MERCHANTS GROUP INC
Form 10-K/A
March 28, 2006

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 10-K/A
Amendment No. 1

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

For the fiscal year ended December 31, 2004

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 1-9640
MERCHANTS GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware	**16-1280763**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
250 Main Street, Buffalo, New York	**14202**
(Address of principal executive offices)	(Zip Code)

716-849-3333
(Registrant s telephone number, including area code)

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

Title of each class **Common Stock, $.01 par value per share**

Name of each exchange on which registered **American Stock Exchange, Inc.**

*Securities registered pursuant to Section 12 (g) of the Ac*t: **NONE**

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

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes o No þ

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

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

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer þ

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

As of March 18, 2005, 2,114,152 shares of common stock were outstanding. The aggregate market value of the common shares held by non-affiliates of Merchants Group, Inc. on June 30, 2004 was $19,836,000. Solely for purposes of this calculation, the Company deemed every person who beneficially owned 5% or more of its common stock and all directors and executive officers to be affiliates.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2005 Annual Meeting of stockholders are incorporated by reference into Part III.

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EXPLANATORY NOTE

Merchants Group, Inc. hereby amends its Form 10-K for the fiscal year ended December 31, 2004, which was filed with the Securities and Exchange Commission on March 31, 2005 (the Original Form 10-K , to reflect revisions to certain disclosures as a result of the comment process with the Securities and Exchange Commission. A summary of the revised disclosures is as follows:

The table showing the Company s re-estimation of its loss and loss adjustment expense reserves appearing on page 12 of Part I Item 1. Business, has been revised to show the Company s initial estimate and re-estimate as of December 31, 2004 of gross liabilities before reinsurance and the liability ceded to reinsurers.

Part I Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations has been amended to provide additional disclosure with respect to the causes of loss reserve development for certain products. In addition the Critical Accounting Policies section was amended to include a description of the actuarial reserving methodologies used by the Company and to show a reasonably likely range of reserves for loss and loss adjustment expenses as of December 31, 2004. Further, the Company amended this section to include disclosure of the amount of loss and loss adjustment expense reserves for each of its products.

The Company s consolidated financial statements included in Part I Item 8. Financial Statements and Supplementary Data were amended to disclose related party transactions as required by Rule 4-08(k) of Regulation S-X. The Company s consolidated financial statements were also amended to include a Note (no. 10) showing the underwriting results of each of the Company s products as well as the total revenues derived from each product.

In addition to the foregoing, the Company s consolidated financial statements included in Part I Item 8. Financial Statements and Supplementary Data were amended as described in Note 1. to the consolidated financial statements. This Form 10-K/A does not reflect events occurring after the filing of the original Form 10-K or modify or update those disclosures affected by subsequent events. Consequently, all other information is unchanged and reflects the disclosures made at the time of the filing of the original Form 10-K. Accordingly, this Form 10K/A should be read in conjunction with the Company s filings made subsequent to the filing of the original Form 10-K. With this Amendment No. 1 the Chief Operating Officer (executive officer) and the Chief Financial Officer of Merchants Group, Inc. have also reissued their certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act.

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DECEMBER 31, 2004

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PART I

Item 1. BUSINESS.

General

Merchants Group, Inc. (the Company), which was incorporated in August 1986 as a Delaware holding company, offers property and casualty insurance generally to preferred risk individuals and small to medium sized businesses in the northeastern United States through its wholly owned subsidiary, Merchants Insurance Company of New Hampshire, Inc. (MNH).

Administration

The Company and MNH operate and manage their business in conjunction with Merchants Mutual Insurance Company (Mutual), a New York domiciled mutual property and casualty insurance company, under a services agreement (the Services Agreement) that became effective January 1, 2003. At December 31, 2004, Mutual owned 12.1% of the Company s issued and outstanding common stock. The Company and MNH do not have any operating assets or employees. Under the Services Agreement, Mutual provides the Company and MNH with the facilities, management and personnel required to operate their day-to-day business.

The Services Agreement covers substantially the same services previously provided under a management agreement among the Company, MNH and Mutual (the Management Agreement) from 1986 to 2002. The Services Agreement provides for negotiated fees (subject to periodic adjustment) for administrative, underwriting, claims and investment management services. The Company and MNH have the discretion to remove invested assets from their investment portfolios managed by Mutual.

The Services Agreement contains termination provisions that vary based on the service rendered. Underwriting services may be terminated on one year s notice, but the termination may not be effective before January 1, 2008. Claims and administrative services may be terminated on 6 months notice. Investment services may be terminated upon one year s notice at any time.

Effective January 1, 2003, Mutual and MNH agreed to pool, or share, underwriting results on their traditional insurance business (Traditional Business) by means of a reinsurance pooling agreement (the Pooling Agreement). The Pooling Agreement applies to premiums earned and losses incurred after the effective date. It does not apply to any new endeavor of either Mutual or MNH outside of their Traditional Business, unless the companies agree otherwise.

The Pooling Agreement provides for MNH to cede, or transfer, to Mutual all premiums and risks on its Traditional Business during the term of the agreement, and then to assume from Mutual a percentage of all of Mutual s and MNH s Traditional Business (the Pooled Business). MNH assumed 40% of the Pooled Business in 2003 and 35% in 2004. MNH s share of the Pooled Business will be reduced to 30% in 2005, though not to exceed $50.0 million in assumed net written premiums, and to 25% in 2006, though not to exceed $42.5 million in assumed net written premiums. MNH s share of the Pooled Business will be 25% in 2007, though not to exceed $37.5 million in net written premiums. If the parties agree, MNH may increase its share or maximum amount of assumed net premiums written of the Pooled Business for any year. Mutual retains a share of the risk in MNH s Traditional Business under Mutual s control pursuant to a profit and loss sharing arrangement in the Pooling Agreement based on the loss and loss adjustment expense (LAE) experience of the Pooled Business. The Company believes the Pooling Agreement and profit (or loss) sharing feature included therein aligns the interests of MNH and Mutual. The decreasing amount of Traditional Business assumed under the Pooling Agreement is intended to provide MNH with the capacity to pursue insurance opportunities independently of Mutual, thereby reducing its dependence on Mutual as its only source of business. The Company and MNH are seeking to identify new business initiatives and the Company has retained an investment bank to assist in its effort to employ the available capacity. Generally, the new business initiatives are expected to be in lines of business which are complementary to the Traditional Business underwritten through the Pooling Agreement with Mutual.

The Pooling Agreement may be terminated by either party at the beginning of any calendar year on or after January 1, 2008 upon not less than 6 months notice. However, the Pooling Agreement may be terminated effective as of January 1, 2006 or 2007 upon 6 months notice, but only by MNH and only if the ratio of net losses and LAE to net earned premiums on a cumulative basis from the inception of the Pooling Agreement exceeds 76%, as of the date notice is given. As of December 31, 2004, the ratio of net losses and LAE to net premiums on a cumulative basis since the inception of the Pooling Agreement was 69.4%.

Marketing

Mutual markets the Traditional Business of the Company and Mutual jointly through 467 independent agents. The primary marketing efforts of the Company and Mutual (collectively referred to as Merchants) are directed to those independent agents who, through their insurance expertise, access to a broad range of products, and focus on service, provide value for the insurance consumer.

Mutual and the Company offer the same portfolio of insurance products. The Company s products are generally offered to preferred risks while Mutual s products are generally offered to standard risks. Preferred risks meet more restrictive underwriting criteria than standard risks and generally generate fewer losses. Accordingly, the preferred risks are charged premium rates that are typically 10-15% lower than standard rates.

The Company believes that Merchants, as a regional insurance group, has certain advantages, including a closer relationship with its agents and a better knowledge of its operating territories, that enable it to compete effectively against national carriers. The Company believes Merchants distinguishes itself from its competitors by providing its agents and policyholders with superior service and ease of doing business, products that target certain segments of the commercial and personal insurance markets, and an agents compensation program which, in addition to standard commission rates, includes a profit sharing plan.

Through Mutual, the Company services its agents from six Strategic Business Centers (Buffalo, Albany and Hauppauge, New York; Manchester, New Hampshire; Moorestown, New Jersey; and Columbus, Ohio) and from its home office in Buffalo, New York. The Strategic Business Centers are located in the Company s operating territories and focus primarily on policy sales and underwriting. The Regional Manager of a Strategic Business Center appoints new agents, and agrees upon premium objectives and annual unit sales with the principal(s) of each agency. Regional Managers and Territory Managers, or TM s, develop customized business plans for each agent. These plans identify profitable business opportunities and recommend the actions required to achieve the objectives agreed to by the agency and the Company.

TM s meet frequently with targeted agents sales staff to review Merchants renewal policies, as well as to solicit policies new to the agent and/or Merchants. While TM s are capable of providing quotes directly to the agent while in an agent s office, much of that capability is migrating to Merchants internet website: www.merchantsgroup.com. There, agents are able to obtain instant quotes for certain commercial lines of business. Presently, the businessowners, contractors coverall and commercial auto product lines are available for instant quoting and Merchants expects that other commercial lines will be available for quoting on the internet during 2005. In addition, businessowners and contractors coverall have been enabled for issue from quote , allowing agents to enter all underwriting information required to issue policies for their customers over the password protected Agency Gateway of the website. This allows for quicker responses to agents quote requests and reduces expenses associated with manual quoting and policy issuance.

Each Strategic Business Center has an Agents Advisory Council that meets at least twice a year. The Advisory Councils provide a forum for Merchants and its agents to discuss issues of mutual interest, and assure that the agents business needs are being considered by Merchants. Additionally, the Co-chairpersons of the Advisory Councils from each Strategic Business Center meet twice each year with senior officers.

In addition to standard commissions paid as a percentage of premiums written, the Company s agents are eligible to participate in the Agents Profit Sharing Plan. This plan rewards agents based on total premiums written and the loss and allocated LAE ratio on business placed during each year by the agent with the Company and Mutual. The Company believes the terms of the Agents Profit Sharing Plan encourage its agents to increase the volume of profitable Traditional Business they place with Merchants. The Company s share of payments for the Agents Profit Sharing Plan for 2004 assumed under the Pooling Agreement totaled $1,418,000, or 2.1% of the Company s share of pro forma pooled direct premiums written. In response to a December 2004 request from the State of New Hampshire Insurance Department (Department) the Company provided certain information to the Department with respect to compensation arrangements between the Company and its agents. The Department made the request of all insurance companies domiciled in New Hampshire.

Insurance Underwriting

The Company is licensed to issue insurance policies in 13 states, primarily in the northeastern United States. In 2004, net premiums written totaled $53,102,000, with 69% of the net premiums written derived from commercial lines of insurance and 31% from personal lines of insurance.

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The following table sets forth the distribution of the Company s direct premiums written by state for the years indicated:

	As of December 31,		
	2002	2003(1)	2004(1)
New York	67%	60%	63%
New Jersey	9	17	14
New Hampshire	10	9	8
Pennsylvania	5	6	7
Rhode Island	5	3	3
Massachusetts	2	2	3
Other	2	3	2
Total	100%	100%	100%

(1) Shown on a group-wide basis for the Pooled Business. See the Administration section of this Item for further discussion.

The Company and Mutual are licensed to underwrite most major lines of property and casualty insurance. They issue policies primarily to individuals and small to medium sized commercial businesses. The types of risks insured include:

- Personal automobile full coverage of standard performance automobiles, generally requiring drivers with good driving records during the past three years at the time of first issuance by Merchants.

