

MEADOWBROOK INSURANCE GROUP INC  
Form 10-K  
March 02, 2015  
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

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

**For the fiscal year ended December 31, 2014**

**OR**

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

**Commission File Number: 1-14094**

**MEADOWBROOK INSURANCE GROUP, INC.**  
(Exact name of Registrant as specified in its charter)

**Michigan**  
(State of Incorporation)

**38-2626206**  
(IRS Employer Identification No.)

**26255 American Drive, Southfield, MI**  
(Address of principal executive offices)

**48034-6112**  
(Zip Code)

**Registrant's telephone number, including area code: (248) 358-1100**  
**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of Each Class</b>	<b>Name of Exchange on Which Registered</b>
Common Stock, \$.01 par value per share	New York Stock Exchange
<b>Securities registered pursuant to Section 12(g) of the Act: None</b>	

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

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

Yes  No

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  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) 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.

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

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

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

The aggregate market value of the voting and non-voting common stock held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of June 30, 2014 was \$360,159,251. As of February 18, 2015, there were 50,090,691 shares of the Company's common stock (\$.01 par value) outstanding.

**Documents Incorporated by Reference**

Certain portions of the Registrant's Proxy Statement for the 2015 Annual Shareholders' Meeting are incorporated by reference into Part III of this report.

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### **MEADOWBROOK INSURANCE GROUP, INC.**

#### **PART I**

#### **ITEM 1. BUSINESS**

##### **Legal Organization**

Meadowbrook Insurance Group, Inc. (NYSE: MIG) is a holding company organized as a Michigan corporation in 1985. Our principal executive offices are located at 26255 American Drive, Southfield, Michigan 48034-6112 (telephone number: (248) 358-1100). Meadowbrook was initially founded in 1955 as Meadowbrook Insurance Agency and was subsequently incorporated in Michigan in 1965.

As used in this Form 10-K, references to the Company, we, us, or our refer to Meadowbrook Insurance Group, Inc. (Meadowbrook) and its subsidiaries: Star Insurance Company (Star), ProCentury Corporation (ProCentury), Meadowbrook Inc., and Crest Financial Corporation. References to Meadowbrook also include Star's wholly-owned subsidiaries Ameritrust Insurance Corporation (Ameritrust), Savers Property and Casualty Insurance Company (Savers), and Williamsburg National Insurance Company (Williamsburg) and ProCentury's wholly-owned subsidiaries Century Surety Company (Century), ProCentury Insurance Company (PIC), and ProCentury Risk Partners Insurance Company (PROPIC).

Star, Savers, Williamsburg, Ameritrust, Century, and PIC are collectively referred to as the Insurance Company Subsidiaries.

##### **Recent Developments**

On December 30, 2014, Fosun International Limited (HKEx stock code: 00656, together with its subsidiaries, Fosun) and the Company announced each entered into a definitive agreement under which Fosun will acquire all of the issued and outstanding common stock of the Company. The transaction follows a thorough review of strategic alternatives by the Company's Board of Directors and represents a 24% premium over the Company's closing price on December 29, 2014 and a premium of 39% to the Company's three-month average closing price for the period ending December 29, 2014. The transaction also represents a multiple of approximately 1.04x the Company's tangible book value per share as of September 30, 2014.

The transaction is subject to the approval of the Company's shareholders as well as regulatory approvals and the satisfaction of other specified closing conditions. The transaction is expected to be completed in the second half of 2015.

See Risks Related to Our Being Acquired by Fosun.

##### **Business Overview**

We are a specialty niche focused commercial insurance underwriter and insurance administration services company, which also owns/operates insurance agencies and third-party administrators. We recognize revenue within the following categories: net earned premiums, net investment income, management administrative fees, commission revenue, claims fees, and net realized gains (losses). We remain committed to our core business model where we seek to combine our diverse revenue streams and efficient capital management to deliver consistent long-term growth in shareholder value.

Our mission dictates our commitment to serving:

- our clients, by providing them with customized insurance products and services, with an emphasis on developing long-term relationships;
- our associates, for whom we foster a positive and professional work environment with a strong commitment to diversity and equal opportunities for advancement;
- our shareholders, by promoting steady growth, financial stability and superior long-term investment opportunities; and
- our communities, by supporting charitable, cultural and educational organizations nationwide, while honoring our responsibility to protect the environment.

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The Company's objective is to create value by emphasizing a regional focus and diverse source of revenues between underwriting premiums, fee-for-service revenue and commissions:

Within our insurance company operations, we believe our approach balances an effective local touch with efficient national coordination and positions us to opportunistically pursue a wide range of business in response to changing market conditions. We market and underwrite specialty property and casualty insurance programs and products on both an admitted and non-admitted basis through a broad and diverse network of independent retail agents, wholesalers, program administrators and general agents, who value service, specialized knowledge, and focused expertise. Program business refers to an aggregation of individually underwritten homogeneous risks that have similar characteristics and are distributed through a select group of agents.

Within our fee-for-service operations, we generate fee revenue by providing administrative and risk management services to self-insured groups, municipal pools and trusts.

Through our agency operations, we earn commission revenue through securing quality business and personal insurance products for our clients. Our agencies are located in Michigan, California, Massachusetts, Kansas, and Florida and produce commercial, personal lines, life and accident and health insurance which are placed primarily with unaffiliated insurance carriers. Although our agencies are a minimal source of business for our Insurance Company Subsidiaries, the agency operations remain a core strategy enabling us to balance our sources of revenue.

