		
Unpaid losses and loss adjustment expenses	$ 2,443,644	$ 2,506,478
Unearned premiums	174,471	196,695
Policyholders dividends accrued	8,428	8,737
Total claims and policy liabilities	2,626,543	2,711,910
Commissions and premium taxes payable	20,377	21,847
Accounts payable and accrued expenses	17,919	24,192
Deferred reinsurance gain - LPT Agreement	393,204	406,581
Notes payable	182,000	182,000
Other liabilities	24,864	33,840
Total liabilities	$ 3,264,907	$ 3,380,370

See accompanying unaudited notes to consolidated financial statements.

Employers Holdings, Inc. and Subsidiaries

Consolidated Balance Sheets
(in thousands, except share data)

	As of September 30, 2009	As of December 31, 2008
	(unaudited)	
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.01 par value; 150,000,000 shares authorized; 53,563,299 and 53,528,207 shares issued and 44,248,831 and 48,830,140 shares outstanding at September 30, 2009, and December 31, 2008, respectively	536	535
Preferred stock, $0.01 par value; 25,000,000 shares authorized; none issued		
Additional paid-in capital	310,011	306,032
Retained earnings	257,852	194,509
Accumulated other comprehensive income, net	99,774	32,804
Treasury stock, at cost (9,314,468 shares at September 30, 2009 and 4,698,067 shares at December 31, 2008)	(143,567)	(89,152)
Total stockholders equity	524,606	444,728
Total liabilities and stockholders equity	$ 3,789,513	$ 3,825,098

See accompanying unaudited notes to consolidated financial statements.

Employers Holdings, Inc. and Subsidiaries

Consolidated Statements of Income
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
		(unaudited)		
Revenues				
Net premiums earned	$ 98,240	$ 73,131	$ 314,221	$ 222,842
Net investment income	22,334	18,474	68,704	55,915
Realized gains (losses) on investments, net	3,564	(1,504)	1,060	(3,211)
Other income	183	295	388	1,155
Total revenues	124,321	90,396	384,373	276,701
Expenses				
Losses and loss adjustment expenses	53,395	25,588	166,657	80,344
Commission (benefit) expense	(1,276)	10,121	25,611	30,465
Dividends to policyholders	1,539	(8)	5,418	78
Underwriting and other operating expenses	33,688	21,915	102,624	66,536
Interest expense	1,824		5,608	
Total expenses	89,170	57,616	305,918	177,423
Net income before income taxes	35,151	32,780	78,455	99,278
Income tax expense (benefit)	4,594	(289)	6,698	13,349
Net income	$ 30,557	$ 33,069	$ 71,757	$ 85,929
Earnings per common share (Note 15):				
Basic	$ 0.68	$ 0.67	$ 1.54	$ 1.74
Diluted	$ 0.67	$ 0.67	$ 1.53	$ 1.74
Cash dividends declared per common share	$ 0.06	$ 0.06	$ 0.18	$ 0.18
Net realized gains on investments				
Net realized gains on investments before credit related impairments on fixed maturity securities	$ 3,564		$ 2,981	
Total other-than-temporary impairments on securities			(1,921)	
Portion of impairment recognized in other comprehensive income				
Credit related impairments included in net realized losses on investments			(1,921)	
Net realized gains on investments, net	$ 3,564		$ 1,060	

See accompanying unaudited notes to the consolidated financial statements.

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Employers Holdings, Inc. and Subsidiaries

Consolidated Statements of Stockholders Equity
(in thousands, except share data)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net	Treasury Stock, at Cost	Total Stockholders Equity
				(unaudited)			
Balance, January 1, 2008	53,527,907	$ 535	$ 302,862	$ 104,536	$ 46,520	$ (75,000)	$ 379,453
Stock-based compensation (Note 14)			2,459				2,459
Stock options exercised	300		5				5
Acquisition of treasury stock (Note 13)						(14,152)	(14,152)
Dividends to common stockholders			3	(8,881)			(8,878)
Comprehensive income:							
Net income for the period				85,929			85,929
Change in net unrealized gains on investments, net of taxes					(50,208)		(50,208)
Total comprehensive income							35,721
Balance, September 30, 2008	53,528,207	$ 535	$ 305,329	$ 181,584	$ (3,688)	$ (89,152)	$ 394,608
Balance, January 1, 2009	53,528,207	$ 535	$ 306,032	$ 194,509	$ 32,804	$ (89,152)	$ 444,728
Stock-based compensation (Note 14)			4,097				4,097
Vesting of restricted stock units, net of shares withheld to satisfy minimum tax withholding (Note 14)	35,092	1	(124)				(123)
Acquisition of treasury stock (Note 13)						(54,415)	(54,415)
Dividends to common stockholders			6	(8,414)			(8,408)
Comprehensive income:							
Net income for the period				71,757			71,757
Change in net unrealized gains on investments, net of taxes					66,970		66,970
Total comprehensive income							138,727
Balance, September 30, 2009	53,563,299	$ 536	$ 310,011	$ 257,852	$ 99,774	$ (143,567)	$ 524,606

See accompanying unaudited notes to the consolidated financial statements.

Employers Holdings, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
(in thousands)

	Nine Months Ended September 30,	
	2009	**2008**
	(unaudited)	
Operating activities		
Net income	$ 71,757	$ 85,929
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,834	5,334
Stock-based compensation	4,097	2,459
Amortization of premium on investments, net	3,668	4,814
Allowance for doubtful accounts premiums receivable	1,901	(717)
Deferred income tax expense	9,092	6,284
Realized (gains) losses on investments, net	(1,060)	3,211
Realized losses on retirement of assets	64	16
Change in operating assets and liabilities:		
Accrued investment income	1,327	492
Premiums receivable	18,759	14,894
Reinsurance recoverable on paid and unpaid losses	29,093	25,914
Funds held by or deposited with reinsureds	4,099	5,817
Federal income taxes	4,730	(11,744)
Unpaid losses and loss adjustment expenses	(62,834)	(57,310)
Unearned premiums	(22,224)	(7,177)
Accounts payable, accrued expenses and other liabilities	(14,503)	(2,040)
Deferred reinsurance gain LPT Agreement	(13,377)	(13,908)
Other	3,944	(7,073)
Net cash provided by operating activities	46,367	55,195
Investing activities		
Purchase of fixed maturities	(165,906)	(208,730)
Purchase of equity securities	(11,934)	(558)
Proceeds from sale of fixed maturities	56,557	149,487
Proceeds from sale of equity securities	19,475	4,010
Proceeds from maturities and redemptions of investments	131,413	41,462
Cash paid for acquisition, net of cash and cash equivalents acquired	(100)	(1,260)
Capital expenditures and other, net	(4,020)	(4,116)
Net cash provided by (used in) investing activities	25,485	(19,705)
Financing activities		
Acquisition of treasury stock	(53,593)	(14,152)
Cash transactions related to stock compensation	(123)	5
Dividends paid to stockholders	(8,408)	(8,878)
Debt issuance costs		(375)
Proceeds from notes payable		150,000
Net cash (used in) provided by financing activities	(62,124)	126,600
Net increase in cash and cash equivalents	9,728	162,090
Cash and cash equivalents at the beginning of the period	202,893	149,703

Cash and cash equivalents at the end of the period	$ 212,621	$ 311,793

See accompanying unaudited notes to the consolidated financial statements.

Employers Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

Employers Holdings, Inc. (EHI) is a holding company and successor to EIG Mutual Holding Company (EIG), which was incorporated in Nevada in 2005. Unless otherwise indicated, all references to the Company refer to EHI, together with its subsidiaries. On October 31, 2008 (Acquisition Date), the Company acquired 100% of the outstanding common stock of AmCOMP Incorporated (AmCOMP), including two insurance subsidiaries, AmCOMP Preferred Insurance Company and AmCOMP Assurance Corporation (the Acquisition) (Note 3). On December 16, 2008, the Florida Commissioner approved the name changes of AmCOMP Preferred Insurance Company and AmCOMP Assurance Corporation to Employers Preferred Insurance Company (EPIC) and Employers Assurance Company (EAC), respectively.

Through its four wholly-owned insurance subsidiaries, Employers Insurance Company of Nevada (EICN), Employers Compensation Insurance Company (ECIC), EPIC and EAC, EHI is engaged in the commercial property and casualty insurance industry, specializing in workers compensation products and services. EICN, domiciled in Nevada, ECIC, domiciled in California, and EPIC and EAC, both domiciled in Florida, provide insurance to employers against liability for workers compensation claims in 30 states.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation of the Company s consolidated financial position and results of operations for the periods presented have been included. The results of operations for an interim period are not necessarily indicative of the results for an entire year. These financial statements have been prepared consistent with the accounting policies described in the Company s 2008 Annual Report on Form 10-K for the year ended December 31, 2008 (Annual Report), and should be read together with the Annual Report, except for the change in financial presentation described in Note 2.

In accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 208, *Segment Reporting,* the Company considers an operating segment to be any component of its business whose operating results are regularly reviewed by the Company s chief operating decision makers to make decisions about resources to be allocated to the segment and assess its performance based on discrete financial information. Currently, the Company has one operating segment: workers compensation insurance and related services.

Estimates and Assumptions

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. As a result, actual results could differ from these estimates. The most significant areas that require management judgment are the estimate of unpaid losses and loss adjustment expenses (LAE), evaluation of reinsurance recoverables, recognition of premium revenue, deferred policy acquisition costs, deferred income taxes and the valuation of investments.

New Accounting Standards

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162* (SFAS No. 168). SFAS No. 168 establishes the FASB Accounting Standards Codification as the single source of authoritative accounting principles in the preparation of financial statements in conformity with GAAP. SFAS No. 168 explicitly recognizes rules and interpretive releases of the Securities and Exchange Commission (SEC) under federal securities laws as authoritative GAAP for SEC registrants. SFAS No. 168 was effective for financial statements issued for periods ending after September 15, 2009. The Company adopted SFAS No. 168 on July 1, 2009 and it had no material impact on the Company s consolidated financial condition and results of operations.

In April 2009, the FASB issued FSP FAS 115-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-2). FSP FAS 115-2 changes the accounting for other-than-temporary impairments (OTTI) on debt securities by: (a) replacing the current requirement that a holder has the positive intent to hold an impaired debt security to recovery with a requirement that a holder does not have the intent to sell an impaired debt security and it is not more likely than not that it will be required to sell the debt security before recovery; (b) requiring the OTTI to be separated into: (i) the amount representing the decrease in cash flows expected to be collected (credit loss), which is recognized in earnings and (ii) the amount representing all other factors, which is recognized in other comprehensive income; and (c) amending existing disclosure requirements, extending those requirements to interim periods and requiring new disclosures intended to provide further disaggregated information as well as information about how the amount of OTTI that was recognized in earnings was determined. Upon adoption, FSP FAS 115-2 requires entities to report a cumulative effect adjustment as of the beginning of the period of adoption to reclassify the non-credit loss component, previously recognized in earnings, from retained earnings to other comprehensive income. FSP FAS 115-2 was effective for interim and annual periods ending after June 15, 2009 and had no impact on the consolidated financial position or results of operations. The Company has included the required disclosures in Note 5. The guidance for FSP FAS 115-2 may now be found in the new codification as a component of ASC 320-10-35, *Investments Debt and Equity* Securities.

In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Indentifying Transactions That Are Not Orderly* (FSP FAS 157-4). FSP FAS 157-4 provides additional guidance on: (a) estimating fair value when the volume of activity for an asset or liability has significantly decreased in relation to normal market activity for the asset or liability; and (b) identifying circumstances that may indicate that a transaction is not orderly. FSP FAS 157-4 requires additional interim disclosures of the inputs and valuation techniques used to measure fair value. Additionally FSP FAS 157-4 modifies the current fair value disclosure categories for debt and equity securities. FSP FAS 157-4 was effective for interim and annual periods ending after June 15, 2009 and did not have a material impact on the consolidated financial statements. The guidance for FSP FAS 157-4 may now be found in the new codification as a component of ASC 820-10-65-4, *Fair Value Measurements and Disclosures.*

In April 2009, the FASB issued FSP FAS 107-1, *Interim Disclosures About Fair Value of Financial Instruments* (FSP FAS 107-1). FSP FAS 107-1 extends the annual disclosure requirements of SFAS 107, *Fair Value of Financial Instruments,* to interim financial statements of publicly traded companies. FSP FAS 107-1 is effective for interim and annual periods ending after June 15, 2009. The Company has included required disclosures in these Notes to Consolidated Financial Statements. The guidance for FSP FAS 107-1 may now be found in the new codification as a component of ASC 825-10-65-1, *Financial Instruments.*

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*, which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 is effective for periods ending after June 15, 2009. SFAS No. 165 had no impact on our consolidated financial condition or results of operations. The guidance for SFAS No. 165 may now be found in the new codification as a component of ASC 855, *Subsequent Events.*

Reclassifications

Certain prior year information has been reclassified to conform to the current period presentation.