- Homeowners properties generally with no losses in the last three years that are less than 30 years old and valued between $125,000 and $500,000.

- Commercial automobile primarily light and medium duty vehicles operating in a limited radius, with complete background information required of all drivers.

- Commercial multi-peril properties with medium to high construction quality and low to moderate fire exposure, and occupancies with low to moderate exposure to hazardous materials and processes.

- General liability low hazard service, mercantile and light processing businesses, generally with at least three years of business experience and with no losses in the last three years.

- Workers compensation risks with low loss frequency and severity, low to moderate exposure to hazardous materials and processes, and favorable experience modification factors. Generally, workers compensation insurance is written in conjunction with other commercial insurance.

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The Company and Mutual use automated underwriting processes for personal automobile, homeowners and certain commercial lines of business, which perform an initial review of policy applications based upon established underwriting guidelines. Applications that do not meet the guidelines for automated acceptance are either referred to underwriters who review the applications and assess exposure, or rejected if the risk characteristics are such that neither the Company nor Mutual would insure the applicant.

Merchants establishes premium rates for most of its policies based on its loss experience, in some cases after considering prospective loss costs provided by the Insurance Services Office, Inc., an industry advisory group, for the individual and commercial classes of business that it insures. Merchants establishes rates independently for its personal automobile and homeowners insurance policies and its specialty products, such as its Contractors Coverall Plus and businessowners policies.

The following table shows, for each of the years in the three year period ended December 31, 2004 (i) the amount of the Company s net premiums written attributable to various personal lines and commercial lines and (ii) underwriting results attributable to each such line as measured by the calendar year loss and allocated loss adjustment expense (LALAE) ratio for such line. The LALAE ratio is the ratio of incurred losses and allocated loss adjustment expenses to net premiums earned for a given period.

	Year ended December 31,								
	2002			2003			2004		
	Premiums Written Amount	%	LALAE Ratio	Premiums Written Amount	%	LALAE Ratio	Premiums Written Amount	%	LALAE Ratio
	(dollars in thousands)								
Personal									
Auto Liability	$ 21,565	30.6%	139.6%	$ 12,202	19.0%	87.4%	$ 7,467	14.1%	59.5%
Auto Physical Damage	12,694	18.0	50.5	7,230	11.3	49.2	3,873	7.3	42.8
Homeowners Multi-Peril	9,620	13.6	54.5	6,382	9.9	58.8	5,080	9.6	59.4
Total	43,879	62.2	93.8	25,814	40.2	69.7	16,420	31.0	55.1
Commercial									
Auto Liability	6,227	8.8	39.1	12,979	20.3	29.3	12,542	23.6	51.2
Auto Physical Damage	1,225	1.7	36.2	2,899	4.5	39.1	2,734	5.1	38.1
Commercial Multi-Peril	14,885	21.1	58.8	17,018	26.5	79.7	15,701	29.6	76.6
Workers Compensation	3,778	5.4	29.3	4,613	7.2	133.7	4,536	8.5	72.8
Other Lines	534	.8	(12.7)	856	1.3	281.4	1,169	2.2	75.5
Total	26,649	37.8	47.5	38,365	59.8	72.9	36,682	69.0	64.6
	$ 70,528	100.0%	71.7	$ 64,179	100.0%	71.6	$ 53,102	100.0%	61.2

Total Personal
& Commercial

Calendar year LALAE ratios set forth in the table above include an estimate of LALAE for that accident year, as well as increases or decreases in estimates made in that year for prior accident years LALAE. Depending on the size of the increase or decrease in prior accident year LALAE, calendar years LALAE ratios may not be as indicative of the profitability of policies in force in a particular year as accident year LALAE ratios, which do not take into account increases or decreases in reserves for prior accident years LALAE.

The following table sets forth the composition of voluntary direct premiums written for 2000 through 2004:

	For the Year Ended December 31,				
	2000	2001	2002	2003(1)	2004(1)
Commercial	64%	58%	40%	63%	73%
Personal	36	42	60	37	27
Total	100%	100%	100%	100%	100%

(1) Shown on a group-wide basis for the Pooled Business. See the Administration section of this Item for further discussion.

Commercial Lines

Merchants commercial business is primarily retail and mercantile in nature and generally consists of small to medium sized, low hazard commercial risks which as a group have relatively stable loss ratios. Merchants underwriting criteria attempts to exclude lines of business and classes of risks that are considered to be high hazard or volatile, or which involve substantial risk of latent injury or other long-tail liability exposures. The Company and Mutual offer specialized products within the commercial multi-peril line such as the Contractors Coverall Plus policy for artisan and trade contractors.

The Company believes that it and Mutual can insure commercial business profitably by selecting those classes of risks that offer better than average profit potential and charging rates commensurate with the quality of the risk insured. Merchants competes for commercial business based upon the service it provides to agents and policyholders, the compensation it pays to its agents and the price of its products. Merchants establishes prices after considering its costs, the exposures inherent in a particular class of risk, estimated investment income, projected future trends in loss frequency and severity, the degree of competition within a specific territory and a provision for profit. Accordingly, the prices of Merchants commercial products may vary considerably from competitors prices.

Personal Lines

Merchants offers personal automobile and homeowners insurance to preferred risk individuals, generally requiring experienced drivers with no accidents or moving violations in the last three years for personal automobile insurance, and medium to high value homes with systems (e.g. heating, plumbing, electrical) that are less than thirty years old in fire protected areas for homeowners insurance. Personal automobile premium rates attempt to cover costs associated with required participation in involuntary personal automobile programs, in addition to the costs directly associated with the policies written voluntarily. Due to volatility in the size of the New York Automobile Insurance Plan (NYAIP) and the poor loss experience associated with that business in most years, the Company has been unable to fully recover costs of the NYAIP business with premium rates charged for its voluntary personal automobile business. In

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2001 the Company implemented a moratorium on writing new voluntary personal automobile business in New York. Further, in order to minimize the adverse impact of assignments from the NYAIP, the Company has purchased territorial credits from an unaffiliated company. The credits against NYAIP assignments were generated by another insurance company for writing private passenger automobile business in localities in New York with private passenger automobile availability problems. The other insurance company, by nature of its concentration in private passenger automobile business in credit territories, generated more credits than it required to offset its NYAIP assignments.

Involuntary Business

As a condition to writing voluntary business in most states in which it operates, the Company and Mutual must participate in state-mandated programs that provide insurance for individuals and businesses unable to obtain insurance voluntarily, primarily for personal automobile insurance. The legislation creating these programs usually allocates a pro rata portion of the risks attributable to such insureds to each company writing voluntary business in the state on the basis of its historical voluntary premiums written or the number of automobiles which it historically insures voluntarily. Due to changing market conditions the Company cannot predict the size of the NYAIP for 2005 or future years.

The Company s gross (direct and assumed) premiums written attributable to involuntary policies were $8,292,000, $5,302,000 and $4,275,000 in 2002, 2003 and 2004, respectively, mostly in New York. The 2003 and 2004 amounts represent the Company s pro-forma share of the applicable amount of pooled direct premiums written.

Pooling Agreement

The Company believes pooling of risks is advantageous for the following reasons: (1) Mutual s risk selection, pricing, marketing and claims philosophies and practices are consistent with and complementary to the Company s; (2) as market conditions change, management can adjust eligibility criteria to permit Merchants as a group to participate in a changing rate environment without concern for any conflict of interest; (3) pooling, especially with Mutual subject to profit and loss sharing, more closely aligns the interests of the Company and Mutual; and (4) by reducing its share of participation in the pool, the Company is able to create more capacity to pursue other endeavors, which it might not otherwise be able to do as a result of regulatory constraints on non-renewal of business, particularly for personal lines business. See Competition in this Item.

Claims

Insurance claims on policies written by the Company and by Mutual are investigated and settled by claims adjusters employed by Mutual pursuant to the Services Agreement. Mutual maintains three claims offices within its operating territories. In areas where there is insufficient claim volume to justify the cost of internal claims staff, the Company and Mutual use independent appraisers and adjusters to investigate claims. Merchants claims policy emphasizes timely investigation of claims, settlement of valid claims for equitable amounts, maintenance of adequate reserves for claims and control of external claims adjustment expenses. In order to support its claims policy, Merchants maintains a program designed to ensure that as soon as practical, claims are assigned an accurate value based on available information. The program includes the centralization of certain branch claims operations and an emphasis on the training of claims adjusters and supervisors by senior claims staff. This claims policy is designed to provide agents and policyholders with prompt service and support.

Claims settlement authority levels are established for each adjuster, supervisor and manager based on their expertise and experience. When Merchants receives notice of a claim, it is assigned to an adjuster based upon its type, severity and line of business. The claims staff then reviews the claim, obtains appropriate information and establishes a loss reserve. Claims that exceed certain dollar amounts or that cannot be readily settled are assigned to more experienced claims staff.

Loss and Loss Adjustment Expense Reserves

The Company, like other insurance companies, establishes reserves for losses and LAE. These reserves are estimates intended to cover the probable ultimate cost of settling all losses incurred and unpaid, including those losses not yet reported to the Company. An insurer s ultimate liability is likely to differ from its interim estimates because during the life of a claim, which may be many years, additional facts affecting the amount of damages and an insurer s liability may become known. The reserves of an insurer are frequently adjusted based on monitoring by the insurer and are periodically reviewed by state insurance departments. The Company retains an independent actuarial firm to satisfy state insurance departments requirements for the certification of reserves for losses and LAE.

Loss reserves are established for known claims based on the type and circumstance of the loss and the results of similar losses. For claims not yet reported to the Company, loss reserves are based on statistical information from previous experience periods adjusted for inflation, trends in court decisions and economic conditions. LAE reserves are intended to cover the ultimate cost of investigating all losses that have occurred and defending lawsuits, if any, arising from these losses. LAE reserves are evaluated periodically using statistical techniques which compare current costs with historical data. Inflation is implicitly reflected in the reserving process through analysis of cost trends and review of historical reserve results. With the exception of workers compensation claims, loss reserves are not discounted for financial statement purposes.

The Company s reserving process is based on the assumption that past experiences, adjusted for the effect of current developments and trends, are relevant in predicting future events. In the absence of specific developments, the process also assumes that the legal climate regarding the claims process and underlying liabilities remains constant. Other assumptions employed by the Company or its actuarial firm change from time to time as circumstances change. In estimating loss and LAE reserves, the Company employs a number of actuarial methods, depending on their applicability to each product, in order to balance the advantages and disadvantages of each method. Typically, several estimates are developed for each product using different methods. However, the Company does not believe it is appropriate to sum the high and low values developed using different actuarial methods for each product to determine a range for the Company s total loss and LAE reserves. Instead the Company s actuary and its consulting actuary only provide the Company with their respective best estimates of total loss and LAE reserves by summing their best estimate for each product. The Company s small size, the presence or absence of a limited number of moderate losses, as well as the timing of the reporting of such losses to the Company by claimants, could result in changes in actuarial estimates that are significant to the Company s net income for a quarter or a year. As such, management recognizes that the best estimate may not be more accurate than other amounts within a few percentage points of total loss and LAE reserves.