2. Change in Financial Presentation

Insurance companies that write workers compensation policies may recognize written premiums using different methodologies. Premiums can be recorded as written at the time the policy installments are billed (Billed Method) or at the inception of the policy recognizing 100% of the annual premium (Annual Method). EPIC, EAC and EICN record premiums using the Annual Method and ECIC has historically recorded premiums using the Billed Method. During the three months ended September 30, 2009, the Company elected to conform its method of recording written premiums for ECIC to the Annual Method in order to be consistent in methodologies across the Company. Prior period amounts have been reclassified for comparative purposes in these consolidated financial statements.

Conforming the method of recording ECIC s written premiums from the Billed Method to Annual Method has no impact on the accompanying Consolidated Income Statements or Statements of Stockholders Equity. The result of conforming the method impacts only premiums receivable and related unearned premium assets and liabilities, which are recorded as of the date the policy becomes effective. The following items in the Consolidated Balance Sheets were affected by the change:

September 30, 2009	As Computed under Annual Method	As Computed under Billed Method	Effect
Premiums receivable	$ 129,842	$ 75,095	$ 54,747
Deferred policy acquisition costs	36,764	28,145	8,619
Total assets	3,789,513	3,726,147	63,366
Unearned premiums	174,471	121,460	53,011
Total claims and policy liabilities	2,626,543	2,573,532	53,011
Commissions and premium taxes payable	20,377	11,758	8,619
Other liabilities	24,864	23,128	1,736
Total liabilities	3,264,907	3,201,541	63,366
Total liabilities and stockholders equity	3,789,513	3,726,147	63,366
December 31, 2008			
Premiums receivable	$ 150,502	$ 91,273	$ 59,229
Deferred policy acquisition costs	41,521	32,365	9,156
Total assets	3,825,098	3,756,713	68,385
Unearned premiums	196,695	139,310	57,385
Total claims and policy liabilities	2,711,910	2,654,525	57,385
Commissions and premium taxes payable	21,847	12,691	9,156
Other liabilities	33,840	31,996	1,844
Total liabilities	3,380,370	3,311,985	68,385
Total liabilities and stockholders equity	3,825,098	3,756,713	68,385

Conforming the method of recording written premiums had no effect on the retained earnings as of September 30, 2009 or December 31, 2008.

The change had no impact on the net change in cash provided by operating activities, but did impact the following items in the Consolidated Statements of Cash Flows.

September 30, 2009	As Computed under Annual Method	As Computed under Billed Method	Effect
Change in operating assets and liabilities:			
Premiums receivable	$ 18,759	$ 14,277	$ 4,482
Unearned premiums	(22,224)	(17,850)	(4,374)
Accounts payable, accrued expense and other liabilities	(14,503)	(14,395)	(108)
September 30, 2008			
Change in operating assets and liabilities:			
Premiums receivable	$ 14,894	$ 12,507	$ 2,387
Unearned premiums	(7,177)	(4,863)	(2,314)
Accounts payable, accrued expense and other liabilities	(2,040)	(1,967)	(73)

3. Acquisition of AmCOMP

On October 31, 2008, EHI acquired 100% of the outstanding common stock of AmCOMP for $188.4 million. The Company believes the Acquisition significantly advances its strategic goals and vision of being the leader in the property and casualty insurance industry specializing in workers compensation.

Pro forma financial information

Net income for the three and nine months ended September 30, 2009, presented in the accompanying consolidated statements of income, includes the results of AmCOMP. The financial information in the table below summarizes the combined historical results of operations of EHI and AmCOMP, on a pro forma basis, as though the companies had been combined as of January 1, 2008. The pro forma financial information is presented for information purposes only and is not indicative of the results that would have been achieved if the Acquisition had taken place at the beginning of the period presented, nor is the pro forma information intended to be indicative of the Company s future results of operations.

The historical financial information has been adjusted to give effect to pro forma items that are directly attributable to the Acquisition and are expected to have a continuing impact on the consolidated results. These items include adjustments for amortization of intangible assets acquired, increases in interest expense and decreases in underwriting and other expenses for integration and restructuring savings. The following table summarizes the pro forma financial information for the stated periods:

	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2008
	(in thousands, except per share data)	
Net premiums earned	$ 122,321	$ 374,319
Net income	28,212	86,433
Earnings per common share basic	0.58	1.75
Earnings per common share diluted	0.57	1.75

4. Strategic Restructuring Plan

On January 23, 2009, the Company announced a strategic restructuring plan to achieve the corporate and operational objectives set forth as part of its acquisition and integration of AmCOMP, and in response to then current economic conditions.

The restructuring plan included a staff reduction of 14% of the Company s total workforce, and consolidation of corporate activities into the Company s Reno, Nevada headquarters. During the three months ended September 30, 2009, the Company incurred net integration, restructuring and severance charges of $0.6 million. During the nine months ended September 30, 2009, the Company incurred integration and restructuring charges of $4.9 million, including $2.5 million in personnel-related termination costs. These charges are included in underwriting and other operating expense in the consolidated statements of income. As of September 30, 2009, the Company had $0.6 million accrued for future restructuring costs that is included in accounts payable and accrued expenses on the accompanying consolidated balance sheet.

5. Investments

The amortized cost, gross unrealized gains, gross unrealized losses and estimated fair value of the Company s investments were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
At September 30, 2009				
Fixed maturity securities				
U.S. Treasuries	$ 156,549	$ 9,548	$ (72)	$ 166,025
U.S. Agencies	129,101	8,354		137,455
States and municipalities	983,993	69,731	(404)	1,053,320
Corporate	318,774	26,129	(693)	344,210
Residential mortgaged-backed securities	278,169	17,558	(769)	294,958
Commercial mortgaged-backed securities	36,046	616	(296)	36,366
Asset-backed securities	13,220	562		13,782
Total fixed maturity securities	1,915,852	132,498	(2,234)	2,046,116
Short-term investments	2,998	2		3,000
Total fixed maturity and short-term investments	1,918,850	132,500	(2,234)	2,049,116
Equity securities				
Consumer goods	14,739	6,991	(10)	21,720
Energy and utilities	4,715	4,708		9,423
Financial	6,611	2,914	(7)	9,518
Technology and communications	7,930	6,159	(3)	14,086
Industrial and other	6,257	4,743	(1)	10,999
Total equity securities	40,252	25,515	(21)	65,746
Total investments	$ 1,959,102	$ 158,015	$ (2,255)	$ 2,114,862

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
At December 31, 2008				
Fixed maturity securities				
U.S. Treasuries	$ 142,942	$ 18,344	$	$ 161,286
U.S. Agencies	125,302	10,566		135,868
States and municipalities	975,387	21,654	(18,828)	978,213
Corporate	248,002	7,716	(5,570)	250,148
Residential mortgage-backed securities	318,512	12,937	(2,002)	329,447
Commercial mortgage-backed securities	42,384	2	(4,797)	37,589
Asset-backed securities	17,698		(858)	16,840
Total fixed maturity securities	1,870,227	71,219	(32,055)	1,909,391
Short-term investments	74,952	306	(234)	75,024
Total fixed maturity and short-term investments	1,945,179	71,525	(32,289)	1,984,415

Equity securities				
Consumer goods	12,620	4,642	(333)	16,929
Energy and utilities	4,947	4,967	(12)	9,902
Financial	7,082	993	(243)	7,832
Technology and communications	10,268	2,765	(226)	12,807
Industrial and other	8,097	3,165	(206)	11,056
Total equity securities	43,014	16,532	(1,020)	58,526
Total investments	$ 1,988,193	$ 88,057	$ (33,309)	$ 2,042,941

The amortized cost and estimated fair value of fixed maturity securities and short-term investments at September 30, 2009, by contractual maturity are shown below. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
	(in thousands)	
Due in one year or less	$ 118,622	$ 120,839
Due after one year through five years	483,065	514,728
Due after five years through ten years	566,097	613,040
Due after ten years	423,631	455,403
Mortgage and asset-backed securities	327,435	345,106
Total	$ 1,918,850	$ 2,049,116

The following is a summary of investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or greater, in each case as of September 30, 2009 and December 31, 2008:

	September 30, 2009					
	Less Than 12 Months		12 Months or Greater		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Estimated Unrealized Losses
	(in thousands)					
Fixed maturity securities						
U.S. Treasuries	$ 5,697	$ (72)	$	$	$ 5,697	$ (72)
States and municipalities	4,140	(27)	16,124	(377)	20,264	(404)
Corporate	14,577	(33)	12,028	(660)	26,605	(693)
Residential mortgaged-backed	32		4,470	(769)	4,502	(769)
Commercial mortgage-backed securities			7,834	(296)	7,834	(296)
Asset-backed securities						
Total fixed maturity securities	24,446	(132)	40,456	(2,102)	64,902	(2,234)
Short-term investments						
Total fixed maturity and short-term investments	24,446	(132)	40,456	(2,102)	64,902	(2,234)
Equity securities						
Consumer goods	2,329	(10)			2,329	(10)
Energy and utilities						
Financial	1,484	(7)			1,484	(7)
Technology and communications	360	(3)			360	(3)
Industrial and other	320	(1)			320	(1)
Total equity securities	4,493	(21)			4,493	(21)
Total investments	$ 28,939	(153)	$ 40,456	$ (2,102)	$ 69,395	$ (2,255)

	December 31, 2008					
	Less Than 12 Months		12 Months or Greater		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Estimated Unrealized Losses
	(in thousands)					
Fixed maturity securities						
U.S. Treasuries	$	$	$	$	$	$
States and municipalities	271,731	(11,206)	78,811	(7,622)	350,542	(18,828)
Corporate	79,397	(4,215)	6,835	(1,355)	86,232	(5,570)
Residential mortgaged-backed	3,790	(1,711)	2,511	(291)	6,301	(2,002)
Commercial mortgage-backed securities	13,854	(1,875)	23,588	(2,922)	37,442	(4,797)
Asset-backed securities	14,741	(456)	2,098	(402)	16,839	(858)
Total fixed maturity securities	383,513	(19,463)	113,843	(12,592)	497,356	(32,055)
Short-term investments	16,887	(234)			16,887	(234)
Total fixed maturity and short-term investments	400,400	(19,697)	113,843	(12,592)	514,243	(32,289)
Equity securities						
Consumer goods	2,647	(333)			2,647	(333)
Energy and utilities	46	(12)			46	(12)
Financial	1,970	(243)			1,970	(243)
Technology and communications	2,118	(226)			2,118	(226)
Industrial and other	975	(206)			975	(206)
Total equity securities	7,756	(1,020)			7,756	(1,020)
Total investments	$ 408,156	(20,717)	$ 113,843	$ (12,592)	$ 521,999	$ (33,309)

During the three and nine months ended September 30, 2009, based on reviews of the fixed maturity securities included in the tables above, the Company determined that the unrealized losses were primarily a result of the changes in the prevailing interest rates and not the credit quality of the issuers. The fixed maturity securities, for the three and nine months ended September 30, 2009, whose fair value was less than amortized cost were not determined to be other-than-temporarily impaired given the severity and duration of the impairment, the credit quality of the issuers, the Company s intent on not selling the securities and that it is not more likely than not that the Company will be required to sell the securities until fair value recovers above cost, or to maturity. The Company recognized impairments of $1.9 million in the fair value of one fixed maturity security for both the three and nine months ended September 30, 2008. This impairment was primarily the result of the credit downgrade of the issuer.