Due to uncertainties inherent in the estimation of incurred losses and LAE, the Company has recorded changes in reserves for prior accident years losses and LAE in most years. In 2002 the Company decreased its reserves for prior years by $3,785,000, primarily due to favorable loss development related to workers compensation and commercial automobile liability policies, somewhat offset by unfavorable development on its private passenger automobile policies. In 2003, the Company decreased its reserves for prior years by $90,000. In 2004, the Company decreased reserves for prior years by $843,000 primarily due to favorable loss development related to private passenger auto liability and workers compensation policies, somewhat offset by unfavorable development on its commercial package policies.

The following table sets forth the changes in the reserve for losses and LAE for 2002, 2003 and 2004.

	Year Ended December 31,		
	2002	2003 (in thousands)	2004
Reserve for losses and LAE at beginning of year	$ 151,355	$ 147,136	$ 146,474
Less reinsurance recoverables	19,242	19,380	22,715
Net balance at beginning of year	132,113	127,756	123,759
Provision for losses and LAE for claims occurring in:			
Current year	66,658	49,702	38,524
Prior years	(3,785)	(90)	(843)
	62,873	49,612	37,681
Losses and LAE payments for claims occurring in:			
Current year	26,387	18,441	13,647
Prior years	40,843	35,168	35,008
	67,230	53,609	48,655
Reserve for losses and LAE at end of year, net	127,756	123,759	112,785
Plus reinsurance recoverables	19,380	22,715	15,630
Balance at end of year	$ 147,136	$ 146,474	$ 128,415

The first line of the following table presents, as of the end of the year at the top of each column, the estimated amount of unpaid losses and LAE net of reinsurance for claims arising in that year and in all prior years, including claims that had occurred but were not yet reported to the Company. For each column, the rows of the table present, for the same group of claims, the amount of unpaid losses and LAE net of reinsurance as re-estimated as of the end of each succeeding year. The estimate is modified as more information becomes known about the number and severity of claims for each year. The cumulative redundancy (deficiency) represents the change in the estimated amount of unpaid losses and LAE net of reinsurance from the end of the year at the top of each column through the end of 2004.

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For each column in the table, the change from the liability for losses and LAE shown on the first line to the liability as re-estimated as of the end of the following year was included in operating results for the following year. That change includes the change in the previous year s column from the liability as re-estimated one year later to the liability as re-estimated two years later which, in turn, includes the change in the second preceding column from the liability as re-estimated two years later to the liability as re-estimated three years later, and so forth.

The rows of the table appearing under the caption Net paid (cumulative) as of. present, as of the end of each succeeding year, the amount of paid losses and LAE for claims unpaid at the end of the year at the top of each column:

	As of December 31, (in thousands)									
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Net liability for losses and LAE:	$ 97,614	$ 113,718	$ 126,260	$ 130,781	$ 126,820	$ 127,458	$ 131,178	$ 132,113	$ 127,756	$ 123,759
Liability re-estimated as of:										
One year later	108,659	120,550	130,768	128,636	123,071	128,886	129,704	128,328	127,666	122,916
Two years later	113,091	128,192	133,029	130,498	120,345	123,299	129,621	132,674	129,722	
Three years later	121,051	129,724	132,948	127,893	113,661	124,944	133,769	135,865		
Four years later	121,791	131,647	129,210	122,508	114,068	128,121	138,538			
Five years later	122,886	127,183	124,238	122,347	117,678	131,977				
Six years later	120,128	123,521	124,319	125,741	120,958					
Seven years later	117,589	123,679	127,659	128,998						
Eight years later	117,626	126,285	130,280							
Nine years later	120,118	128,433								
Ten years later	121,612									
Net cumulative redundancy (deficiency):										
	$ (23,998)	(14,715)	(4,020)	1,783	5,862	(4,519)	(7,360)	(3,752)	(1,966)	843
	% (24.6)	(12.9)	(3.2)	1.4	4.6	(3.5)	(5.6)	(2.8)	(1.5)	.7
Net paid (cumulative) as of:										
One year later	36,916	38,549	40,954	42,433	37,125	40,970	45,461	40,843	35,168	35,008
Two years later	60,074	64,323	69,035	66,477	63,325	69,393	70,075	64,959	61,031	
Three years later	77,982	84,638	86,364	86,313	80,142	86,670	85,772	83,552		
Four years later	91,948	96,491	98,300	97,770	89,383	96,222	98,053			
Five years later	99,171	104,063	105,787	104,282	94,809	102,892				
Six years later	103,829	109,492	109,639	107,431	99,131					

Seven years later	107,367	111,851	111,822	110,193						
Eight years later	108,747	113,593	114,246							
Nine years later	110,119	114,959								
Ten years later	110,827									
Initial gross liability for losses and LAE:	$ 104,199	$ 120,114	$ 134,532	$ 141,157	$ 136,632	$ 133,485	$ 145,006	$ 151,354	$ 147,135	$ 146,475
Initial ceded liability for losses and LAE:	6,585	6,396	8,272	10,376	9,812	6,027	13,828	19,241	19,379	22,716
Initial net liability	$ 97,614	$ 113,718	$ 126,260	$ 130,781	$ 126,820	$ 127,458	$ 131,178	$ 132,113	$ 127,756	$ 123,759
Gross liability as currently re-estimated	129,225	136,752	140,646	137,323	129,292	144,546	166,878	165,082	157,882	146,386
Ceded liability as currently re-estimated	7,613	8,319	10,366	8,325	8,334	12,569	28,340	29,217	28,160	23,470
Net liability as currently re-estimated	$ 121,612	$ 128,433	$ 130,280	$ 128,998	$ 120,958	$ 131,977	$ 138,538	$ 135,865	$ 129,722	$ 122,916
Gross cumulative redundancy (deficiency):	$ (25,026)	(16,638)	(6,114)	3,834	7,340	(11,061)	(21,872)	(13,728)	(10,747)	89
	% (24.0)	(13.9)	(4.5)	2.7	5.4	(8.3)	(15.1)	(9.1)	(7.3)	0.1

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The loss and LAE reserves reported in the Company s consolidated financial statements prepared in accordance with generally accepted accounting principles (GAAP) differ from those reported in the statements filed by MNH with the New Hampshire Insurance Department in accordance with statutory accounting principles (SAP) as follows:

	As of December 31,		
	2002	2003	2004
		(in thousands)	
Loss and LAE reserves on a SAP basis	$ 127,756	$ 123,759	$ 112,785
Adjustments:			
Ceded reinsurance balances recoverable	19,380	22,715	15,630
Loss and LAE reserves on a GAAP basis	$ 147,136	$ 146,474	$ 128,415

Reinsurance

The Company follows the customary industry practice of reinsuring a portion of the exposure under its policies and as consideration pays to its reinsurers a portion of the premium received on its policies. Insurance is ceded principally to reduce an insurer s liability on individual risks and to protect against catastrophic losses. Although reinsurance does not legally discharge an insurer from its primary liability for the full amount of coverage provided by its policies, it does make the assuming reinsurer liable to the insurer to the extent of the reinsurance ceded.

The Company is a party to reinsurance contracts under which certain types of policies are automatically reinsured without the need for approval by the reinsurer with respect to the individual risks that are covered (treaty reinsurance). The Company also is a party to reinsurance contracts which are handled on an individual policy or per risk basis and require the specific agreement of the reinsurer as to each risk insured (facultative reinsurance). Occasionally, the Company may secure facultative reinsurance to supplement its coverage under treaty reinsurance.

Prior to January 1, 1998, the Company s excess of loss reinsurance agreements for automobile liability, general liability and workers compensation insurance provided for recovery of losses over $500,000 up to a maximum of $5,000,000 per occurrence. For claims occurring from 1987 through 1992, the $500,000 threshold was indexed for inflation for casualty lines other than workers compensation and New York State no-fault, and applied retroactively to all occurrences until they are settled. There was no index provision for casualty claims occurring after 1992. This coverage was supplemented by additional treaty reinsurance covering losses up to $5,000,000 in excess of the first $5,000,000. Prior to January 1, 1998, property reinsurance agreements provided for recovery of property losses over $500,000 up to $2,000,000 per occurrence without any index provision.

Beginning January 1, 1998, the Company s property and casualty excess of loss reinsurance agreement provided for recovery of casualty losses over $500,000 up to $10,000,000 per occurrence and property losses over $500,000 up to $10,000,000 per risk. This coverage is supplemented by a contingent casualty layer of reinsurance for workers compensation claims of $5,000,000 in excess of the first $10,000,000 subject to a calendar year limit of $20,000,000. Effective January 1, 2002, the Company increased its retention on casualty losses to $750,000. Effective January 1, 2004, the Company adjusted the property loss occurrence limit to $5,000,000 per risk. Individual property facultative reinsurance was purchased for all exposures greater than $5,000,000. Effective January 1, 2005, the Company adjusted the property loss occurrence limit to $10,000,000 per risk.

Property catastrophe coverage provides for recovery of 47.5% of the first $5,000,000 and of 95% of the next $55,000,000 above aggregate retained losses of $5,000,000 per occurrence. The property catastrophe reinsurance coverage is shared by the Company and Mutual in accordance with the Pooling Agreement (see Administration above) for a covered event.

Under the terms of the Pooling Agreement (see Administration above) effective as of January 1, 2003 Mutual and MNH pool, or share, underwriting results on their Traditional Business. The Pooling Agreement does not apply to any new endeavor of either Mutual or MNH outside of their Traditional Business, unless the companies agree otherwise.

The Pooling Agreement provides for MNH to cede, or transfer, to Mutual all of its premiums and risks on its Traditional Business during the term of the agreement, and then to assume from Mutual a percentage of all of Mutual s and MNH s Traditional Business (the Pooled Business). MNH assumed 40% of the Pooled Business in 2003 and 35% of the Pooled Business in 2004. MNH s share of the Pooled Business will be reduced to 30% of the pooled business in 2005, though not to exceed $50.0 million in net written premiums. MNH s share of the Pooled Business will be reduced to 25% in 2006 and 2007, though not to exceed $42.5 million and $37.5 million in assumed net written premiums, respectively. If the parties agree, MNH may increase its share or maximum amount of assumed net premiums written of the Pooled Business for any year. The decreasing amount of Traditional Business assumed under the Pooling Agreement is intended to provide MNH with the capacity to pursue insurance opportunities independently of Mutual, thereby reducing its dependence on Mutual as its only source of business. Mutual retains a share of the risk in MNH s Traditional Business under Mutual s control pursuant to a profit and loss sharing arrangement in the Pooling Agreement based on the loss and LAE experience of the Pooled Business. The Company believes the Pooling Agreement and profit (or loss) sharing feature included therein align the interests of MNH and Mutual.

The Pooling Agreement may be terminated by either party at the beginning of any calendar year upon not less than 6 months notice, but not effective before January 1, 2008. However, the Pooling Agreement may be terminated effective January 1, 2006 or 2007 upon 6 months notice, but only by MNH and only if the ratio of net losses and LAE to net earned premiums on a cumulative basis from the inception of the Pooling Agreement exceeds 76%, as of the date notice is given. See PART 1, Item 1. BUSINESS. Administration.

Investments

The primary source of funds for investment by the Company is premiums collected. Although premiums, net of commissions and other underwriting costs, are taken into income ratably over the terms of the policies, they provide funds for investment from the date they are received. Similarly, although establishment of and changes in reserves for losses and LAE are included in results of operations immediately, the amounts so set aside are available to be invested until the Company pays those claims.