During the nine months ended September 30, 2009, based on reviews of the equity securities included in the tables above, the Company recognized impairments of $1.9 million in the fair values of 26 securities as a result of the severity and duration of the change in fair value of those securities. The Company did not recognize any impairments during the three months ended September 30, 2009, because the Company determined that the unrealized losses were not considered to be other-than-temporary due to the financial condition and near term prospects of the issuers. During the three and nine months ended September 30, 2008, based on review of the equity securities, the Company recognized impairments of $1.9 million and $3.6 million in the fair values of 33 and 46 equity securities, respectively, as a result of the severity and duration of the change in fair value of those securities. For its other equity securities, the Company determined that the unrealized losses were not considered to be other-than-temporary due to the financial condition and near term prospects of the issuers.

Net realized gains (losses) and the change in fair value over cost or amortized cost on fixed maturity and equity securities are determined on a specific-identification basis and were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in thousands)			
Net realized gains (losses)				
Fixed maturity securities	$	$ (649)	$ (422)	$ (664)
Equity securities	3,564	(855)	1,656	(2,547)
Short-term investments			(174)	
Total	3,564	(1,504)	1,060	(3,211)
Change in fair value over (under) cost or amortized cost				
Fixed maturity securities	64,184	(33,163)	91,100	(54,820)
Equity securities	5,796	(8,711)	9,982	(21,926)
Short-term investments	(111)	(427)	(70)	(498)
Total	$ 69,869	$ (42,301)	$ 101,012	$ (77,244)

Net investment income was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in thousands)			
Fixed maturity securities	$ 22,157	$ 17,221	$ 67,505	$ 52,323
Equity securities	336	461	1,063	1,408
Short-term investments and cash equivalents	433	1,353	2,038	3,860
	22,926	19,035	70,606	57,591
Investment expenses	(592)	(561)	(1,902)	(1,676)
Net investment income	$ 22,334	$ 18,474	$ 68,704	$ 55,915

The Company is required by various state laws and regulations to keep securities or letters of credit on deposit with those states in a depository account. At September 30, 2009 and December 31, 2008, securities having a fair value of $564.2 million and $582.1 million, respectively, were on deposit. These laws and regulations govern not only the amount, but also the type of security that is eligible for deposit and in all cases are restricted or limited to fixed maturity securities. Additionally, certain reinsurance contracts require company funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities assumed by the Company. The fair value of securities held in trust for reinsurance at September 30, 2009 and December 31, 2008 were $6.1 million and $6.7 million, respectively.

6. Fair Value of Financial Instruments

Estimated fair value amounts, defined as the quoted market price of a financial instrument, have been determined using available market information and other appropriate valuation methodologies. However, judgment is required in developing each of the estimates of fair value where quoted market prices are not available. Accordingly, these estimates are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions or estimating methodologies may have an effect on the estimated fair value amounts.

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The estimated fair values of the Company s financial instruments at September 30, 2009, are as follows:

	Carrying Value	Estimated Fair Value
	(in thousands)	
Financial assets		
Investments (Note 5)	$ 2,114,862	$ 2,114,862
Cash and cash equivalents	212,621	212,621
Financial liabilities		
Notes payable (Note 10)	182,000	182,000
Derivatives (Note 11)	2,400	2,400

Other financial instruments qualify as insurance-related products and are specifically exempted from fair value disclosure requirements.

As of December 31, 2008, the carrying value of cash and cash equivalents, notes payable, derivatives and investments equaled the estimated fair value on the accompanying consolidated balance sheet. The Company s estimates of fair value for financial assets and financial liabilities are based on the inputs used in valuation and give the highest priority to quoted prices in active markets. Additionally, it is required that observable inputs be used in the valuations when available. The disclosure of fair value estimates is based on whether the significant inputs into the valuation are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company s significant market assumptions. The three levels of the hierarchy are as follows:

Level 1 Unadjusted quoted market prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2 Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; or valuations based on models where the significant inputs are observable (e.g., interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.

Level 3 Valuations based on models where significant inputs are not observable. The unobservable inputs reflect the Company s own assumptions about the assumptions that market participants would use.

The following methods were used by the Company in estimating the fair value disclosures for financial investments in the accompanying consolidated financial statements and in these notes:

Cash and cash equivalents, premiums receivable, and accrued expenses and other liabilities. The carrying amounts for these financial instruments, as reported in the accompanying consolidated balance sheets, approximate their values.

Notes payable. The Company s notes payable is composed of floating rate long-term debt. Accordingly, the carrying amount is estimated to approximate fair value.

Derivatives. The fair value of the Company s interest rate swap is derived by using an industry standard swap valuation model, with market-based inputs for swaps having similar characteristics (Note 11).

Investments. For investments that have quoted market prices in active markets, the Company uses the quoted market prices as fair value and includes these prices in the amounts disclosed in Level 1 of the hierarchy. When quoted market prices are unavailable, the Company estimates fair value based on objectively verifiable information, if available. The fair value estimates determined by using objectively verifiable information are included in the amount disclosed in Level 2 of the hierarchy. If quoted market prices and an estimate determined by using objectively verifiable information are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or Level 3. The Company bases all of its estimates of fair value for assets on the bid price as it represents what a third party market participant would be willing to pay in an arm s length transaction. The following section describes the valuation methods used by the Company for each type of investment that it holds and is carried at fair value.

Equity securities. The Company utilizes market quotations for equity securities that have quoted prices in active markets.

Fixed maturity securities and short-term investments. The Company s estimates of fair value measurements for these securities are estimated using relevant inputs, including available relevant market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. Additionally, an Option Adjusted Spread model is used to develop prepayment and interest rate scenarios. Industry standard models are used to analyze and value securities with embedded options or prepayment sensitivities.

Each asset class is evaluated based on relevant market information, relevant credit information, perceived market movements and sector news. The market inputs utilized in the pricing evaluation include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. The extent of the use of each market input depends on the asset class and the market conditions. Depending on the security, the priority of the use of inputs may change or some market inputs may not be relevant. For some securities, additional inputs may be necessary.

This method of valuation will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If objectively verifiable information is not available, the Company would be required to produce an estimate of fair value using some of the same methodologies, but would have to make assumptions for market based inputs that are unavailable due to market conditions.

Because the fair value estimates of most fixed maturity securities are determined by evaluations that are based on observable market information rather than market quotes, most estimates of fair value for fixed maturity securities and short term investments are based on estimates using objectively verifiable information and are included in the amount disclosed in Level 2 of the hierarchy. The fair value estimates for determining Level 3 pricing include the Company s assumption about risk assessments and market participant assumptions based on the best information available, including quotes from market makers and other broker/dealers recognized as market participants, using standard or trade derived inputs, new issue data, monthly payment information, cash flow generation, prepayment speeds, spread adjustments and/or rating updates.

The following table presents the items on the accompanying consolidated balance sheet that are stated at fair value and the fair value measurements used (expressed as Levels 1, 2 and 3, respectively) as of September 30, 2009:

	Level 1	Level 2	Level 3
		(in thousands)	
Fixed maturity securities			
U.S. Treasuries	$	$ 166,025	$
U.S. Agencies		137,455	
States and municipalities		1,053,320	
Corporate		344,210	
Residential mortgage-backed securities		294,883	75
Commercial mortgage-backed securities		36,366	
Asset-backed securities		8,632	5,150
Total fixed maturity securities		2,040,891	5,225
Short-term investments		3,000	
Total fixed maturity securities and short-term investments		2,043,891	5,225
Equity securities			
Consumer goods	21,720		
Energy and utilities	9,423		
Financial	9,518		
Technology and communications	14,086		
Industrial and other	10,999		
Total equity securities	$ 65,746	$	$
Derivatives			
Other liabilities		(2,400)	

The following table provides a reconciliation of the beginning and ending balances that are measured using Level 3 inputs for the three months ended September 30, 2009:

	Residential Mortgage-backed Securities	Asset-backed Securities	States and Municipalities
		(in thousands)	
Balance, June 30, 2009	$ 77	$ 5,300	$ 1,128
Transfers in (out) of Level 3			(1,128)
Unrealized gains (losses) in other comprehensive income	6	(150)	
Purchase, settlements and issuances, net	(8)		
Balance, September 30, 2009	$ 75	$ 5,150	$

7. Income Taxes

Income tax expense for interim periods is measured using an estimated effective tax rate for the annual period. During the nine months ended September 30, 2009, the Company recognized net income before taxes of $78.5 million and income tax expense of $6.7 million, an effective tax rate of 8.5%, as compared to the marginal rate of 35%. The lower effective tax rate is primarily attributable to anticipated annualized non-taxable investment income and the non-taxable benefit from the increase in the contingent profit commission on the LPT Agreement (Note 9).

8. Liability for Unpaid Losses and Loss Adjustment Expenses

The following table represents a reconciliation of changes in the liability for unpaid losses and LAE for the nine months ended:

	September 30, 2009	September 30, 2008
	(in thousands)	
Unpaid losses and LAE, gross of reinsurance, at beginning of period	$ 2,506,478	$ 2,269,710
Less reinsurance recoverables, excluding bad debt allowance, on unpaid losses and LAE	1,076,350	1,052,641
Net unpaid losses and LAE at beginning of period	1,430,128	1,217,069
Losses and LAE, net of reinsurance, incurred in:		
Current period	219,627	147,569
Prior periods	(39,593)	(53,317)
Total net losses and LAE incurred during the period	180,034	94,252
Deduct payments for losses and LAE, net of reinsurance, related to:		
Current period	48,166	25,860
Prior periods	165,491	99,240
Total net payments for losses and LAE during the period	213,657	125,100
Ending unpaid losses and LAE, net of reinsurance	1,396,505	1,186,221
Reinsurance recoverable, excluding bad debt allowance, on unpaid losses and LAE	1,047,139	1,026,179
Unpaid losses and LAE, gross of reinsurance, at end of period	$ 2,443,644	$ 2,212,400

Total net losses and LAE included in the above table excludes the impact of the amortization of the deferred reinsurance gain LPT Agreement (Deferred Gain) and any adjustment to the LPT Agreement ceded reserves (Note 9).

The reduction in the liability for unpaid losses and LAE attributable to insured events of prior periods was $39.6 million and $53.3 million for the nine months ended September 30, 2009 and 2008, respectively. The major sources of this favorable development are actual paid losses being less than expected and the impact of new information on selected claim payments and on emergence patterns used in the projection of future loss payments.

9. LPT Agreement

The Company is a party to a 100% quota share retroactive reinsurance agreement (LPT Agreement) under which $1.5 billion in liabilities for losses and LAE related to claims incurred by EICN prior to July 1, 1995 were reinsured for consideration of $775.0 million. The LPT Agreement provides coverage up to $2.0 billion. The initial Deferred Gain resulting from the LPT Agreement was recorded as a liability in the accompanying consolidated balance sheets and is being amortized using the recovery method, whereby the amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries. The Company amortized $4.7 million and $13.4 million of the Deferred Gain for the three and nine months ended September 30, 2009, respectively, and $4.5 million and $13.9 million of the Deferred Gain for the three and nine months ended September 30, 2008, respectively, which is reflected in losses and LAE incurred in the accompanying consolidated statements of income. Any adjustments to the Deferred Gain, as a result of adjustments to the related LPT Agreement reserves, are also recorded in losses and LAE incurred in the accompanying consolidated statements of income. No adjustments occurred in the current periods. The remaining Deferred Gain was $393.2 million and $406.6 million as of September 30, 2009 and December 31, 2008, respectively, which is included in the accompanying Consolidated Balance Sheets as deferred reinsurance gain LPT Agreement.

In addition, the Company is entitled to receive a contingent profit commission under the LPT Agreement. The contingent profit commission is an amount based on the favorable difference between actual paid losses and loss expense and expected paid losses and loss expense as established in the LPT Agreement. The calculation of actual amounts paid versus expected amounts is determined every five years beginning June 30, 2004 for the first twenty-five years of the agreement. The Company is paid 30% of the favorable difference between the actual and expected losses and loss expense paid at each calculation point. Conversely, the Company could be required to return any previously paid contingent profit commission, plus interest, in the event of unfavorable differences.