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The investments of the Company are regulated by New Hampshire insurance law and are reviewed by the Board of Directors of the Company. Other than certain short-term investments held to maintain liquidity, the Company primarily invests in corporate bonds, mortgage-backed and other asset-backed securities including collateralized mortgage obligations, and tax-exempt securities with expected maturities of 10 years or less. The mortgage-backed securities held by the Company are typically purchased at expected yields which are greater than comparable maturity Treasury securities and are AAA or AA rated.

The Company had $40,979,000 of tax-exempt bonds in its investment portfolio at December 31, 2004. The Company believes these tax-exempt bonds are of high quality (rated A or better) and, at the time of purchase, offered an after-tax total return potential greater than comparable taxable securities.

At December 31, 2004 the Company had $7,412,000 of short-term investments with maturities less than 30 days and $2,150,000 of non-investment grade securities. These non-investment grade securities represented 1% of the investment portfolio as compared to $2,496,000, or 1%, of the investment portfolio at December 31, 2003.

The table below provides information regarding the Company s investments as of the dates indicated.

	As of December 31, (dollars in thousands)					
	2002		2003		2004	
	Amount	%	Amount	%	Amount	%
Fixed Maturities (1):						
U.S. Government and Agencies	$ 12,855	6.1%	$ 8,377	4.1%	$ 5,028	2.5%
Corporate Securities	60,215	28.8	28,714	14.2	28,003	14.2
Mortgage and Asset Backed Securities	91,813	43.8	113,313	55.8	110,082	55.7
Tax-Exempt Bonds	28,685	13.7	43,401	21.4	40,979	20.7
Total Bonds	193,568	92.4	193,805	95.5	184,092	93.1
Preferred Stocks (2)	7,367	3.5	5,797	2.9	3,509	1.8
Short-Term Investments (3)	6,420	3.1	1,118	.6	7,412	3.7
Other (4)	2,042	1.0	2,167	1.0	2,696	1.4
Total Invested Assets	$ 209,397	100.0%	$ 202,887	100.0%	$ 197,709	100.0%

(1) Fixed Maturities are shown at their carrying amounts in the respective balance sheet. Held to Maturity fixed maturities are included at amortized cost. Available for Sale fixed maturities are included at fair value.

(2) Shown at fair value.

(3) Shown at cost, which approximates fair value.

(4) Shown at estimated fair value or unpaid principal balance, which approximates estimated fair value.

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The table below sets forth the Company s net investment income and net realized gains and losses, excluding the effect of income taxes, for the periods shown:

	Year Ended December 31, 2002	2003	2004
	(dollars in thousands)		
Average investments	$206,435	$200,996	$196,148
Net investment income	10,403	8,815	7,881
Net investment income as a percentage of average investments (1)	5.0%	4.4%	4.0%
Net gains (losses) on investments	$ 953	$ 2,500	$ (221)

(1) The taxable equivalent yield for the years ended December 31, 2002, 2003 and 2004 was 5.4%, 4.4% and 4.3%, respectively, assuming an effective tax rate of 34%.

The table below sets forth the carrying value of bonds and percentage distribution of various maturities at the dates indicated. Fixed Maturities are shown at their carrying amounts in the respective balance sheet. Held to Maturity fixed maturities are included at amortized cost. Available for Sale fixed maturities are included at fair value. Mortgage and asset backed securities are presented based upon their projected cash flows.

	As of December 31, 2002		2003		2004	
	Amount	%	Amount	%	Amount	%
			(dollars in thousands)			
1 year or less	$ 81,736	42.2%	$ 33,243	17.2%	$ 49,275	26.8%
1 year through 5 years	106,696	55.1	137,234	70.8	112,476	61.1
5 years through 10 years	3,198	1.7	21,065	10.9	18,870	10.2
More than 10 years	1,938	1.0	2,263	1.1	3,471	1.9
Total	$ 193,568	100.0%	$ 193,805	100.0%	$ 184,092	100.0%

Competition

The property and casualty insurance business is highly competitive. The Company is in direct competition with many national and regional multiple-line insurers, many of which are substantially larger than the Company and have considerably greater financial resources. Competition is further intensified by the independent agency system because each of the independent agents who sells the Company s policies also represents one or more other insurers. Also, the Company s agents compete with direct writing insurers and this indirectly affects the Company.

Historically, the property and casualty industry has tended to be cyclical in nature. During the up cycle, or hard market, the industry is characterized by price increases, strengthening of loss and LAE reserves, surplus growth and improved underwriting results. Near the end of the up cycle, an increase in capacity causes insurance companies to begin to compete for market share on the basis of price. This price competition causes the emergence of the down cycle, or soft market, characterized by a reduction in the premium growth rate and a general decline in profitability. Often times, the down cycle is accompanied by a decline in the adequacy of loss and LAE reserves and a decrease in premium writing capacity. The property and casualty insurance industry experienced a cyclical downturn for most of the 1990 s through 2001 due primarily to intense premium rate competition and an excess capacity to write premiums. Recently, there has been price firming primarily within the commercial lines segment of the property casualty industry. However, some of the circumstances which led to the most recent cyclical downturn in the property and casualty insurance industry have become evident, and the Company believes that this price firming or hard market is nearing its end.

Regulation

General

MNH is subject to regulation under applicable insurance statutes, including insurance holding company statutes, of the various states in which it writes insurance. Insurance regulation is intended to provide safeguards for policyholders rather than to protect stockholders of insurance companies or their holding companies. Insurance laws of the various states establish regulatory agencies with broad administrative powers including, but not limited to, the power to grant or revoke licenses to transact insurance business and to regulate trade practices, investments, premium rates, the deposit of securities, the form and content of financial statements and insurance policies, accounting practices, the maintenance of specified reserves and capital, and insurers consumer privacy policies. The regulatory agencies of each state have statutory authority to enforce their laws and regulations through various administrative orders, civil and criminal enforcement proceedings, and the suspension or revocation of certificates of authority. In extreme cases, including insolvency, impending insolvency and other matters, a regulatory authority may take over the management and operation of an insurer s business and assets.

Under insolvency or guaranty laws in the states in which MNH operates, insurers doing business in those states can be assessed up to prescribed limits for policyholder losses caused by other insurance companies that become insolvent. The extent of any requirement for MNH to make any further payment under these laws is not determinable. Most laws do provide, however, that an assessment may be excused or deferred if it would threaten a solvent insurer s financial strength. In addition, MNH is required to participate in various mandatory pools or underwriting associations in certain states in which it operates.

The property and casualty insurance industry has been the subject of regulations and legislative activity in various states attempting to address the affordability and availability of different lines of insurance. The regulations and legislation generally restrict the discretion an insurance company has in operating its business. It is not possible to predict the effect, if any, that new regulations and legislation would have on the Company and MNH.

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The Company depends on cash dividends from MNH to pay cash dividends to its stockholders and to meet its expenses. MNH is subject to New Hampshire state insurance laws which restrict its ability to pay dividends without the prior approval of state regulatory authorities. These restrictions limit dividends to those that, when added to all other dividends paid within the preceding twelve months, would not exceed 10% of the insurer s policyholders surplus as of the preceding December 31st. The maximum amount of dividends that MNH could pay during any twelve-month period ending in 2004 without the prior approval of the New Hampshire Insurance Commissioner is \$6,171,000. MNH paid \$1,200,000 and \$800,000 of dividends to the Company in August 2004 and February 2005, respectively.

In certain states in which it operates, MNH is required to maintain deposits with the appropriate regulatory authority to secure its obligations under certain insurance policies written in the jurisdiction. At December 31, 2004, investments of MNH having a par value of \$1,900,000 were on deposit with regulatory authorities.

MNH and Mutual are required to file detailed annual reports with the appropriate regulatory agency in each of the states in which they do business. Their business and accounts are subject to examination by such agencies at any time, and the laws of many states require periodic examination. The State of New Hampshire Insurance Department most recently examined the accounts of MNH as of December 31, 2003 and has indicated in a draft report that MNH s annual statement as of that date will be accepted as submitted, without adjustment.

The National Association of Insurance Commissioners (NAIC) applies a risk-based capital measurement formula to all property and casualty insurance companies. The formula calculates a minimum required statutory net worth based on the underwriting, investment, credit, loss reserve and other business risks inherent in an individual company s operations. Any insurance company that does not meet threshold risk-based capital measurement standards could be forced to reduce the scope of its operations and ultimately could become subject to statutory receivership proceedings. MNH s capital exceeds the statutory minimum as determined by the risk-based capital measurement formula as of December 31, 2004.

The NAIC has established eleven financial ratios (the Insurance Regulatory Information System, or IRIS) to assist state insurance departments in their oversight of the financial condition of insurance companies operating in their respective states. The NAIC calculates these ratios based on statutory information submitted by insurers on an annual basis and shares the information with the applicable state insurance departments. The ratios relate to leverage, profitability, liquidity and loss reserve development. One of the Company s ratios as of December 31, 2004 relating to investment yield fell outside of the acceptable range of ratios. MNH earned an investment yield of 4.0% (4.3% on a taxable equivalent basis) compared to the minimum NAIC threshold of 4.5%. The Company s inability to operate within an acceptable range of the aforementioned IRIS ratio is not expected to have a material effect on the Company s business or its operations.

Rates

Premium rate regulations vary greatly among states and lines of insurance, but generally require either approval of the regulatory authority or review by the authority prior to changes in rates. Rate filings are based upon an actuarial analysis of historical results and competition in the market. However, in certain states, insurers writing in designated product lines may periodically revise rates within the limits of applicable flexibility bands (flex-bands) on a file and use basis, but must obtain the state insurance department s prior approval in order to implement rate increases or decreases outside these flex-bands.

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Renewal of Policies

Many states restrict the ability of insurers to non-renew insurance policies or to exit a line of business. In particular, New York substantially limits the ability of insurers to non-renew personal automobile insurance. This restricts the Company s ability to mitigate its exposure to the NYAIP.

Insurance Holding Companies

The Company is subject to statutes governing insurance holding company systems. Typically, these statutes require the Company to file information periodically concerning its capital structure, ownership, financial condition, general business operations and material inter-company transactions not in the ordinary course of business. Under the terms of applicable New Hampshire statutes, any person or entity desiring to purchase shares which would result in such person beneficially owning 10% or more of the Company s outstanding voting securities would be required to obtain regulatory approval prior to the purchase.

Involuntary Business

As a condition to writing voluntary insurance in most of the states in which it operates, the Company must participate in programs that provide insurance for persons or businesses unable to obtain insurance voluntarily. Uncertainties as to the size of the involuntary market population make it difficult to predict the amount of involuntary business in a given year.

Employees

The Company and MNH have no employees. At December 31, 2004, Mutual had 315 full-time equivalent employees. The Company believes that Mutual s relationship with its employees is satisfactory.

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Executive Officers of the Registrant

The names of the executive officers of the Company and their ages, titles and biographies as of the date hereof are set forth below.