The Company accrues the estimated ultimate contingent profit commission to be received through June 30, 2024. Increases or decreases in the estimated contingent profit commission are reflected in commission expenses in the period that the estimate is revised. The estimate was revised to increase the ultimate contingent profit commission by $14.1 million, yielding a net negative commission expense for the three months ended September 30, 2009.

10. Notes Payable

Notes payable is comprised of the following as of September 30, 2009 and December 31, 2008 (in thousands):

Amended Credit Facility, due March 26, 2011 with variable interest as described below	$ 150,000
Acquired notes payable:	
Dekania Surplus Note, due April 30, 2034 with variable interest of 425 basis points above 90-day LIBOR	10,000
ICONS Surplus Note, due May 26, 2034 with variable interest of 425 basis points above 90-day LIBOR	12,000
Alesco Surplus Note, due December 15, 2034 with variable interest of 405 basis points above 90-day LIBOR	10,000
Balance, September 30, 2009 and December 31, 2008	$ 182,000

Effective September 30, 2008, EHI and Wells Fargo Bank, National Association (Wells Fargo) entered into a Second Amended and Restated Secured Revolving Credit Facility (Amended Credit Facility). The Amended Credit Facility provides the Company with: (a) a $150.0 million line of credit through December 31, 2009; (b) a $100.0 million line of credit from January 1, 2010 through December 31, 2010; and (c) a $50.0 million line of credit from January 1, 2011 through March 26, 2011. Amounts outstanding bear interest at a rate equal to, at the Company s option: (a) a fluctuating rate of 1.25% above Wells Fargo s prime rate or (b) a fixed rate that is 1.25% above the LIBOR rate then in effect. The Company paid a non-refundable commitment fee of $0.4 million, which is being amortized over the contractual life of the Amended Credit Facility. In addition, the Company is required to pay a quarterly commitment fee equal to a per annum rate of 0.10% on any portion of the Amended Credit Facility that is unused. The Amended Credit Facility contains customary non-financial covenants and requires EHI to maintain $7.5 million of cash and cash equivalents.

On September 30, 2008, EHI borrowed $150.0 million through the Amended Credit Facility. The proceeds borrowed under the Amended Credit Facility were used to finance the acquisition of AmCOMP and for general working capital purposes. The LIBOR rate on the Amended Credit Facility at September 30, 2009 was 0.25% and interest paid during the nine months ended September 30, 2009, including the interest rate swap (Note 11), totaled $4.4 million. The Amended Credit Facility is secured by fixed maturity securities and cash and cash equivalents, which had a fair value of $211.7 million at September 30, 2009.

Notes Payable Acquired in the Acquisition

EPIC has a $10.0 million surplus note outstanding to Dekania CDO II, Ltd., issued as part of a pooled transaction (Dekania Surplus Note). The note matures in 2034 and became callable by the Company in the second quarter of 2009. The terms of the note provide for quarterly interest payments at a rate 425 basis points in excess of the 90-day LIBOR. Both the payment of interest and repayment of the principal under this note, as well as the surplus notes described in the succeeding two paragraphs, are subject to the prior approval of the Florida Department of Financial Services. Interest paid during the three and nine months ended September 30, 2009 totaled $0.1 million and $0.4 million, respectively.

EPIC has a $12.0 million surplus note outstanding to ICONS, Inc., issued as part of a pooled transaction (ICONS Surplus Note). The note matures in 2034 and became callable by the Company in the second quarter of 2009. The terms of the note provide for quarterly interest payments at a rate 425 basis points in excess of the 90-day LIBOR. Interest paid during the three and nine months ended September 30, 2009 totaled $0.1 million and $0.5 million, respectively.

EPIC has a $10.0 million surplus note outstanding to Alesco Preferred Funding V, LTD, issued as part of a pooled transaction (Alesco Surplus Note). The note matures in 2034 and becomes callable by the Company in the fourth quarter of 2009. The terms of the note provide for quarterly interest payments at a rate 405 basis points in excess of the 90-day LIBOR. Interest paid during the three and nine months ending September 30, 2009 totaled $0.1 million and $0.4 million, respectively.

11. Derivatives

Interest Rate Swap

On September 30, 2008, the Company, in connection with the borrowings made under the Amended Credit Facility (Note 10), executed an interest rate swap with Wells Fargo with a notional amount of $100.0 million. Execution of the interest rate swap established a fixed interest rate of 4.84% on the notional amount through September 30, 2010. The Company uses its interest rate swap to mitigate the risks associated with unexpected cash outflows resulting from shifts in variable interest rates. As of September 30, 2009 and December 31, 2008, the interest rate swap had a negative fair value of $2.4 million and $3.9 million, respectively, and is included in other liabilities on the accompanying consolidated balance sheets. The corresponding unrealized losses of $2.4 million and $3.9 million are included in accumulated other comprehensive income, net.

12. Accumulated Other Comprehensive Income

Accumulated other comprehensive income, net, is comprised of unrealized appreciation on investments classified as available-for-sale and unrealized depreciation on interest rate swap, net of deferred tax expense. The following table summarizes the components of accumulated other comprehensive income:

	September 30,	
	2009	2008
	(in thousands)	
Net unrealized gain (loss) on investments, before taxes	$ 155,760	$ (5,674)
Net unrealized loss on interest rate swap, before taxes	(2,400)	
Deferred tax (expense) benefit	(53,586)	1,986
Total accumulated other comprehensive income (loss), net of taxes	$ 99,774	$ (3,688)

The following table summarizes the changes in the components of total comprehensive income for the stated periods:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in thousands)			
Unrealized gains (losses) arising during the period, before taxes	$ 73,757	$ (43,805)	$ 103,540	$ (80,455)
Less: income tax expense (benefit)	25,503	(15,331)	35,881	(28,159)
Unrealized gains (losses) arising during the period, net of taxes	48,254	(28,474)	67,659	(52,296)
Less reclassification adjustment:				
Gains (losses) realized in net income	3,564	(1,504)	1,060	(3,211)
Income tax expense (benefit)	1,247	(526)	371	(1,123)
Reclassification adjustment for gains (losses) realized in net income	2,317	(978)	689	(2,088)
Other comprehensive income (loss)	45,937	(27,496)	66,970	(50,208)
Net income	30,557	33,069	71,757	85,929
Total comprehensive income	$ 76,494	$ 5,573	$ 138,727	$ 35,721

13. Stockholders Equity

Stock Repurchase Program

On February 21, 2008, the EHI Board of Directors authorized a stock repurchase program (the 2008 Program). The 2008 Program authorized the Company to repurchase up to $100.0 million of the Company s common stock through June 30, 2009. On February 25, 2009, the EHI Board of Directors extended the 2008 Program through December 31, 2009. From inception of the 2008 Program through September 30, 2009, the Company repurchased 5,403,196 shares at a cost of $68.6 million, or $12.69 per share. EHI expects that shares may be repurchased from time to time at prevailing market prices in open market or private transactions. There can be no assurance that the Company will continue to undertake any repurchase of its common stock pursuant to the program.

For the three and nine months ended September 30, 2009, 1,547,106 and 4,616,401 shares of common stock were repurchased under the 2008 Program at an average cost of $14.42 and $11.79 per share, respectively. As of September 30, 2009, the 9,314,468 shares of common stock repurchased by the Company since its initial public offering in February 2007 are reported as treasury stock, at cost, in the accompanying consolidated balance sheets. As of September 30, 2009, average cost of common stock repurchased through the Company s stock repurchase programs was $15.41 per share.

14. Stock-Based Compensation

The Amended and Restated Equity and Incentive Plan provides for the grant, in the sole discretion of the Compensation Committee of the Board of Directors, of stock options (including incentive stock options and nonqualified stock options), stock appreciation rights, restricted stock, restricted stock units, stock-based performance awards and other stock-based awards. In the second quarter of 2009 and 2008, nonqualified stock options and restricted stock units were granted. As of September 30, 2009, nonqualified stock options, restricted stock units, and performance share awards have been granted.

Net stock-based compensation expense recognized in the accompanying consolidated statements of income is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in thousands)			
Stock-based compensation related to:				
Nonqualified stock options	$ 488	$ 375	$ 1,291	$ 878
Restricted stock units	426	301	1,047	601
Performance shares	1,146	296	1,759	980
Total	2,060	972	4,097	2,459
Less: related tax benefit	719	333	1,315	851
Net stock-based compensation expense	$ 1,341	$ 639	$ 2,782	$ 1,608

Nonqualified Stock Options

On May 28, 2009, the Company awarded 531,082 options to certain officers of the Company. These options have a service vesting period of four years and vest 25% on May 29, 2010, and 25% on each of the subsequent three anniversaries of such date. The options are subject to accelerated vesting in the following circumstances: death or disability of the holder, or in connection with a change of control of the Company. The options expire seven years from the date of grant. The per share exercise price of these options is equal to the fair value of the stock on the grant date, or $11.84.

The fair value of the stock options granted is estimated using a Black-Scholes option pricing model that uses the assumptions noted in the following table. During the nine months ended September 30, 2009, the expected stock price volatility used to value the options granted in 2009 was based on the volatility of the Company s historical stock price since February of 2007. During the nine months ended September 30, 2008, the expected stock price volatility used to value the options granted in 2008 was based on a weighted average of the Company s historical stock price volatility since February of 2007 and the historical volatility of peer companies stock for a period of time equal to the expected term of the options. The expected term of the options granted in 2009 and 2008 were calculated using the plain-vanilla calculation provided in the guidance of the SEC s Staff Accounting Bulletin No. 107. The dividend yield was calculated using amounts authorized by the Board of Directors. The risk-free interest rate is the yield on the grant date of the options of U.S. Treasury zero coupon securities with a maturity comparable to the expected term of the options.

The fair value of the stock options was calculated using the following weighted average assumptions for the stated periods:

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Expected volatility	51.0%	34.9%
Expected life (in years)	4.8	4.8
Dividend yield	2.0%	1.3%
Risk-free interest rate	2.5%	3.4%
Weighted average grant date fair value of options granted per option	$ 4.59	$ 6.01

Changes in outstanding stock options for the nine months ended September 30, 2009 were as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
			(in years)
Options outstanding at January 1, 2009	1,024,085	$ 18.72	5.9
Granted	531,082	11.84	6.6
Exercised			
Expired	(4,139)	17.84	
Forfeited	(38,113)	18.73	
Options outstanding at September 30, 2009	1,512,915	16.30	5.7
Exercisable at September 30, 2009	410,763	18.46	4.9

Restricted Stock Units

On May 29, 2009, 24,984 restricted stock units (RSUs) awarded to the non-employee members of the Board of Directors during 2008 vested with an intrinsic value of $0.3 million. Five of the Board members elected to defer settlement in common shares and the vested RSUs will be settled in common stock six months following the awardee s termination of service from the Board of Directors. Prior to settlement, dividend equivalents are paid with respect to these vested RSUs and are credited as additional vested RSUs. On March 25, June 3 and September 3, 2009, in connection with the Company s dividends to its stockholders, an additional 136, 182 and 161 RSUs, respectively, were credited to the holders of vested RSUs.

Additionally, on May 29, 2009, 35,874 RSUs, awarded to certain officers of the Company during 2008 vested with an intrinsic value of $0.4 million. Of the 35,874 RSUs vested, 10,151 shares of common stock were withheld to satisfy minimum employee tax withholding.

On May 28, 2009, the Company awarded the non-employee members of the Board of Directors, in the aggregate, 40,536 RSUs. These RSUs vest on May 28, 2010, except for accelerated vesting in the case of death or disability of the Director or in connection with a change of control. Vested RSUs will be settled in common stock within 30 days after the vesting date or can be deferred until nine months following the awardee s termination of service from the Board of Directors, at the awardee s election. In the event of a deferral election, dividend equivalents are paid with respect to vested RSUs and are credited as additional vested RSUs. The aggregate fair value of the RSUs on the date of grant was $0.5 million.

Additionally, on May 28, 2009, the Company awarded 176,871 RSUs to certain officers of the Company. The RSUs have a service vesting period of four years and vest 25% on May 28, 2010 and 25 % on each of the subsequent three anniversaries of such date. The RSUs are subject to accelerated vesting in certain limited circumstances, such as: death or disability of the holder, or in connection with a change of control of the company. The fair value of the RSUs on the date of grant was $2.1 million.