Name of Executive Officer and Position(s)	Age	Principal Occupation During the Past Five Years
Robert M. Zak Senior Vice President and Chief Operating Officer	47	President and Chief Executive Officer of MNH and Mutual since November 1, 1995; Sr. Vice President of MNH and Mutual from 1992 to 1995; Chief Financial Officer of the Company, MNH and Mutual from 1991 through 1996; Vice President Financial Services of MNH and Mutual from 1989 through 1996; Secretary of MNH and Mutual from 1990 through November 1, 1995.
Edward M. Murphy Vice President, Chief Investment Officer and Assistant Secretary	54	Vice President and Chief Investment Officer of the Company, Mutual and MNH since 1991; Assistant Vice President of Mutual and MNH from 1989 to 1991.
Kenneth J. Wilson Vice President, Treasurer, Chief Financial Officer and Secretary	57	Vice President, Treasurer and Chief Financial Officer of the Company, Mutual and MNH since 1996; President and Chief Executive Officer of Carbadon Corp. and its operating subsidiary, Empire of America Realty Credit Corp., from December 1995 to December 1996 and Chief Financial Officer from November 1992 to December 1996.

Item 2. PROPERTIES.

Although the Company has no facilities, it benefits from the facilities of Mutual pursuant to the Services Agreement, under which the Company is charged a fee for a portion of the costs of such facilities.

The Company s corporate headquarters are located in Buffalo, New York in a building owned by Mutual that contains approximately 113,000 square feet of office space. Mutual also has regional underwriting and/or claims office facilities in Buffalo, Albany and Hauppauge, New York; Manchester, New Hampshire; Moorestown, New Jersey and Columbus, Ohio. All of the offices except the Buffalo office are leased.

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Item 3. LEGAL PROCEEDINGS.

MNH, like many other property and casualty insurance companies, is subject to environmental damage claims asserted by or against its insureds. Management of the Company is of the opinion that based on various court decisions throughout the country certain of these claims should not be recoverable under the terms of MNH s insurance policies because of either specific or general coverage exclusions contained in the policies. However, there is no assurance that the courts will agree with MNH s position in every case, nor can there be assurance that material claims will not be asserted under policies which a court will find do not explicitly or implicitly exclude claims for environmental damages. Management, however, is not aware of any pending claim or group of claims which would result in a liability that would have a material adverse effect on the financial condition of the Company or MNH.

In addition to the foregoing matters, MNH is a defendant in a number of other legal proceedings in the ordinary course of its business. Management of the Company is of the opinion that the ultimate aggregate liability, if any, resulting from such proceedings will not materially affect the financial condition of the Company or MNH.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

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PART II

Item 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The Company s common stock is traded on the American Stock Exchange (AMEX symbol: MGP). The following table sets forth the high and low closing prices of the common stock for the periods indicated as reported on the American Stock Exchange.

2004:	High	Low	Dividend
Fourth Quarter	$24.67	$22.65	$ .10
Third Quarter	26.00	23.08	.10
Second Quarter	26.38	24.40	.10
First Quarter	25.50	23.70	.10

2003:	High	Low	Dividend
Fourth Quarter	$25.05	$21.10	$ .10
Third Quarter	22.30	19.90	.10
Second Quarter	21.80	19.75	.10
First Quarter	23.90	21.80	.10

The number of stockholders of record of the Company s Common Stock as of February 15, 2005 was 78. Securities held by nominees are counted as one stockholder of record.

The Company has paid a quarterly cash dividend to its common stockholders since 1993. Continued payment of this dividend and its amount will depend upon the Company s operating results, financial condition, capital requirements and other relevant factors, including legal restrictions applicable to the payment of dividends by its insurance subsidiary, MNH.

As a holding company, the Company depends on dividends from its subsidiary, MNH, to pay cash dividends to its stockholders. MNH is subject to New Hampshire state insurance laws which restrict its ability to pay dividends without the prior approval of state regulatory authorities. These restrictions limit dividends to those that, when added to all other dividends paid within the preceding twelve months, would not exceed 10% of the insurer s policyholders surplus as of the preceding December 31. The maximum amount of dividends that MNH could pay during any twelve-month period ending in 2005 without prior approval of the New Hampshire Insurance Commissioner is $6,171,000.

During the fourth quarter of its fiscal year, neither the Company nor any affiliated purchaser (as defined in SEC Rule 10b-18(a)(3)) made any purchases of any of its equity securities on its behalf.

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Equity Compensation Plan Information

Plan Category	Number of Securities to be Issued Upon Exercise Of Outstanding Options, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities) Reflected in Column (a)) (c)
Equity Compensation Plans Approved by Security Holders	0	N/A	0
Equity Compensation Plans Not Approved by Security Holders	0(1)	$ 24.77	0
Total	0		0

(1) Through an employment agreement with MNH, MNH s former Chief Operating Officer participated in a non-cumulative bonus equal to the product of 80,000 and the difference between the averages of the last reported sales prices of the Company s common stock for (i) the 20 business days immediately following the release of the Company s year-end results and (ii) for the

20 business days immediately following the release of the Company s year-end results for the prior year.

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Item 6. SELECTED FINANCIAL DATA.

The selected financial data set forth in the following table for each of the five years in the period ended December 31, 2004 have been derived from the audited consolidated financial statements of the Company.

	As of December 31,				
	2000	2001	2002	2003	2004
	(in thousands, except per share amounts)				
Net premiums written	$ 94,342	$ 93,973	$ 70,528	$ 64,179	$ 53,102
Net premiums earned	$ 94,259	$ 93,885	$ 83,120	$ 65,097	$ 57,123
Net investment income	13,903	13,295	10,403	8,815	7,881
Net investment gains (losses)	109	(580)	953	2,500	(221)
Other revenues	355	696	635	560	722
Total revenues	108,626	107,296	95,111	76,972	65,505
Net losses and loss adjustment expenses	71,374	75,144	62,873	49,612	37,681
Amortization of deferred policy acquisition costs	24,979	24,880	22,227	16,925	14,852
Other underwriting expenses	5,266	6,017	5,744	5,031	8,291
Total expenses	101,619	106,041	90,844	71,568	60,824
Income before income taxes	7,007	1,255	4,267	5,404	4,681
Provision for income taxes	2,668	434	1,729	1,039	919
Net income	$ 4,339	$ 821	$ 2,538	$ 4,365	$ 3,762
Earnings per share					
Basic	$ 1.75	$ .35	$ 1.19	$ 2.07	$ 1.78
Diluted	$ 1.74	$ .35	$ 1.19	$ 2.07	$ 1.78
Weighted average number of shares outstanding:					
Basic	2,485	2,343	2,125	2,110	2,114
Diluted	2,487	2,343	2,129	2,111	2,118
Balance Sheet Data: (at year end)					
Total investments	$ 215,654	$ 213,132	$ 209,397	$ 202,887	$ 197,709
Total assets	280,938	285,078	265,897	$ 268,678	$ 255,704
Reserve for losses and loss adjustment expenses	145,075	151,355	147,136	146,474	128,415
Unearned premiums	50,857	50,179	35,119	36,176	33,685
Stockholders equity	70,122	68,551	67,924	70,259	71,974
Dividend Data:					
Cash dividend per common share	$ .40	$ .40	$ .40	$ .40	$ .40

Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

2004 Compared to 2003

The following discussion should be considered in light of the statements under the heading Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995, at the end of this Item. All capitalized terms used in this Item that are not defined in this Item have the meanings given to them in the Notes to Consolidated Statements contained in Item 15 (a) (1) of this Form 10-K.

Results of operations for 2004 and 2003 reflect the effects of the Services Agreement and the Reinsurance Pooling Agreement among the Company, its wholly-owned insurance subsidiary, MNH, and Mutual, effective January 1, 2003. The Services Agreement calls for Mutual to provide underwriting, administrative, claims and investment services to the Company and MNH. The Reinsurance Pooling Agreement provides for the pooling, or sharing, of insurance business traditionally written by Mutual and MNH on or after the effective date. MNH s share of pooled (combined Mutual and MNH) premiums earned and losses and loss adjustment expenses (LAE) for 2004 and 2003 in accordance with the Reinsurance Pooling Agreement was 35% and 40%, respectively. The Reinsurance Pooling Agreement pertains to premiums earned and incurred losses and LAE. Direct premiums written by MNH or Mutual are not pooled. MNH s pooling percentage will be 30% in 2005, though not to exceed $50,000,000 in assumed net written premiums. MNH s share of pooled premiums will be reduced to 25% in 2006 and 2007, though not to exceed $42,500,000 and $37,500,000 in net written premiums, respectively.

Total combined Mutual and MNH or group-wide direct premiums written (DWP) for the year ended December 31, 2004 were $191,138,000, an increase of $15,995,000 or 9%, from $175,143,000 in 2003. The Company s pro-forma share of combined direct premiums written in 2004, in accordance with the Reinsurance Pooling Agreement, was $66,900,000 compared to $70,057,000 in 2003. The table below shows a comparison of direct premiums written by major category in 2004 and 2003:

	Group-wide DWP Year ended December 31,			MNH Pro Forma Share Year ended December 31,		
	2004	2003	Variance	2004	2003	Variance
	(000 s omitted)			(000 s omitted)		
Voluntary Personal Lines	$ 50,879	$ 63,548	(20%)	$ 17,808	$ 25,419	(30%)
Voluntary Commercial Lines	119,113	103,262	15%	41,690	41,305	1%
Umbrella Program	17,536	3,136	459%	6,138	1,254	389%
Involuntary	3,610	5,197	(31%)	1,264	2,079	(39%)
Total Direct Written Premiums	$ 191,138	$ 175,143	9%	$ 66,900	$ 70,057	(5%)

The 20% (or $12,669,000) decrease in group-wide voluntary personal lines direct premiums written resulted from a 27% decrease in private passenger automobile (PPA) direct premiums written and a 1% decrease in homeowners direct premiums written. The decrease in PPA direct premiums written is the result of the companies decision, implemented in 2001, not to write new policies in certain jurisdictions and from the approval of the companies plan to withdraw from the New Jersey PPA market by the New Jersey Department of Banking and Insurance, which was effective in June 2003. As a result, voluntary PPA policies in force at December 31, 2004 were 19,931, a decrease of 8,492 or 30%, from 28,423 at December 31, 2003.

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Mutual introduced a monoline commercial umbrella program in the fourth quarter of 2003 (the Umbrella Program). The Umbrella Program is marketed exclusively through one independent agent and approximately 95% of the premiums related to Umbrella Program policies are reinsured with an A rated national reinsurer through a quota share reinsurance treaty.

Group-wide voluntary commercial lines direct premiums written were $119,113,000, an increase of $15,851,000, or 15%, from $103,262,000 in 2003. This increase resulted from period to period increases in every significant group-wide commercial line of business. The average premium per group-wide, non-Umbrella Program commercial lines policy increased 7% from the year earlier period. Total non-Umbrella Program commercial lines policies in force at December 31, 2004 were 33,415, an increase of 6% from 31,485 at December 31, 2003.

The 31% decrease in group-wide involuntary direct premiums written resulted primarily from a decrease in assignments from the New York Automobile Insurance Plan (NYAIP). Direct premiums written related to policies assigned from the NYAIP decreased to $2,783,000 for 2004 from $3,909,000 for 2003. The NYAIP provides coverage for individuals who are unable to obtain auto insurance in the voluntary market. Assignments from the NYAIP vary depending upon a company s PPA market share and the size the NYAIP. The Company is unable to predict the volume of future assignments from the NYAIP.

In order to minimize the adverse impact of assignments from the NYAIP, the Company purchased territorial credits from an unaffiliated company pursuant to Section 6.A.7. of the NYAIP Manual. The credits against NYAIP assignments were generated by the other insurance company for writing PPA business in certain localities in New York with PPA market availability problems. The other insurance company, by nature of its concentration in PPA business in credit territories, generated more credits than it required to offset its NYAIP assignments. The credits purchased reduced the Company s share of the NYAIP. The credits purchased decreased direct premiums written related to NYAIP assignments during 2004 by approximately $2,351,000 and by approximately $2,256,000 for 2003.

Group-wide pooled net premiums written for 2004 were $163,546,000, an increase of $1,857,000, or 1%, from $161,689,000 for 2003. This increase resulted from the 9% increase in group-wide direct premiums written, offset by an increase in 2004 as compared to 2003 of reinsurance premiums ceded to third parties, primarily for premiums written related to the Umbrella Program. The Company s share of pooled net premiums written in 2004 in accordance with the Reinsurance Pooling Agreement was $53,102,000, a decrease of $11,077,000 or 17% from $64,179,000 in 2003. This decrease resulted primarily from the 5 percentage point decrease in the Company s participation in the Reinsurance Pooling Agreement.

Total revenues for 2004 were $65,505,000, a decrease of $11,467,000 or 15%, from $76,972,000 in 2003.

The Company s share of pooled net premiums earned in accordance with the Reinsurance Pooling Agreement for 2004 was $57,123,000. The Company s share of net premiums earned in 2003 were $65,097,000. This $7,974,000, or 12%, decrease in net premiums earned primarily resulted from the 5 percentage point decrease in the Company s participation in the Reinsurance Pooling Agreement.

Net investment income was $7,881,000, a decrease of $934,000 or 11% from $8,815,000 in 2003. The average pre-tax yield associated with the investment portfolio decreased 40 basis points to 4.0% in 2004 compared to 2003. Average invested assets for 2003 decreased 2% from the year earlier period.

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Net investment losses were $221,000 ($.07 per fully diluted share after taxes) in 2004 compared to $2,500,000 of net investment gains ($.78 per fully diluted share after taxes) in 2003. The 2004 amount included an aggregate $700,000 of investment losses related to an other-than-temporary impairment in the value of two investment securities owned by the Company at December 31, 2004. The 2003 amount related primarily to the sale of an otherwise illiquid security to its issuer through a share repurchase program.

Other revenues were $722,000 in 2004, an increase of $162,000 or 29% from $560,000 in 2003, primarily due to a $180,000 decrease in premium receivable charge-offs.

Net losses and LAE were $37,681,000 for 2004, a decrease of $11,931,000 or 24% from $49,612,000 for 2003. The decrease in net losses and LAE was due to the 12% decrease in net premiums earned and a 10.2 percentage point decrease in the loss and LAE ratio to 66.0% in 2004 from 76.2% in 2003. This 10.2 percentage point decrease in the loss and LAE ratio was due to a 9.0 percentage point decrease in the loss and LAE ratio for the current accident year to 67.4% in 2004 from 76.4% in 2003 and a $753,000 decrease in the change in the Company s estimates of losses incurred related to prior accident years.

The 9.0 percentage point decrease in the loss and LAE ratio for the current accident year primarily resulted from:

- A reduction in PPA liability net earned premium as a percentage of total Company net earned premium to 16.7% in 2004 from 20.2% in 2003. PPA liability is the Company s highest loss and LAE ratio line of business and accounted for 1.5 percentage points of the decrease.

- An improvement in the PPA liability loss and LAE ratio to 86.6% in 2004 from 111.6% in 2003 which accounted for 4.2 percentage points of the decrease. This improvement was due to improved involuntary loss experience, primarily from the NYAIP.

- An improvement in the commercial package loss and LAE ratio to 69.0% in 2004 from 81.8% in 2003 which accounted for 3.5 percentage points of the decrease. This improvement was the result of a reduction in loss frequency.

The Company recorded decreases to its estimate of losses and LAE related to prior accident years of $843,000 and $90,000 in 2004 and 2003, respectively, a change of $753,000. These decreases in losses and LAE relating to prior accident years reduced the loss and LAE ratio in 2004 and 2003 by 1.5 and .1 percentage points, respectively. The reserve development for each product and for each accident year during 2004 was within the range of reasonably likely reserves by product as of December 31, 2003. It is not appropriate to predict future increases or decreases in the estimate of losses and LAE for prior accident years from past experience. See Critical Accounting Policies and Estimates for a further discussion of the Company s Reserves for Losses and LAE. The following table documents the changes in the estimate of losses and LAE related to prior accident years recorded in 2004 for the Company s primary products.

Accident Year	Home-owners	PPA Liability	Commercial Auto Liability	Workers Compen-sation	Commercial Package	General Liability	All Other	Total
	Increases (decreases) (in thousands)							
Prior to 2001	$ (109)	$ 455	$ 764	$ 533	$ 2,183	$ 1,119	$ (176)	$ 4,769
2001	152	(17)	121	(1,221)	(450)	(123)	(41)	(1,579)
2002	60	(269)	(1,072)	(921)	915	59	94	(1,134)
2003	(7)	(1,529)	268	(433)	(909)	(299)	10	(2,899)
Total	$ 96	$ (1,360)	$ 81	$ (2,042)	$ 1,739	$ 756	$ (113)	$ (843)

The Company experienced favorable development during 2004 in its PPA liability product of $1,529,000 relating to accident year 2003, primarily due to lower claims frequency and lower estimated severity on involuntary business assigned from the NYAIP. These changes are consistent with increased fraud prevention, detection and prosecution efforts stemming from certain legislative changes in New York State. Furthermore, the Company believes that due to increased market availability in the voluntary market, many of the worst drivers previously insured in the NYAIP no longer obtain insurance from the NYAIP. The impact of the legislative activity and the shift in the market was not evident until 2004 and as such are reflected in current reserve estimates.

The Company experienced favorable development during 2004 in its workers compensation product of $1,221,000 relating to accident year 2001 and $921,000 relating to accident year 2002. The accident year 2001 development resulted from lower than expected emergence of paid losses and incurred losses in 2004, and a reduction in the expected loss per claim to $11,500 as of 2004 from $12,200 as of 2003.

The Company made no significant changes to its procedures for processing or reserving for workers compensation claims during 2004. In addition to the comments above related to the 2001 accident year, the $2,042,000 of favorable loss development on the workers compensation product stems from inherent uncertainty in estimating ultimate costs in circumstances that involve the complex and changing medical condition of claimants. However, the Company believes that the decrease in loss estimates for workers compensation business is consistent with changes initiated by the Company in 2002 to reduce the concentration in its workers compensation policy portfolio of classes of risk that are subject to high severity losses, which became evident in the loss development activity in 2004. The underwriting changes have continued through 2004. The Company believes that it took several years for the absence of severe losses to become apparent, as such losses, if any, typically do not become apparent for several years.

During 2004, the Company experienced unfavorable development in its commercial package and general liability products amounting to $3,302,000 related to accident years prior to 2001, due to greater than anticipated incurred loss development. For instance, the Company experienced adverse jury verdicts in 2004 on prior accident year claims that it believed had no merit and were therefore not reflected in case reserves. These claims, when considered in the loss development factors used during 2004, impacted severity for several accident years.

The Company has made no changes to its procedures for processing or reserving for commercial package and general liability claims and is not aware of any changes to its business that might have caused a change in loss development patterns, except for the two large claims noted above.

The Company s reduction in its estimate of losses and LAE related to prior accident years represented less than 1% of the recorded reserve for losses at December 31, 2003 and is within a reasonable range of loss reserve volatility for the products being underwritten.

The Company made no changes to the key assumptions used in evaluating the adequacy of its reserves for losses and LAE during 2004. A reasonable possibility exists in any year that relatively minor fluctuations in the estimate of reserves for losses and LAE may have a significant impact on the Company s net income. This is due primarily to the size of the Company s reserves for losses and LAE ($128,415,000 at December 31, 2004) relative to its net income.

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Involuntary automobile insurance business increased the Company s calendar year loss and LAE ratio by approximately .2 and 1.8 percentage points for the years ended December 31, 2004 and 2003, respectively.

The ratio of amortized deferred policy acquisition costs and other underwriting expenses to net premiums earned increased to 40.5% for 2004 from 33.7% for 2003. A $2,073,000 or 12%, decrease in the amortization of deferred acquisition costs was more than offset by a $3,260,000 or 65% increase in other underwriting expenses. Other underwriting expenses included $1,543,000 (2.7 percentage points of the expense ratio) of retrospective commission expense related to the Reinsurance Pooling Agreement which provides for retrospective commission income or expense based on actual experience compared to a targeted loss and LAE ratio. The commission is owed to Mutual based on a decrease during 2004 in the estimated cumulative loss and LAE ratio on the pooled business since the inception of the Reinsurance Pooling Agreement.

During 2003 the Company recorded $305,000 of retrospective commission income related to the Reinsurance Pooling Agreement. This amount reduced the 2003 ratio of amortized deferred policy acquisition costs and other underwriting expenses to net premiums earned by .5 percentage points. Other underwriting expenses also include $266,000 related to the November 2004 resignation of the Company s President and $486,000 of consulting and due diligence expenses pertaining to the investigation of business opportunities. Other underwriting expenses also included $462,000 and $228,000 in 2004 and 2003, respectively, related to the purchase of territorial credits against NYAIP assignments discussed earlier in this item. Commissions (other than retrospective commissions under the Reinsurance Pooling Agreement), premium taxes and other state assessments that vary directly with the Company s premium volume represented 19.9% and 19.7% of net premiums earned in 2004 and 2003, respectively.

The provision for income taxes for 2003 includes the effect of a May 2003 change in New York State law with respect to the taxation of non-life insurance companies. This change eliminated state income taxes for all non-life insurance companies and increased the premium tax rate from 1.3% to 2.0%. This change in New York State law lowered the Company s effective income tax rate by approximately 4 percentage points in 2003. Further, as a result of this change, the Company reduced its deferred tax liability with respect to New York State income taxes to $0 during 2003. This one time benefit reduced the Company s effective income tax rate for 2003 by 9 percentage points. In addition, tax exempt income reduced the Company s effective income tax rate by 8 and 4 percentage points, respectively, for the years ended December 31, 2004 and 2003. In addition, the Company recorded adjustments to prior years taxes and reversed excess tax reserves related to uncertain tax positions which reduced the Company s effective income tax rate by 4 and 3 percentage points, respectively, for the year ended December 31, 2004.

2003 Compared to 2002

Total revenues for 2003 were $76,972,000, a decrease of $18,139,000 or 19% from $95,111,000 in 2002.

Results of operations for 2003 reflect the effects of the Services Agreement and the Reinsurance Pooling Agreement among the Company, its wholly-owned insurance subsidiary, MNH, and Mutual, effective January 1, 2003. MNH did not participate in a pooling agreement in 2002 and therefore the results of operations for 2002 reflect business written independently by MNH. This analysis provides a comparison of the Company s share of pooled premiums for 2003 to unpooled premiums for the same period in 2002, as well as a comparison of the pooled, or combined Mutual and MNH, premiums written for 2003 to the combined business of Mutual and MNH for the same period in 2002, even though the companies were not party to a reinsurance pooling agreement in 2002.