Changes in outstanding RSUs for the nine months ended September 30, 2009 were as follows:

	Number of RSUs	Weighted Average Grant Date Fair Value
RSUs outstanding at January 1, 2009	199,881	$ 18.92
Granted	217,886	11.84
Forfeited	(7,334)	19.21
Vested	(45,243)	19.21
RSUs outstanding at September 30, 2009	365,190	14.66

Vested but unsettled RSUs at September 30, 2009	40,094	17.69

15. Earnings Per Share

Basic earnings per share includes no dilution and is computed by dividing income applicable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of equity. Diluted earnings per common share includes common shares assumed issued under the treasury stock method, which reflects the potential dilution that would have occurred had shares been repurchased from the proceeds of potentially dilutive shares.

The following table presents the net income and the weighted average common shares outstanding used in the earnings per common share calculations for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in thousands, except share and per share data)			
Net income available to common stockholders basic and diluted	$ 30,557	$ 33,069	$ 71,757	$ 85,929
Weighted average number of common shares outstanding basic	45,113,973	49,005,235	46,706,063	49,339,966
Effect of dilutive securities:				
Performance share awards	128,976	66,246	96,111	48,454
Unvested restricted stock units	49,334	3,433	9,577	1,174
Dilutive potential common share	178,310	69,679	105,688	49,628
Weighted average number of common shares outstanding diluted	45,292,283	49,074,914	46,811,751	49,389,594

The Company s outstanding options have been excluded in computing the diluted earnings per share for the three and nine months ended September 30, 2009 and 2008 because their inclusion would be anti-dilutive.

16. Subsequent Events

We have evaluated subsequent events through November 5, 2009, the date which our financial statements have been issued and were available to be issued.

On November 4, 2009, the Board of Directors authorized a share repurchase program for up to $50 million of the Company s common stock. The Company expects that shares may be purchased at prevailing market prices from January 1, 2010 through December 31, 2010 through a variety of methods, including open market or private transactions, in accordance with applicable laws and regulations. The timing and actual number of shares repurchased will depend on a variety of factors, including the share price, corporate and regulatory requirements and other market and economic conditions. Repurchases under the 2010 Stock Repurchase Program may be commenced or suspended from time to time without prior notice, and the program may be suspended or discontinued at any time.

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

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes thereto included in Item 1 of Part I. Unless otherwise indicated, all references to we, us, our, the Company or similar terms refer to Employe Holdings, Inc. (EHI), together with its subsidiaries. The information contained in this quarterly report is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this quarterly report and in our other reports filed with the Securities and Exchange Commission (SEC), including our 2008 Annual Report on Form 10-K for the year ended December 31, 2008 (Annual Report).

The discussion under the heading Risk Factors in our Annual Report, as updated by the discussion in Part II, Item 1A of this quarterly report and similar discussions in our other SEC filings, describe some of the important risk factors that may affect our business, results of operations and financial condition. You should carefully consider those risks in addition to the other information in this report and in our other filings with the SEC before deciding to purchase, hold, or sell our common stock.

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and 21E of the Securities Exchange Act of 1934. You should not place undue reliance on these statements. These forward-looking statements include those related to our expected financial position, business, financing plans, litigation, future premiums, revenues, earnings, pricing, investments, business relationships, expected losses, loss reserves, acquisitions, competition, and rate increases with respect to our business and the insurance industry in general. Statements that include the words expect, intend, plan, believe, project, estimate, may, should, continue, anticipate, will and similar statements of a future or forward-looking nature identify forward-looking statements.

All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause our actual results to differ materially from those indicated in these statements. We believe that these factors include, but are not limited to, the following:

impact of the unprecedented volatility and uncertainty in the financial markets;

adequacy and accuracy of our pricing methodologies;

our dependence on several concentrated geographic areas and on the workers compensation market;

developments in the frequency or severity of claims and loss activity that our underwriting, reserving or investment practices do not anticipate based on historical experience or industry data;

changes in rating agency policies or practices;

negative developments in the workers compensation insurance market;

increased competition on the basis of coverage availability, claims management, safety services, payment terms, premium rates, policy terms, types of insurance offered, overall financial strength, financial ratings and reputation;

changes in the availability, cost or quality of reinsurance and failure of our reinsurers to pay claims timely or at all;

changes in regulations or laws applicable to us, our policyholders or the agencies that sell our insurance;

changes in legal theories of liability under our insurance policies;

changes in general economic conditions, including interest rates, inflation and other factors;

effects of acts of war, terrorism, or natural or man-made catastrophes;

non-receipt of expected payments;

performance of the financial markets and their effects on investment income and the fair values of investments;

failure of our information technology or communication systems;

adverse state and federal judicial decisions;

litigation and government proceedings;

loss of the services of any of our executive officers or other key personnel;

cyclical nature of the insurance industry;

investigations into issues and practices in the insurance industry;

changes in demand for our products;

the operations acquired from AmCOMP Incorporated (AmCOMP) will not be integrated successfully; and

disruption from the AmCOMP transaction making it more difficult to maintain relationships with customers, employees, agents and producers.

The foregoing factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in this report.

These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical or anticipated results, depending on a number of factors. These risks and uncertainties include, but are not limited to, those listed under the heading Risk Factors in our Annual Report, as updated by the discussion in Part II, Item 1A of this quarterly report. All subsequent written and oral forward-looking statements attributable to us or individuals acting on our behalf are expressly qualified in their entirety by these cautionary statements. We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. Before making an investment decision, you should carefully consider all of the factors identified in this report that could cause actual results to differ.

Overview

EHI is a Nevada holding company and is the successor to EIG Mutual Holding Company (EIG), which was incorporated in Nevada in 2005. EHI s principal executive offices are located at 10375 Professional Circle, in Reno, Nevada. Our insurance subsidiaries are:

	State of Domicile
Employers Insurance Company of Nevada (EICN)	Nevada
Employers Compensation Insurance Company (ECIC)	California
Employers Preferred Insurance Company (EPIC)	Florida
Employers Assurance Company (EAC)	Florida

We are a specialty provider of workers compensation insurance focused on select small businesses engaged in low to medium hazard industries. Workers compensation is a statutory system under which an employer is required to provide coverage for its employees medical, disability, vocational rehabilitation and death benefit costs for work-related injuries or illnesses. We distribute our products almost exclusively through independent agents and brokers and through our strategic partnerships and alliances. We operate in a single reportable segment and conduct operations in 30 states. Each of our insurance subsidiaries is rated A- (Excellent) by A.M. Best.

Our strategy has historically been to target businesses located primarily in several western states, with concentrations in California and Nevada. On October 31, 2008, we acquired AmCOMP, which increased our premiums by approximately two-thirds, added nearly 10,000 additional policies, expanded our geographic reach and added a concentration of business in Florida. One percent of our pre-acquisition premiums were written in the states where AmCOMP produced business. We believe this acquisition significantly advances our strategic goals and our vision of being the leader in the property and casualty insurance industry specializing in workers compensation. We also believe the transaction will result in meaningful synergies and expense-related efficiencies.

In January 2009, we began implementation of a strategic restructuring plan to achieve the corporate and operational objectives of the acquisition and integration of AmCOMP, and in response to then current economic conditions. The restructuring plan included net staff reductions of approximately 150 employees, or 14% of our total workforce, and consolidation of corporate functions into our Reno, Nevada headquarters. The restructuring, which consisted of office consolidations, rebranding and staff reductions, was largely completed in the first half of 2009. We are continuing with our integration plan, including consolidation of our claims and underwriting systems, and expect completion in early 2010.

In June 2009, Standard and Poor s added the Company to the S&P SmallCap 600 Index, which we believe is one of the preferred small-capitalization market indices in the United States.

Our results of operations incorporate the acquired operations of AmCOMP from November 1, 2008.

Revenues

We derive our revenues primarily from the following:

Net Premiums Earned. Net premiums earned increased for the nine months ended September 30, 2009, as compared to 2008. The increase was attributable to additional premiums from our newly acquired subsidiaries, EPIC and EAC.

Previously, we have used two accepted methodologies for recording written premiums. Three of our insurance subsidiaries, EPIC, EAC and EICN, have historically recorded written premiums using an annual method, where 100% of the estimated annual premium is recorded at the inception of the policy. ECIC has historically recorded written premiums using a billed method, where premiums are recorded at the time policy installments are billed. On September 1, 2009, we conformed the method of recording written premiums for ECIC to an annual method in order to be consistent across the Company. Conforming the method had no impact on the income statement, equity or net cash flows. The change only affects the balance sheet accounts for premiums receivable and related unearned premium assets and liabilities. The change to written premiums has been applied to all periods presented and did not have a material effect on any periods presented.

Overall, direct premiums written increased 31.2% for the nine months ended September 30, 2009, compared to the same period of 2008, primarily attributable to the acquisition of AmCOMP. Excluding the impact from our newly acquired subsidiaries, direct premiums written would have decreased for the nine months ended September 30, 2009, as compared to 2008. The decrease reflects the impact of price competition, economic contraction and our commitment to disciplined pricing objectives and underwriting guidelines. The economic contraction has disproportionately impacted Nevada and Florida, and we have seen lower estimated payrolls, upon which our premiums are based, and lower numbers of jobs in certain sectors, such as construction and tourism, in those states. These factors have contributed to Nevada falling from our second largest state to fifth largest, in terms of direct premiums written.

California, our largest market, represented 46.8% of our business for the nine months ended September 30, 2009. In California, we reduced our rates 38.5% from January 1, 2006, through December 31, 2008. This compared to the recommendation of the California Commissioner of Insurance (California Commissioner) of a 45.0% rate reduction for the same period. In October 2008, in response to a recommendation by the California Workers Compensation Insurance Rating Bureau (WCIRB) to increase advisory rates by 16.0%, the California Commissioner approved a 5.0% average increase in advisory pure premium rates on new and renewal policies beginning January 1, 2009. Effective February 1, 2009, we increased our overall average rate in California by 10.0% on new and renewal policies.

In April 2009, the WCIRB submitted a revised recommendation to increase advisory pure premium rates 23.7% effective July 1, 2009. The recommendation was based upon two principal components. First, the WCIRB s evaluation of December 31, 2008 loss experience produced an indicated increase in the claims cost benchmark of 16.9%, indicating increased medical costs. Second, a rate increase of 5.8% was directly attributable to additional costs arising from recent Workers Compensation Appeals Board decisions. On July 8, 2009, the California Commissioner rejected the recommendation of the WCIRB and left advisory pure premium rates unchanged. On August 15, 2009, we increased our rates by an average of 10.5% for all new and renewal policies.

In August 2009, the WCIRB made a recommendation to increase advisory pure premium rates approximately 22.8% effective January 1, 2010. The recommendation was based upon two principal components. First, the WCIRB s evaluation of March 31, 2009 loss experience produced an indicated increase in the claims cost benchmark of 16.0%, reflecting increased medical costs. Second, a rate increase of 5.8% was directly attributable to additional costs arising from recent Workers Compensation Appeals Board decisions. The California Commissioner has not issued a decision on the recommendation of the WCIRB as of the date of this filing.

We anticipate filing a rate increase for new and renewal policies in California effective on or after February 15, 2010. The average rate we charge does not necessarily indicate the rate charged to individual policyholders because an insured s experience modification factor is subject to revision annually and our underwriters may increase or decrease rates based upon individual risk characteristics.

We expect that approximately 15% of our business will be generated in administered pricing states, primarily Florida and Wisconsin. In administered pricing states, rate changes are adopted by the respective state s Commissioner of Insurance (Commissioner) who sets the rates that we are allowed to charge in those states.

In 2003, Florida enacted workers compensation reforms. The reforms have resulted in significant declines in claim frequency, an improvement in loss development and a reduction in the cost of claims. As a result, the Florida Commissioner approved an 18.4% rate decrease for all new and renewal policies effective January 1, 2008 and an 18.6% rate decrease for all new and renewal policies effective January 1, 2009.