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Total combined Mutual and MNH or group-wide direct premiums written for the year ended December 31, 2003 were $175,143,000, an increase of $2,403,000 or 1% from $172,740,000 in 2002. The Company s pro-forma share of combined direct premiums written in 2003, in accordance with the Reinsurance Pooling Agreement, was $70,057,000. The Company recorded $72,803,000 of direct premiums written in 2002. The table below shows a comparison of direct premiums written by major category in 2003 and 2002:

	Group-wide DWP Year ended December 31,			MNH Pooled Share Year ended December 31,	MNH DWP	
	2003	2002	Variance	2003	2002	Variance
	(000 s omitted)			(000 s omitted)		
Voluntary Personal Lines	$ 63,548	$ 68,649	(7%)	$ 25,419	$ 39,981	(36%)
Voluntary Commercial Lines	106,398	97,032	10%	42,559	26,825	59%
Involuntary	5,197	7,059	(26%)	2,079	5,997	(65%)
Total Direct Written Premiums	$ 175,143	$ 172,740	1%	$ 70,057	$ 72,803	(4%)

The 7% decrease in group-wide voluntary personal lines direct premiums written resulted from a 10% decrease in PPA direct premiums written, somewhat offset by a 1% increase in homeowners direct premiums written. The decrease in PPA direct premiums written is the result of the group s policy, implemented in 2002, not to write new policies in certain jurisdictions and from the approval of the companies plan to withdraw from the New Jersey PPA market by the New Jersey Department of Banking and Insurance, which was effective in June 2003. As a result, voluntary PPA policies in force at December 31, 2003 were 28,423, a decrease of 5,996 or 17% from 34,419 at December 31, 2002.

The 10% increase in group-wide voluntary commercial lines direct premiums written resulted from a 16% increase in average premium per commercial lines policy, somewhat offset by a 5% decrease in commercial lines policies in force. A 6% average increase in commercial lines premium rates contributed to the increase in average premium per commercial lines policy.

The 26% decrease in group-wide involuntary written premiums, which consist primarily of involuntary PPA insurance, resulted primarily from a decrease in group-wide assignments from the NYAIP to $3,909,000 in 2003 from $6,201,000 in 2002. The NYAIP provides coverage for individuals who are unable to obtain auto insurance in the voluntary market. Assignments from the NYAIP vary depending upon a company s PPA market share and the size of the NYAIP. The Company is unable to predict the volume of future assignments from the NYAIP.

In order to minimize the adverse impact of assignments from the NYAIP, the Company purchased territorial credits from an unaffiliated insurance company. The credits against NYAIP assignments were generated by the other insurance company for writing PPA business in certain localities in New York with PPA market availability problems. The other insurance company, by nature of its concentration in PPA business in credit territories, generated more credits than it required to offset its NYAIP assignments. The credits purchased reduced the Company s share of the NYAIP by $2,256,000 in 2003.

Group-wide pooled net premiums written for 2003 were $161,689,000, a decrease of $2,407,000, or 1% from $164,096,000 for 2002. This decrease resulted from the 1% increase in group-wide direct premiums written, offset by an increase in 2003 as compared to 2002, of reinsurance premiums ceded to third parties. The Company s share of pooled net premiums written in 2003 in accordance with the

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Reinsurance Pooling Agreement was $64,179,000, a decrease of $6,349,000 or 9% from its unpooled net premiums written of $70,528,000 in 2002.

The Company s share of pooled net premiums earned in accordance with the Reinsurance Pooling Agreement for 2003 was $65,097,000. Net premiums earned in 2002 were $83,120,000. The decrease in net premiums earned primarily resulted from the decreases in net premiums written in 2002 and 2003. Had MNH s share of pooled premiums earned in 2003 been 35% (MNH s share for 2004), earned premiums for 2003 would have been $59,960,000.

Net investment income was $8,815,000 in 2003, a decrease of $1,588,000 or 15% from $10,403,000 in 2002. The average pre-tax yield associated with the investment portfolio decreased 98 basis points to 4.4% in 2003 compared to 2002. Average invested assets for 2003 decreased 3% from the year earlier period.

Net investment gains were $2,500,000 ($.78 per fully diluted share after taxes) in 2003 compared to $953,000 ($.30 per fully diluted share after taxes) in 2002. A majority of the 2003 amount ($2,050,000) resulted from the Company taking advantage of a share repurchase program for an otherwise illiquid security.

Other revenues were $560,000 in 2003, a decrease of $75,000 or 12% from $635,000 in 2002, primarily due to a $93,000 or 10% decrease in service fee income.

Net losses and LAE were $49,612,000 for 2003, a decrease of $13,261,000 or 21% from $62,873,000 for 2002. This decrease resulted primarily from a 22% decrease in net premiums earned. The loss and LAE ratio was 76.2% for 2003 compared to 75.6% for 2002.

The Company recorded decreases to its estimate of losses and LAE related to prior accident years of $90,000 and $3,785,000 in 2003 and 2002, respectively. These decreases in losses and LAE relating to prior accident years reduced the loss and LAE ratio in 2003 and 2002 by .1 and 4.6 percentage points, respectively. The decrease recorded in 2002 was primarily the result of favorable loss development related to known claims on workers compensation policies, as the Company experienced fewer claims that required an increase in the reserve for future medical expenses due to the estimated duration of treatment increasing from a fixed period of time to lifetime care. In addition, the Company also settled a higher than anticipated number of workers compensation claims through lump sum settlements in jurisdictions where such settlements are permitted. The following table documents the changes in the estimate of losses and LAE related to prior accident years recorded in 2003 for the Company s primary products:

Accident Year	Home-owners	PPA Liability	Commercial Auto Liability	Workers Compen-sation	Commercial Package	General Liability	All Other	Total
	Increases (decreases) (in thousands)							
Prior to 2000	$ (40)	$ 78	$ (460)	$ 4,496	$ (2,533)	$ 1,612	$ 21	$ 3,174
2000	(148)	307	(993)	924	63	809	9	971
2001	(85)	(715)	(563)	(161)	1,757	70	(101)	202
2002	(277)	(3,717)	(938)	(205)	746	(47)	1	(4,437)
Total	$ (550)	$ (4,047)	$ (2,954)	$ 5,054	$ 33	$ 2,444	$ (70)	$ (90)

The Company experienced favorable development related to its PPA liability product of $3,717,000 for accident year 2002, primarily relating to lower claims frequency and lower estimated severity on involuntary business assigned from the NYAIP. These changes are consistent with increased fraud prevention, detection and prosecution efforts stemming from certain legislative changes in New York State. Furthermore, the Company believes that due to increased market availability in the voluntary market, many of the worst drivers previously insured in the NYAIP no longer obtain insurance from the NYAIP.

The Company experienced favorable loss development related to its commercial auto liability product relating to all accident years, primarily due to a reduction in claim severity that was consistent with changes in underwriting selection criteria that reduced the percentage of commercial automobile policies that were likely to generate more severe accidents. These classes included heavy-duty commercial vehicles and vehicles that traveled outside of a certain radius of operations in their day-to-day business. The reduction in loss severity did not become apparent for a period of time after the change in underwriting guidelines was initiated.

The Company experienced unfavorable loss development related to its workers compensation product of $5,420,000 relating to accident years 2000 and prior. This development resulted from a greater than expected number of reserve increases recorded by the Company to individual case reserves to record the estimated costs for life-time medical care for claims occurring from 1991 to 1999. The Company is not able to attribute these changes to any cause other than the volatility inherent in estimating medical expenses on claims from the workers compensation product.

The Company s reduction in its estimate of losses and LAE related to prior accident years represented less than 1% of the recorded reserve for losses and LAE at December 31, 2002. A reasonable possibility exists in any year that relatively minor fluctuations in the estimate of reserves for losses and LAE may have a significant impact on the company s net income. This is due primarily to the size of the Company s reserves for losses and LAE ($146,474,000 at December 31, 2003) relative to its net income.

The Company made no changes to the key assumptions used in evaluating the adequacy of its reserves for losses and LAE during 2003.

Involuntary automobile insurance business increased the Company s calendar year loss and LAE ratio by approximately 1.8 and 9.0 percentage points for the years ended December 31, 2003 and 2002, respectively. The combined ratio on involuntary automobile business was greater than the combined ratio on voluntary automobile business.

The ratio of amortized deferred policy acquisition costs and other underwriting expenses to net premiums earned was 33.7% in both 2003 and 2002. An increase in the premium tax rate in New York State, which is discussed in the following paragraph, added .5 percentage points to the Company s ratio of amortized deferred policy acquisition costs and other underwriting expenses to net premiums earned in the 2003 period. Other underwriting expenses for 2003 included $305,000 of retrospective commission income to be received from Mutual in accordance with the Reinsurance Pooling Agreement. This retrospective commission income reduced the ratio of deferred policy acquisition costs and other underwriting expenses to net premiums earned by .5 percentage points. Other underwriting expenses also included $228,000 related to the purchase of territorial credits against NYAIP assignments discussed earlier in this Item, which added .4 percentage points to the ratio of amortized deferred policy acquisition costs and other underwriting expenses to net premiums earned. There were no such credits purchased in 2002. Commissions, premium taxes and other state assessments that vary directly with the Company s premium volume represented 19.7% of net premiums earned in 2003 and in 2002.

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The provision for income taxes for 2003 includes the effect of a May 2003 change in New York State law with respect to the taxation of non-life insurance companies. This change eliminated state income taxes for all non-life insurance companies and increased the premium tax rate from 1.3% to 2.0%. This change in New York State law lowered the Company s effective income tax rate by approximately 4 percentage points in 2003. Further, as a result of this change, the Company reduced its deferred tax liability with respect to New York State income taxes to $0 during 2003. This one time benefit reduced the Company s effective income tax rate for 2003 by 9 percentage points. In addition, tax exempt income reduced the Company s effective income tax rate by 4 and 2 percentage points, respectively, for the years ended December 31, 2003 and 2002.

Critical Accounting Policies

Reserve for Losses and LAE

The Reserve for Losses and LAE is an estimate of the ultimate cost of settling all losses incurred and unpaid, including those losses not yet reported to the Company, and is stated net of reinsurance. The amount of loss reserves for reported claims is based upon a case-by-case evaluation of the circumstances pertaining to the claim and the policy provisions relating to the loss. Reserves for claims that have occurred but have not been reported (IBNR) to the Company and for the costs of settling or adjusting claims are determined using commonly accepted actuarial techniques based on historical information for each of the Company s products, adjusted for current conditions.

The Company s primary assumption when determining its reserves is that past experience, adjusted for the effect of current developments and trends, is relevant in predicting future events. When establishing its loss reserves, the Company analyzes historical data and estimates the impact of various loss development factors such as the historical loss experience of the Company and of the industry, the mix of products sold, trends in claim frequency and severity, the Company s claim processing procedures, changes in legislation, judicial decisions, legal developments, including the prevalence of litigation in the areas served by the Company, and changes in general economic conditions including inflation.