In February 2009, the Florida Commissioner approved a 6.4% increase in workers compensation rates to be effective April 1, 2009, for new and renewal business. This rate increase was the result of the impact of an October 2008 Florida Supreme Court decision that materially impacted the statutory caps on attorney fees that were part of the 2003 reforms. In June 2009, the Florida Commissioner approved a 6.0% decrease in workers compensation rates effective July 1, 2009, for new and renewal policies and the unexpired portions of outstanding policies with an anniversary date from April 1, 2009 through June 30, 2009. This rate decrease was due to the impact of Florida House Bill 903, which restored the statutory caps on attorney fees, and effectively reversed the April 1, 2009 rate increase.

In August 2009, the National Council on Compensation Insurance (NCCI) recommended a 6.8% overall rate decrease in Florida, effective January 1, 2010, for new and renewal policies. According to the NCCI, this decrease is the result of significant reductions in claims frequency, although the NCCI has noted that the pace of improvement has moderated. The Florida Commissioner approved this rate decrease, making the cumulative rate decrease since the reforms of 2003 63.2%.

In July 2008, the Wisconsin Commissioner approved a 2.9% overall rate increase on new and renewal policies effective October 1, 2008. On May 14, 2009, the Wisconsin Compensation Rating Bureau recommended an overall rate increase of 0.4% for new and renewal policies effective October 1, 2009. On July 29, 2009, the Wisconsin Commissioner approved the recommended increase.

The following table sets forth our direct premiums written by state and as a percentage of total direct premiums written for:

	Three Months Ended September 30,				Nine Months Ended September 30,			
State	2009[(1)]	Percentage of 2009 Total	2008[(1)]	Percentage of 2008 Total	2009[(1)]	Percentage of 2009 Total	2008[(1)]	Percentage of 2008 Total
	(in thousands, except percentages)							
California	$ 42,894	51.2%	$ 57,013	75.5%	$ 142,205	46.8%	$ 172,829	74.7%
Florida	3,087	3.7	(14)		22,121	7.3	298	0.1
Wisconsin	3,487	4.2			18,138	6.0		
Illinois	6,397	7.6	1,014	1.3	16,999	5.6	2,196	0.9
Nevada	4,763	5.7	8,822	11.7	15,713	5.2	30,187	13.0
Texas	3,011	3.6	675	0.9	13,817	4.5	1,275	0.6
Georgia	2,464	2.9			9,273	3.1		
Tennessee	2,547	3.0			9,152	3.0		
Indiana	1,759	2.1			8,783	2.9		
Kentucky	3,240	3.9			7,432	2.4		
Virginia	1,602	1.9			6,211	2.0		
Colorado	1,530	1.8	2,369	3.1	5,216	1.7	8,395	3.6
Other	7,070	8.4	5,642	7.5	28,634	9.5	16,214	7.1
Total	$ 83,851	100.0%	$ 75,521	100.0%	$ 303,694	100.0%	$ 231,394	100.0%

(1) On September 1, 2009, we changed our method of recording ECIC written premiums to an annual method. As a result, the method of calculating 2008 written premiums has been conformed for this change to be comparable to 2009 written premiums. The direct premiums written for all periods presented are calculated assuming written premiums are 100% of the estimated annual premium. Historically, written premiums for ECIC were recorded using a billed method, where premiums were recorded at the time policy installments were billed.

In January 2009, we began writing business in Iowa and currently write business in 30 states and are licensed to write business in six additional states and the District of Colombia.

We market and sell our worker s compensation insurance primarily through independent agents and brokers, and through strategic partnerships and alliances. Our strategic partnerships and alliances generated $53.1 million, or 17.5% of our direct premiums written, for the nine months ended September 30, 2009, as compared to $63.3 million, or 27.4%,

for the same period in 2008. The decrease was primarily attributable to increased overall premium related to the acquisition, as well as $10.2 million lower direct premiums written, period over period.

The number of policies in-force, at the specified dates, was as follows:

States	September 30, 2009	December 31, 2008	September 30, 2008
California	28,144	27,942	27,615
Nevada	4,300	5,221	5,468
Florida	2,749	3,112	149
Texas	1,645	1,747	214
Wisconsin	927	892	
Other	7,083	6,685	2,656
Total	44,848	45,599	36,102

Policy count decreased 1.6% during the first nine months of 2009, with the decreases primarily occurring in Nevada and Florida. Nevada policy count decreased 921, or 17.6%, while Florida policy count decreased 363, or 11.7%. However, we experienced policy count growth in the majority of states, particularly in the Midwest and Southeast, which partially offset the declines in Nevada and Florida. For example, Illinois, Georgia, and Virginia each had a greater than 14% increase in policy count for the nine months ended September 30, 2009. The decline in policies in Florida and Nevada was the result of increased pricing competition and the continuing economic contraction.

During the 12 months ended September 30, 2009, our overall policy count increased by 8,746 policies, or 24.2%, primarily attributable to the acquisition. California continued its policy count growth with an increase of 529, or 1.9%. For the same 12 month period, Nevada s policy count continued its decline, with a decrease of 1,168 or 21.4%.

Premium revenues in 2009 reflect additional premiums from the acquisition, cumulative rate increases of 21.6% in California, the overall net 2009 rate decrease in Florida of 18.6%, rate reductions in several other states, as well as the impacts of competitive pressures and lower payrolls due to the economic contraction. We believe our policy count in the majority of our states will continue to grow, particularly in the Midwest and Southeast where we believe our A- (Excellent) A.M. Best rating will lead to an increase in new business submissions. We emphasize disciplined pricing objectives and underwriting guidelines and we believe we are well positioned to continue to grow profitably. However, we cannot be certain how these trends will ultimately impact our consolidated financial position and results of operations.

Net Investment Income and Realized Gains (Losses) on Investments. We invest our holding company assets, statutory surplus and the funds supporting our insurance liabilities (including unearned premiums and unpaid losses and loss adjustment expenses (LAE)) in cash and cash equivalents, short-term investments, fixed maturity securities and equity securities. Net investment income includes interest and dividends earned on our invested assets and amortization of premiums and discounts on our fixed maturity securities less bank service charges and custodial and portfolio management fees. Realized gains and losses on our investments are reported separately from our net investment income. Realized gains and losses on investments include the gain or loss on a security at the time of sale compared to its original cost (equity securities) or amortized cost (fixed maturity securities). Realized losses are also recognized when securities are written down as a result of an other-than-temporary impairment (OTTI).

We have established a high quality/short duration bias in our investment portfolio, and the high underlying credit quality of our municipal bond holdings helped to mitigate the effects of the deterioration in the financial markets. The performance of our investment portfolio, with its diversified structure and quality bias, has been exceptionally strong and our realized and unrealized losses have been minimal, considering the unprecedented volatility and uncertainty in the financial markets.

Expenses

Our expenses consist of the following:

Losses and Loss Adjustment Expenses (LAE). Losses and LAE represent our largest expense item and include claim payments made, estimates for future claim payments and changes in those estimates for current and prior periods and costs associated with investigating, defending, and adjusting claims. The quality of our financial reporting depends in large part on accurately predicting our losses and LAE, which are inherently uncertain as they are estimates of the ultimate cost of individual claims based on actuarial estimation techniques. In states other than Nevada, we have a short

operating history and must rely on a combination of industry experience and our specific experience to establish our best estimate of losses and LAE reserves. The interpretation of historical data can be impacted by external forces, principally legislative changes, economic fluctuations and legal trends. In recent years, we experienced lower losses and LAE in California than we anticipated due to factors such as regulatory reform designed to reduce loss costs in that market. However, there is uncertainty about whether recent paid loss trends in California will continue. The WCIRB s most recent evaluation of loss experience takes into consideration increasing medical cost. We have established reserves for losses based on our current best estimate of loss costs, taking into consideration of medical cost and incurred loss trends. As we continue to gain experience in markets other than Nevada, we rely more on our own loss experience and place less reliance on industry experience.

Commission Expense. Commission expense includes direct commissions to our agents and brokers for the premiums that they produce for us. Also included in commission expense are incentive payments, other direct marketing costs and fees. Commission expense is net of contingent commission income related to the LPT Agreement. Commissions paid to our agents and brokers are deferred and amortized to commission expense in our consolidated statements of income as the premiums generating these commissions are earned.

We are entitled to receive a contingent profit commission under the LPT Agreement. The contingent profit is an amount based on the favorable difference between actual paid losses and loss expenses and expected paid losses and loss expenses under the LPT Agreement. Loss expenses are deemed to be 7% of total losses paid and are paid to us as compensation for management of the LPT claims. The reinsurers pay us 30% of any favorable difference in actual amounts paid compared to contractually expected amounts to be paid under the agreement. The calculation of the contingent profit commission, which is based on actual amounts paid versus expected amounts is determined every five years beginning June 30, 2004 for the first twenty-five years of the agreement. We are required to return any previously paid contingent profit commission, with interest, through June 30, 2024 in the event of unfavorable differences between actual and expected paid losses and loss expenses.

We estimate ultimate contingent profit commission through June 30, 2024 and record it as commission expense. Increases or decreases in the estimated contingent profit commission are reflected in commission expense in the period that the estimate is revised. For both the three and nine months ended September 30, 2009, we decreased commission expenses by $14.1 million as a result of an increase in contingent profit commissions and received $5.7 million from the reinsurers. Estimated total losses and loss adjustment expenses covered by the LPT, and to be paid through June 30, 2024 were reduced by approximately $40 million from the previous estimate. Pursuant to the LPT Agreement, actual amounts paid for losses under the LPT for the period July 1, 1999 through June 30, 2009, were $467.8 million as compared to contractually expected losses and loss expenses of $550 million.

Dividends to Policyholders. In administered pricing states such as Florida and Wisconsin, insurance rates are set by state insurance regulators. Rate competition generally is not permitted in these states and, consequently, policyholder dividend programs are an important competitive factor. In Florida and Wisconsin, and to a much more limited extent in several of our other states, we offer dividend programs to eligible policyholders under which a portion of the premium paid by a policyholder may be returned in the form of a dividend. Eligibility for these programs varies based upon the nature of the policyholder s operations, expected premium paid, loss experience and existing controls intended to minimize workers compensation claims and costs. An estimated provision for policyholders dividends is accrued as the related premiums are earned. Such dividends do not become a fixed liability until declared by the respective Boards of Directors of our insurance subsidiaries. Additionally, Florida statutes require payment of additional policyholders dividends to Florida policyholders pursuant to a formula based on underwriting results (Florida Dividends). Our ultimate obligation for Florida Dividends is dependent on our filings with the Florida Office of Insurance Regulation and on our prescribed loss reserves included in our annual statutory financial statements.

Underwriting and Other Operating Expenses. Underwriting and other operating expenses includes the costs to acquire and maintain an insurance policy (excluding commissions) consisting of premium taxes and certain other general expenses that vary with, and are primarily related to, producing new or renewal business. These acquisition costs are deferred and amortized to underwriting and other operating expense in the consolidated statements of income as the related premiums are earned. Other underwriting expenses consist of general administrative expenses such as salaries and benefits, rent, office supplies, depreciation and all other operating expenses not otherwise classified separately, and fees and assessments of boards, bureaus and statistical agencies for policy service and administration items such as manuals, rating plans and experience data.

Our underwriting and other operating expense is a reflection of our operating efficiency in producing, underwriting and administering our business. Policy acquisition costs are variable based on premiums earned. However, underwriting and other costs are more fixed in nature and become a larger percentage of net premiums earned as premiums trend lower.

As a result of the restructuring plan, we now anticipate one-time pre-tax expenditures of approximately $7.5 million for 2009 related to the integration of operations acquired from AmCOMP which includes $1.4 million of capitalized costs. Additionally, we expect to achieve pre-tax cost savings of approximately $12.0 million in 2009 and annualized pre-tax cost savings of $20.0 to $22.0 million beginning in 2010. For the nine months ended September 30, 2009, we have incurred one-time pre-tax integration and restructuring charges, not including capitalized costs, of approximately $4.9 million, including $2.5 million of severance benefits.

Interest Expense. We incur interest expenses on $32.0 million in acquired surplus notes and the $150 million Second Amended and Restated Secured Credit Facility (Amended Credit Facility). Interest expense is paid quarterly in arrears on the surplus notes. The expense for each interest payment on the surplus notes is based on the three-month LIBOR rate plus 405 to 425 basis points.

Interest expense is paid quarterly in arrears on the Amended Credit Facility. The interest expense is based on the 30-day LIBOR rate plus 125 basis points. Additionally, we have an interest rate swap agreement on the Amended Credit Facility. Interest paid on the Amended Credit Facility and the interest rate swap was $4.4 million for the nine months ended September 30, 2009.

Results of Operations

Three Months Ended September 30, 2009 and 2008

The following table summarizes our consolidated financial results for the three months ended September 30, 2009 and 2008:

	2009 (4)	2008	Increase (Decrease) 2009 over 2008	Percentage Increase (Decrease) 2009 over 2008
	(in thousands, except for percentages)			
Selected Financial Data				
Gross premiums written(1)	$ 84,842	$ 75,857	$ 8,985	11.8%
Net premiums written(1)	82,790	73,076	9,714	13.3
Net premiums earned	$ 98,240	$ 73,131	$ 25,109	34.3%
Net investment income	22,334	18,474	3,860	20.9
Realized gains (losses) on investments, net	3,564	(1,504)	5,068	n/a
Other income	183	295	(112)	(38.0)
Total revenues	124,321	90,396	33,925	37.5
Losses and LAE	53,395	25,588	27,807	108.7
Commission (benefit) expense	(1,276)	10,121	(11,397)	n/a
Dividends to policyholders	1,539	(8)	1,547	n/a
Underwriting and other operating expenses	33,688	21,915	11,773	53.7
Interest expense	1,824		1,824	n/a
Income tax expense (benefit)	4,594	(289)	4,883	n/a
Total expenses	93,764	57,327	36,437	63.6
Net income	$ 30,557	$ 33,069	$ (2,512)	(7.6)
Selected Operating Data				
Losses and LAE ratio	54.3%	35.0%	19.3%	
Commission expense ratio	(1.3)	13.8	(15.1)	
Dividends to policyholders ratio	1.6		1.6	
Underwriting and other operating expenses ratio	34.3	30.0	4.3	
Combined ratio(2)	88.9	78.8	10.1	
Net income before impact of the deferred reinsurance gain LPT Agreement(3)	$ 25,889	$ 28,520	$ (2,632)	(9.2)

(1) On September 1, 2009, we changed our method of recording ECIC written premiums to an annual method. As a result, the method of calculating 2008 written premiums has been conformed for this change to be comparable to 2009 written premiums. The gross and net premiums written for all periods presented are calculated assuming the written premiums are 100% of the estimated annual premium. Historically, written premiums for ECIC were recorded using a billed method, where premiums were recorded at the time policy installments were billed.

(2) The combined ratio is calculated by dividing the sum of losses and LAE, commission expense, dividends to policyholders and underwriting and other operating expenses by net premiums earned. Because we only have one operating segment, holding company expenses are included in our calculation of the combined ratio.

(3) We define net income before impact of the deferred reinsurance gain LPT Agreement as net income less: (a) amortization of deferred reinsurance gain LPT Agreement and (b) adjustments to LPT Agreement ceded reserves. Deferred reinsurance gain LPT Agreement reflects the unamortized gain from our LPT Agreement. Under GAAP, this gain is deferred and is being amortized using the recovery method, whereby the amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries, and the amortization is reflected in losses and LAE. We periodically reevaluate the remaining direct reserves subject to the LPT Agreement. Our reevaluation results in corresponding adjustments, if needed, to reserves, ceded reserves, reinsurance

recoverables and the deferred reinsurance gain, with the net effect being an increase or decrease, as the case may be, to net income. Net income before impact of the deferred reinsurance gain LPT Agreement is not a measurement of financial performance under GAAP, but rather reflects the difference in accounting treatment between statutory and GAAP, and should not be considered in isolation or as an alternative to net income before income taxes and net income or any other measure of performance derived in accordance with GAAP.

We present net income before impact of the deferred reinsurance gain LPT Agreement because we believe that it is an important supplemental measure of operating performance to be used by analysts, investors and other interested parties in evaluating us. The LPT Agreement was a non-recurring transaction which does not result in ongoing cash benefits, and, consequently, we believe this presentation is useful in providing a meaningful understanding of our operating performance. In addition, we believe this non-GAAP measure, as we have defined it, is helpful to our management in identifying trends in our performance because the excluded item has limited significance in our current and ongoing operations.

The table below shows the reconciliation of net income to net income before impact of the deferred reinsurance gain LPT Agreement for the three months ended:

	September 30,	
	2009	2008
	(in thousands)	
Net income	$ 30,557	$ 33,069
Less impact of the deferred reinsurance gain LPT Agreement	4,668	4,549
Net income before impact of the deferred reinsurance gain LPT Agreement	$ 25,889	$ 28,520

(4) The table below reflects the impact to our results of operations from the acquisition of AmCOMP for the three months ended September 30:

	2009
	(in thousands)
Selected Financial Data	
Gross premiums written	$ 29,700
Net premiums written	29,223
Net premiums earned	$ 39,849
Net investment income	5,235
Realized losses on investments	
Other income	80
Total revenues	45,164
Losses and LAE	28,294
Commission expense	4,115
Dividends to policyholders	1,534
Underwriting and other operating expenses	11,197
Underwriting and other operating expenses integration and restructuring	
Interest expense	394
Income tax benefit	(148)
Total expenses	45,386
Net loss	$ (222)

Net Income

Net income decreased $2.5 million, or 7.6%, for the three months ended September 30, 2009, compared to the same period of 2008. The change in net income was primarily driven by a $27.8 million increase in losses and LAE and a $11.8 million increase in underwriting and other operating expenses, partially offset by a $25.1 million increase in net premiums earned and an $11.4 million decrease in commission expense related to the $14.1 million increase in the LPT contingent profit commission. Net income increased $0.2 million as a result of the acquired operations of AmCOMP. Net income includes amortization of deferred reinsurance gain LPT Agreement of $4.7 million and $4.5 million for the three months ended September 30, 2009 and 2008, respectively. Excluding the impact of the LPT Agreement, net income would have been $25.9 million and $28.5 million for the three months ended September 30, 2009 and 2008, respectively.

Revenues

Net premiums earned increased 34.3% for the three months ended September 30, 2009, compared to the same period of 2008. The increase was attributable to net premiums earned from our newly acquired Florida insurance subsidiaries, EPIC and EAC, which contributed $39.8 million to net premiums earned for the quarter. This increase was partially offset by lower direct premiums written in certain markets, primarily California and Nevada, which had $14.1 million and $4.1 million lower direct premiums written in the third quarter of 2009 compared to the third quarter of 2008, respectively, as a result of rate reductions, competition and impacts of the economic contraction. The acquired operations, particularly in Florida, have also been affected by the economic contraction, as evidenced by lower estimated payrolls, upon which our premiums are based, combined with rate reductions.

Our average in-force policy size increased 13.5% to $9,087 from $8,006, at September 30, 2009 and 2008, respectively. Excluding the impact of the acquisition, our average in-force policy size would have decreased $1,191, or 14.9%, to $6,815 at September 30, 2009, as compared to September 30, 2008, primarily due to declining payrolls.

Net investment income increased 20.9% for the three months ended September 30, 2009. The increase in net investment income was primarily related to the increase in invested assets. Fixed maturity securities acquired in the acquisition accounted for a 25.2% increase in invested assets for the three months ended September 30, 2009, compared to the same period of 2008. The average pre-tax book yield on invested assets decreased to 4.4% at September 30, 2009, as compared to 4.5% at September 30, 2008. The tax equivalent yield on invested assets increased to 5.6% at September 30, 2009, as compared to 5.3% at September 30, 2008.

For the three months ended September 30, 2009, realized gains on investments were $3.6 million, compared to realized losses of $1.5 for the same period of 2008. The realized gains are attributable to the sale of previously impaired equity securities. The realized losses for the three months ended September 30, 2008 were the result of other-than-temporary impairments on equity securities and one fixed maturity security of $3.8 million, which were partially offset by gains of $2.3 million realized on the sale of equity securities in 2008.

Expenses

Losses and LAE increased $27.8 million, for the three months ended September 30, 2009, compared to the three months ended September 30, 2008, primarily as a result of the acquisition. Excluding the impact of the acquisition, losses and LAE would have decreased 1.9%, attributable to a decrease in earned premium. The quarter over prior year quarter change in overall net premiums earned reduced losses and LAE by approximately $18.9 million. Losses and LAE were 54.3% and 35.0% of net premiums earned for the three months ended September 30, 2009 and 2008, respectively. Additionally, our current accident year loss estimates were 69.7% and 75.4% for the three months ended September 30, 2009 and 2008, respectively. During the third quarter of 2009, favorable prior accident year loss development decreased $14.6 million, to $10.4 million, compared to the third quarter of 2008.

The table below reflects the losses and LAE reserve adjustments for the three months ended:

	September 30,	
	2009	2008
	(in millions)	
Prior accident year favorable development, net	$ 10.4	$ 25.0
LPT amortization of the deferred reinsurance gain	$ 4.7	$ 4.5
LPT reserve favorable change	$	$

There was no adjustment to the direct reserves subject to the LPT Agreement in either period. Excluding the impact from the LPT Agreement, losses and LAE would have been $58.1 million and $30.1 million, or 59.1% and 41.2%, of net premiums earned for the three months ended September 30, 2009 and 2008, respectively.

Commission expense decreased $11.4 million, for the three months ended September 30, 2009, compared to the three months ended September 30, 2008, resulting in a negative commission expense for the quarter of $1.3 million. The change is primarily attributable to a $14.1 million increase in the accrual for the LPT contingent profit commission, partially offset by the increased commission expense attributable to the acquisition. Excluding the impact of the LPT contingent profit commission, commission expense would have been 13.0% and 13.8% of net premiums earned for the three months ended September 30, 2009 and 2008, respectively. Excluding the impact of the acquisition and the LPT contingent profit commission, our commission expense would have decreased approximately $1.4 million, or 13.8%, primarily attributable to a decrease in net premiums earned.

Dividends to policyholders increased $1.5 million for the three months ended September 30, 2009, directly attributable to the acquired operations of AmCOMP, particularly the policyholders dividend plans in Florida and Wisconsin, which are administered pricing states.

Underwriting and other operating expenses increased 53.7% for the three months ended September 30, 2009, as compared to the same period of 2008. The increase was primarily related to the acquired operations of AmCOMP. The acquired operations contributed $11.2 million to our underwriting expenses for the third quarter of 2009. Excluding the impact of the acquisition and one-time integration and restructuring charges, our underwriting and other operating expenses would have remained flat. In 2008, there was a $1.6 million decrease in the allowance for bad debts. During the three months ended September 30, 2009, we incurred net one-time integration and restructuring charges of $0.6 million.

Interest expense increased $1.8 million for the three months ended September 30, 2009. We first incurred debt on September 30, 2008. For the quarter ended September 30, 2008, we had no debt or related interest expense.

Income taxes increased $4.9 million for the third quarter of 2009 compared to the third quarter 2008. The increase was primarily due to a tax benefit in the three months ended September 30, 2008, related to the final reversal of the liability for previously unrecognized tax benefits of $10.6 million, including interest. The effective tax rate for the three months ended September 30, 2009, was 13.1%, as compared to a tax benefit rate of 0.9%, for the same period of 2008.

Combined Ratio

The combined ratio increased 10.1 percentage points for the three months ended September 30, 2009, to 88.9%, compared to 78.8% for the three months ended September 30, 2008. The acquired operations of AmCOMP resulted in an increase in the combined ratio of 16.6 percentage points. Excluding the impact of the acquired operations, the net improvement in the combined ratio was attributable to the increase in the LPT contingent profit commission, partially offset by the decrease in the prior accident year loss development.