Management determines the amount of reserves for losses and LAE to be recorded based upon analyses prepared by the Company s internal and external actuaries and management s assessment of a reasonable amount of reserves. The reasonable estimate is determined after considering the estimates produced using a variety of actuarial techniques for each of the Company s products. The following is a summary of the methods used:

Paid Loss Development

The paid loss development method is based on the assumption that past rates of claims payments are indicative of future rates of claims payments. An advantage of this method is that paid losses contain no case reserve estimates. Additionally, paid losses are not as greatly influenced by changes in claims reserving practices as are incurred losses. Estimates can be distorted if changes in claims handling practices or procedures cause an acceleration or deceleration in claims payments. Furthermore, paid loss development may produce biased estimates for long-tailed products where paid loss development factors are large at early evaluation points.

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Incurred Loss Development
The incurred loss development method is based on the assumption that the past relative adequacy of case reserves is consistent with the current relative adequacy of case reserves. Because incurred losses include payments and case reserves, a larger volume of data is considered in the estimate of ultimate losses. As a result, incurred loss data patterns may be less erratic than paid loss data patterns, particularly for coverages on which claims are reported relatively quickly but have a long payout pattern. Because this method assumes that the relative adequacy of case reserves has been consistent, changes in claims handling procedures or the occurrence or absence of large losses may cause estimates to be erratic.

Bornhuetter-Ferguson with Premium and Paid Loss
The Bornhuetter-Ferguson (BF) with premium and paid loss method is a combination of the paid loss development method and an expected loss ratio assumption. The expected loss ratios are modified to the extent actual loss payments differ from payments expected based on the selected paid loss development pattern. This method avoids possible distortions resulting from a large development factor being applied to a small base of paid losses in order to estimate ultimate losses. This method will react slowly if actual ultimate losses differ substantially from losses inherent in the expected loss ratio.

Bornhuetter-Ferguson with Premium and Incurred Loss
The Bornhuetter-Ferguson (BF) with premium and incurred loss method is a combination of the incurred loss development method and an expected loss ratio assumption. The expected loss ratios are modified to the extent actual incurred losses differ from expected incurred losses based on the selected incurred loss development pattern. This method avoids possible distortions resulting from a large development factor being applied to a small base of incurred losses in order to estimate ultimate loss. This method will react slowly if actual ultimate losses differ substantially from losses inherent in the expected loss ratio.

Ultimate Claims and Average Loss
This method multiplies the estimated number of ultimate claims by a selected ultimate average loss for each accident year to produce ultimate loss estimates. If loss development methods produce erratic or unreliable estimates, this method can provide more stable estimates, consistent with recent loss history. This method may produce erratic results if there has been a change in the way claims are counted or in the mix of types of loss. The occurrence or absence of large losses can also distort the average loss estimate.

Allocated loss adjustment expenses (ALAE) are estimated separately from losses because ALAE payment patterns differ from loss payment patterns. The company employs the following methods to estimate ALAE reserves.

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Paid ALAE Development
This method is analogous to the paid loss development method except paid ALAE is developed instead of paid losses. Paid ALAE patterns often are more stable than paid loss patterns. However, paid ALAE typically develop more slowly than paid losses, resulting in a large leveraging impact on less mature accident years.

Bornhuetter-Ferguson with Ultimate Loss and Paid ALAE
The Bornhuetter-Ferguson (BF) with ultimate loss and paid ALAE method is a combination of the paid ALAE development method and an expected ratio of ultimate ALAE to ultimate loss. The expected ALAE to loss ratios are modified to the extent paid ALAE differ from expected based on the selected paid ALAE development pattern. This method avoids possible distortions resulting from a large development factor being applied to a small base of paid ALAE in order to estimate ultimate ALAE. This is a useful method for estimating ultimate ALAE for less mature accident years.

Estimated ultimate losses and LAE and the resulting reserve for losses and LAE are determined based on the results of the methods described above along with the following considerations:

- How results of methods based on paid losses compare to methods based on incurred losses.
- How results of paid and incurred development methods compare to results of paid and incurred BF methods.
- Whether diagnostic tests cause management to favor the results of one or more methods over the results of other methods. Such tests include:
  - o closed claim to reported claim ratios
  - o average case reserves per open claim
  - o paid loss per closed claim
  - o paid loss to incurred loss ratios
  - o the reasonableness of ultimate loss & ALAE ratios and ultimate severities
  - o management s consideration of other factors such as premium and loss trends, large loss experience, legislative and judicial changes and changes in underwriting guidelines and practices.

To the extent these considerations result in changes to the Company s estimates of reserves for losses and LAE related to prior accident years, the Company recognizes such changes in the accounting period in which the change becomes known.

As stated previously, the above methods assume that past experience adjusted for the effects of current developments and trends is an appropriate basis for predicting future events. As a result of a number of factors, it is possible that ultimate actual payments for losses and LAE will differ from amounts contemplated in recorded reserves. A range of reasonably likely reserves by product as of December 31, 2004 developed by the Company s actuaries based on a variety of generally accepted actuarial methods is shown in the table below. Generally the low and the high values in the range represent reasonable minimum and maximum amounts of these actuarial indications using the methods described above.

	Range of Net Loss & LAE Reserves ($000 s)		
Products	Low	Recorded	High
Personal Auto	$16,379	$ 19,269	$ 21,967
Homeowners	$ 2,365	$ 2,994	$ 3,653
Commercial Auto	$11,762	$ 15,683	$ 20,388
Workers Compensation	$22,997	$ 27,707	$ 32,694
Commercial General Liability	$35,528	$ 41,974	$ 49,949
Commercial Property	$ 4,202	$ 5,002	$ 5,952
Other	$ 117	$ 156	$ 195
All Products	$99,633	$112,785	$121,650

Because the reserve estimates by product are independent of each other it is highly unlikely that the low estimate or the high estimate for each product will occur at the same time. Accordingly, the low and the high estimates for All Products shown above are less than the sum of the low and high estimates of each of the Company s products.

Despite the many factors considered in the reserving process, it is reasonably possible that actual payments for losses & LAE will differ from those contemplated in the Company s reserves. Such fluctuations could have a significant impact on the Company s net income. This is primarily due to the size of the Company s reserves for losses and LAE ($128,415,000 at December 31, 2004) relative to its net income. For every 1% change in the estimate for reserves for losses and LAE at December 31, 2004, the effect on the Company s pre-tax net income would be $1,284,000.

The following table presents the liability for the reserve for unpaid loss and loss adjustment expenses separated into case reserves, reserves for loss incurred but not reported (IBNR) and reserves for LAE by major product:

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	December 31, 2004	December 31, 2003
Case reserves:		
PPA liability	$ 10,099	$ 15,987
Homeowners	2,097	2,139
Commercial auto liability	7,677	7,741
Workers compensation	15,698	15,354
Commercial package	13,795	15,163
General liability	750	1,348
Other	243	369
Total case reserves	50,359	58,101
IBNR:		
PPA liability	6,197	7,357
Homeowners	257	235
Commercial auto liability	6,154	6,121
Workers compensation	9,884	12,133
Commercial package	14,467	13,174
General liability	1,107	1,543
Other	(223)	(589)
Total IBNR	37,843	39,974
Reserve for LAE:		
PPA liability	2,973	3,395
Homeowners	640	689
Commercial auto liability	1,852	2,042
Workers compensation	2,125	2,026
Commercial package	13,712	15,377
General liability	3,145	1,957
Other	136	198
Total reserve for LAE	24,583	25,684
Subtotal	112,785	123,759
Reinsurance recoverables	15,630	22,715
Reserve for losses and LAE	$ 128,415	$ 146,474

Included in the reserve for losses and LAE at December 31, 2004 was $10,784,000 of reserves for accident years 1994 and prior. Reserves related to workers compensation comprised $7,552,000 of this amount at December 31, 2004. The following table presents workers compensation claim count and paid loss data for accident years older than ten years as of each date:

	For the year ended December 31,	
	2004	2003
	(dollars in thousands)	
Number of claims pending, beginning of period	44	42
Number of claims reported		
Number of claims settled or dismissed	(2)	(5)
Number of claims pending, end of period	42	37
Losses paid ($000 s)	$ 388	$ 764
Loss settlement expenses paid ($000 s)	$ 25	$ 24

The workers compensation claims consist primarily of reserves for the estimated cost of lifetime medical care for injured claimants. In developing the reserves for such claimants, the Company estimates the nature, frequency and duration of future medical treatments and pharmaceutical usage, in some instances for the lifetime of the claimant. Periodic reevaluation of these factors, based on new information on the

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claimant or changes in medical procedures, devices or pharmaceuticals, may result in changes in estimates for individual claims that are significant to the Company.

Deferred Policy Acquisition Costs

Policy acquisition costs, such as commissions (net of reinsurance commissions), premiums taxes and certain other underwriting expenses which vary directly with premium volume, are deferred and amortized over the terms of the related insurance policies. Deferred policy acquisition costs are evaluated on an aggregate basis at least annually, to determine if recorded amounts exceed estimated recoverable amounts after allowing for anticipated investment income. Premium deficiencies if any, are recorded as amortization of deferred policy acquisition costs. Actual amounts may vary from the Company s estimates.

Investments

Fixed maturity investments are classified as available for sale and are carried at fair value. Net unrealized holding gains or losses, net of taxes, are shown as accumulated other comprehensive income. Investment income is recognized when earned, and gains and losses are recognized when investments are sold and in instances when a decline in the fair value of a security is determined to be other-than-temporary.

The Company s investment committee, comprised of the Chief Operating Officer, the Chief Investment Officer and the Chief Financial Officer, meets monthly and monitors the Company s investment portfolio for declines in value that are other-than-temporary. This assessment requires significant judgment. The investment committee considers the nature of the investment, the severity and length of the decline in fair value, events specific to the issuer including valuation modeling, overall market conditions, and the Company s intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in market value. When a decline in the fair value of a security is determined to be other-than-temporary, the Company adjusts the cost basis of that security to fair value. A charge to earnings is recorded as a loss. Future increases in fair value and future decreases in fair value if not other-than-temporary, are included in other comprehensive income.

Liquidity and Capital Resources

In developing its investment strategy the Company determines a level of cash and short-term investments which, when combined with expected cash flow, is estimated to be adequate to meet expected cash obligations. Due to declining written premiums however, the Company s operating activities have resulted in a use of cash each year since 2001. The Company s decreasing participation percentage in the pooled business over the remaining years of the Reinsurance Pooling Agreement will likely result in continued negative cash flows from operations. Net cash used in operations was $11,577,000 in 2004. The Company believes that careful management of the relationship between assets and liabilities will minimize the likelihood that investment portfolio sales will be necessary to fund insurance operations, and that the effect of any such sales, if any, on the Company s stockholders equity will not be material.

The Company s objectives with respect to its investment portfolio include maximizing total return within investment guidelines while protecting policyholders surplus and maintaining flexibility. The Company relies on premiums as a major source of cash, and therefore liquidity. Cash flows from the Company s investment portfolio, in the form of interest or principal payments, are an additional source of liquidity.

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At December 31, 2004, the Company owned 111 investment securities of which 50 had unrealized losses. As of December 31, 2004 all of the Company s fixed maturity investments were exchange traded or are readily marketable and are supported by the broker/dealer community. The total potential impact on the Company s future earnings if the unrealized losses associated with its investment portfolio at December 31, 2004 were to become other-than-temporary would be $901,000, or $595,000 after taxes.

Included in net investment losses for the year ended December 31, 2004 are write-downs on two investment securities held in the Company s investment portfolio at December 31, 2004 determined to have had an other-than-temporary impairment in market value. The total a