Results of Operations

Nine Months Ended September 30, 2009 and 2008

The following table summarizes our consolidated financial results for the nine months ended September 30, 2009 and 2008:

	2009 [4]	2008	Increase (Decrease) 2009 over 2008	Percentage Increase (Decrease) 2009 over 2008
	(in thousands, except for percentages)			
Selected Financial Data				
Gross premiums written[1]	$ 306,270	$ 232,431	$ 73,839	31.8%
Net premiums written[1]	298,159	224,317	73,842	32.9
Net premiums earned	$ 314,221	$ 222,842	$ 91,379	41.0%
Net investment income	68,704	55,915	12,789	22.9
Realized gains (losses) on investments, net	1,060	(3,211)	4,271	n/a
Other income	388	1,155	(767)	(66.4)
Total revenues	384,373	276,701	107,672	38.9
Losses and LAE	166,657	80,344	86,313	107.4
Commission (benefit) expense	25,611	30,465	(4,854)	(15.9)
Dividends to policyholders	5,418	78	5,340	n/a
Underwriting and other operating expenses	102,624	66,536	36,088	54.2
Interest expense	5,608		5,608	n/a
Income tax expense	6,698	13,349	(6,651)	(49.8)
Total expenses	312,616	190,772	121,844	63.9
Net income	$ 71,757	$ 85,929	$ (14,172)	(16.5)
Selected Operating Data				
Losses and LAE ratio	53.0%	36.0%	17.0%	
Commission expense ratio	8.2	13.7	(5.5)	
Dividends to policyholders ratio	1.7		n/a	
Underwriting and other operating expenses ratio	32.7	29.9	2.8	
Combined ratio[2]	95.6	79.6	16.0	
Net income before impact of the deferred reinsurance gain LPT Agreement[3]	$ 58,380	$ 72,021	$ (13,641)	(18.9)

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(1) On September 1, 2009, we changed our method of recording ECIC written premiums to an annual method. As a result, the method of calculating 2008 written premiums has been conformed for this change to be comparable to 2009 written premiums. The gross and net premiums written for all periods presented are calculated assuming the written premiums are 100% of the estimated annual premium. Historically, written premiums for ECIC were recorded using a billed method, where premiums were recorded at the time policy installments were billed.

(2) The combined ratio is calculated by dividing the sum of losses and LAE, commission expense, dividends to policyholders and underwriting and other operating expenses by net premiums earned. Because we only have one operating segment, holding company expenses are included in our calculation of the combined ratio.

(3) We define net income before impact of the deferred reinsurance gain LPT Agreement as net income less: (a) amortization of deferred reinsurance gain LPT Agreement and (b) adjustments to LPT Agreement ceded reserves. Deferred reinsurance gain LPT Agreement reflects the unamortized gain from our LPT Agreement. Under GAAP, this gain is deferred and is being amortized using the recovery method, whereby the amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries, and the amortization is reflected in losses and LAE. We periodically reevaluate the remaining direct reserves subject to the LPT Agreement. Our reevaluation results in corresponding adjustments, if needed, to reserves, ceded reserves, reinsurance

recoverables and the deferred reinsurance gain, with the net effect being an increase or decrease, as the case may be, to net income. Net income before impact of the deferred reinsurance gain LPT Agreement is not a measurement of financial performance under GAAP, but rather reflects the difference in accounting treatment between statutory and GAAP, and should not be considered in isolation or as an alternative to net income before income taxes and net income or any other measure of performance derived in accordance with GAAP.

We present net income before impact of the deferred reinsurance gain LPT Agreement because we believe that it is an important supplemental measure of operating performance to be used by analysts, investors and other interested parties in evaluating us. The LPT

Agreement was a non-recurring transaction which does not result in ongoing cash benefits, and, consequently, we believe this presentation is useful in providing a meaningful understanding of our operating performance. In addition, we believe this non-GAAP measure, as we have defined it, is helpful to our management in identifying trends in our performance because the excluded item has limited significance in our current and ongoing operations.

The table below shows the reconciliation of net income to net income before impact of the deferred reinsurance gain LPT Agreement for the nine months ended:

	September 30,	
	2009	2008
	(in thousands)	
Net income	$ 71,757	$ 85,929
Less impact of the deferred reinsurance gain LPT Agreement	13,377	13,908
Net income before impact of the deferred reinsurance gain LPT Agreement	$ 58,380	$ 72,021

(4) The table below reflects the impact to our results of operations from the acquisition of AmCOMP for the nine months ended September 30:

	2009
	(in thousands)
Selected Financial Data	
Gross premiums written	$ 123,038
Net premiums written	119,948
Net premiums earned	$ 128,422
Net investment income	15,958
Realized losses on investments	(155)
Other income	74
Total revenues	144,299
Losses and LAE	92,194
Commission expense	13,012
Dividends to policyholders	5,402
Underwriting and other operating expenses	35,201
Underwriting and other operating expenses integration and restructuring	1,747
Interest expense	1,315
Income tax benefit	(2,283)
Total expenses	146,588
Net loss	$ (2,289)

Net Income

Net income decreased $14.2 million, or 16.5%, for the nine months ended September 30, 2009, compared to the same period of 2008. The change in net income was primarily driven by an $86.3 million increase in losses and LAE and a $36.1 million increase in underwriting and other operating expenses, partially offset by a $91.4 million increase in net premiums earned. Net income decreased $2.3 million as a result of the acquired operations of AmCOMP. Net income includes amortization of deferred reinsurance gain LPT Agreement of $13.4 million and $13.9 million for the nine months ended September 30, 2009 and 2008, respectively. Excluding the impact of the LPT Agreement, net income would have been $58.4 million and $72.0 million for the nine months ended September 30, 2009 and 2008, respectively.

Revenues

Net premiums earned increased 41.0% for the nine months ended September 30, 2009, compared to the same period of 2008. The increase was primarily attributable to net premiums earned from our newly acquired Florida insurance subsidiaries, EPIC and EAC, which contributed $128.4 million to net premiums earned for the nine months ended September 30, 2009. This increase was partially offset by lower direct premiums written in certain markets, primarily California and Nevada, which had $30.6 million and $14.5 million lower direct premiums written in the first nine months of 2009 compared to the same period of 2008, respectively, as a result of rate reductions, competition and impacts of the economic contraction. The acquired operations, particularly in Florida, have also been affected by economic contraction, as indicated by lower estimated payrolls, upon which our premiums are based, combined with rate reductions.

Our average in-force policy size increased 13.5% to $9,087 from $8,006, at September 30, 2009 and 2008, respectively. Excluding the impact of the acquisition, our average in-force policy size would have decreased $1,191, or 14.9%, to $6,815 at September 30, 2009, as compared to September 30, 2008, primarily due to declining payrolls.

Net investment income increased 22.9% for the nine months ended September 30, 2009. The increase in net investment income was related to the increase in invested assets. Fixed maturity securities acquired from the acquisition accounted for a 25.2% increase in invested assets for the nine months ended September 30, 2009, compared to the same period of 2008. The average pre-tax book yield on invested assets remained constant at 4.6% at September 30, 2009, as compared to the same period 2008. The tax equivalent yield on invested assets increased to 5.6% at September 30, 2009, as compared to 5.3% at September 30, 2008. This was primarily due to the increase in the duration of our fixed maturity securities.

For the nine months ended September 30, 2009, realized gains on investments were $1.1 million, compared to realized losses of $3.2 for the same period of 2008. The realized gains are attributable to the sale of previously impaired equity securities. Realized gains for the first nine months of 2009 were partially offset by the other-than-temporary impairments in the first two quarters of 2009, totaling $1.9 million. The realized losses for the nine months ended September 2008 were the result of other-than-temporary impairments of $5.5 million on one fixed maturity and equity securities in our investment portfolio, which were partially offset by realized gains of $2.3 million on the sale of equity securities.

Expenses

Losses and LAE increased $86.3 million for the nine months ended September 30, 2009, compared to the nine months ended September 30, 2008, primarily as a result of the acquisition. Excluding the impact of the acquisition, losses and LAE would have decreased 7.3%, attributable to the decrease in earned premium. The change in overall net premiums earned reduced losses and LAE by approximately $60.5 million. Losses and LAE were 53.0% and 36.0% of net premiums earned for the nine months ended September 30, 2009 and 2008, respectively. During the nine months ended September 30, 2009, favorable prior accident year loss development decreased $13.7 million, to $39.6 million, compared to the same period of 2008. Additionally, our current accident year loss estimates were 69.9% and 66.2% for the nine months ended September 30, 2009 and 2008, respectively.

The table below reflects the losses and LAE reserve adjustments for the nine months ended:

	September 30,	
	2009	2008
	(in millions)	
Prior accident year favorable development, net	$ 39.6	$ 53.3
LPT amortization of the deferred reinsurance gain	$ 13.4	$ 13.9
LPT reserve favorable change	$	$

There was no adjustment to the direct reserves subject to the LPT Agreement in either period. Excluding the impact from the LPT Agreement, losses and LAE would have been $180.0 million and $94.2 million, or 57.3% and 42.3%, of net premiums earned for the nine months ended September 30, 2009 and 2008, respectively.

Commission expense decreased $4.9 million or 15.9%, for the nine months ended September 30, 2009, compared to the nine months ended September 30, 2008. The decrease is primarily attributable to a $14.1 million increase in the LPT contingent profit commission, partially offset by increased commission expense attributable to the acquisition. Excluding the impact of the LPT contingent profit commission, commission expense would have been 12.6% and 13.7% of net premiums earned for the nine months ended September 30, 2009 and 2008, respectively. Excluding the impact of the acquisition and the LPT contingent profit commission, our commission expense would have decreased approximately $3.8 million, or 12.4%, primarily attributable to a decrease in net premiums earned.

Dividends to policyholders increased $5.4 million for the nine months ended September 30, 2009, directly related to the acquired operations of AmCOMP, particularly the policyholders dividend plans in Florida and Wisconsin, which are administered pricing states.

Underwriting and other operating expenses increased 54.2% for the nine months ended September 30, 2009, as compared to the same period in 2008, primarily related to the acquired operations of AmCOMP. The acquired operations contributed $35.2 million to our underwriting expenses for the nine months ended September 30, 2009. Excluding the impact of the acquisition and one-time integration and restructuring charges, our underwriting and other operating expenses would have decreased $4.0 million, primarily due to declining compensation expense not related to restructuring and a decline in premium taxes due to lower net premiums earned. Additionally, during the nine months ended September 30, 2009, we incurred total one-time integration and restructuring charges of $4.9 million, including $2.5 million in severance expenses related to our corporate restructuring.

Interest expense increased $5.6 million for the nine months ended September 30, 2009. For the nine months ended September 30, 2008, we had no debt or related interest expense.

Income taxes decreased 49.8% for the nine months ended September 30, 2009, compared to the same period of 2008. The effective tax rate for the nine months ended September 30, 2009 was 8.5%, as compared to 13.4% for the same period of 2008. The decrease was primarily due to a $20.8 million decrease in pre-tax income, the impact of tax-exempt investment income and change in the LPT contingent profit commission of $14.1 million, which is not subject to income tax. This favorable change was partially offset by the final reversal of the liability for previously unrecognized tax benefits in the amount of $10.6 million, including interest for the nine months ended September 30, 2008.

Tax-exempt income as a percentage of pre-tax income was 37.5% and 26.4% for the nine months ended September 30, 2009 and 2008, respectively. While we expect the levels of tax-preferred investment income to remain relatively stable during 2009, we cannot be certain how changes to pre-tax income may ultimately impact our effective rate in future periods.

Combined Ratio

The combined ratio increased 16.0 percentage points for the nine months ended September 30, 2009, to 95.6%, compared to 79.6% for the nine months ended September 30, 2008. The acquired operations of AmCOMP resulted in an increase in the combined ratio of 13.4 percentage points. Also increasing the combined ratio was the decrease of the favorable prior accident year loss development period over period. The remainder of the increase was primarily the result of lower premiums earned for the period due to rate cuts, competitive pressures, and overall economic conditions, partially offset by the increase in the LPT contingent profit commission.

Liquidity and Capital Resources

Parent Company. We are a holding company and substantially all of our operations have historically been conducted through our insurance subsidiaries, EICN and ECIC. On October 31, 2008, we completed the acquisition of AmCOMP and, as a result, added two new insurance subsidiaries: EPIC and EAC. Dividends to EHI from our insurance subsidiaries are contingent upon our subsidiaries earnings and subject to business considerations and regulatory requirements. The primary uses of cash are to pay stockholder dividends, repurchase common stock, pay interest and principal payments on outstanding debt obligations and support general operating expenses.

Historically, we have met our cash requirements and financed our growth principally from underwriting operations, asset maturities, and investment income. T