Our strategy is to generate profitable results and to deliver consistent, long-term shareholder value. To achieve these results we seek to leverage the unique characteristics of our balanced business model to generate:

- consistent, profitable underwriting results;
- predictable investment income in a low-risk, high-quality, primarily fixed income portfolio;
- steady fee and commission income;
- strong cash flow from our Insurance Company Subsidiaries and non-regulated fee-based services to leverage invested assets to equity and manage debt service;
- steady growth through rate increases and select new business with proven track records;

We create a competitive advantage by investing in the talent and technology to efficiently service our clients; through strategically identified industry niches and individual account selectivity; and through adequate pricing and focused claims handling.

We monitor our objectives and strategy within the context of the interest rate environment, insurance market cycle conditions, inflation and general economic conditions. Our enterprise risk management ( ERM ) and capital management strategies are designed to ensure our compliance with regulatory guidelines and that our industry reputation is in good-standing. As we seek to maximize long-term shareholder value, our priorities and corresponding risk appetite may be influenced by these factors.

#### *The Meadowbrook Approach*

We have built our business in a manner that is designed to adapt to changing market conditions and deliver more predictable results. The following highlights key aspects of our model that contribute to our balanced approach:

**Diverse Revenue Sources:** We generate the vast majority of our revenues from net earned premiums. To help generate our premiums, we have developed specialty niche expertise relative to a wide range of underwriting risks. Consequently, our premium base is broadly diversified by line of business, customer, type of distribution and

geography. We also generate fee-for-service revenues from risk management services and commission revenue from our agencies that are not related to our insurance underwriting operations. Our range of capabilities provides flexibility for our long-term business development efforts as we seek to generate profitable growth. We also believe revenue diversification reduces our risk profile and enhances the sustainability of our business model.

Positioned to Manage Insurance Cycles: We serve markets that operate on different cycles and believe our mix of admitted and non-admitted capabilities enhances our balanced business model. Our admitted market

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capabilities generally provide a consistent source of revenues as this market generally has less pronounced cycles, higher renewal retentions, and more stable pricing than the non-admitted markets. Our non-admitted capabilities enable us to respond opportunistically to otherwise unavailable insurance and volatile pricing environments.

Conservative Investment Philosophy: We seek to generate consistent investment income through a low-risk, high-quality investment portfolio. We manage overall credit, interest rate, and liquidity risks when making investment decisions. We invest in highly-rated, investment grade securities. Our market risk to the investment portfolio is primarily interest rate risk associated with debt securities. Our exposure to equity price risk is related to our investments in high dividend equities. These investments comprise 7.0% of our investment portfolio. The duration of our high quality investment portfolio is well matched to our loss reserves and our investment approach reinforces our focus on underwriting profitability.

Ability to Attract and Retain Talented Insurance Professionals throughout United States: We have assembled a team of talented insurance professionals and are committed to providing career development opportunities and building a culture focused on delivering superior customer service. Our associates possess a wide range of expertise across all functions and lines of business. Moreover, our regional structure enables our associates to deliver strong and responsive local service to our clients. We believe this is a unique aspect of our business model that enables us to better serve our agency network.

Culture of Disciplined Underwriting, Claims Handling & Reserving: We have built a control environment that emphasizes a commitment to disciplined underwriting, claims handling and reserving. New business opportunities undergo a rigorous due diligence process with input provided from key functional areas and existing business is actively managed as discussed below.

Our underwriters are focused on achieving pricing adequacy and appropriate risk selection through adherence to program or insurance product underwriting guidelines. Underwriting trends are closely monitored, which enables us to proactively manage our business as we seek to deliver more predictable results. Our specialty lines products rely on dedicated underwriter leadership whereby the product is managed to meet a defined type of insured and we retain full underwriting and pricing authority. Our main street excess and surplus lines business includes binding authority and brokerage production sources. Our non-admitted program business employs dedicated underwriting specialists in the particular class of business being considered. These professionals review policy files for completeness and compliance with our terms, conduct on-site audits, and, when necessary, send and enforce underwriting notifications on files found to be out of compliance. With regard to property coverages, we limit exposures from catastrophe prone areas and purchase excess of loss and catastrophe reinsurance.

Additionally, our actuarial associates support underwriting with pricing and loss analysis. Corporate loss reserves are determined for each line of business, as Meadowbrook regularly performs a complete and detailed reserve analysis. Meadowbrook's actuaries utilize both standard and proprietary systems to accurately and efficiently analyze reserves. We also engage an outside actuarial firm to review our reserve estimates.

Finally, we have built a strong claims handling function internally that plays a substantial role in claims management and handling activities. Meadowbrook employs approximately 233 claims personnel who operate from 14 regional offices, located throughout the United States. We also operate a centralized support call center and manage a network of independent adjusters. Claims monitoring is conducted through self and corporate audits, internal controls and executive oversight reports.

### *Description of Programs, Products, and Services*

We market and underwrite specialty property and casualty insurance programs and products on both an admitted and non-admitted basis. We categorize our products into the following four categories:

Admitted Programs and Standard Market Products: The admitted programs that we write are characterized by risks that are homogeneous or similar within specialty line, class and niche segments of business but have a diverse geographic profile. We also write a range of standard market products that are distributed through specialty agents. Generally, the average account premium for our admitted programs and standard market products is approximately \$6,200. Due to the specialized nature of the program and distribution style, our



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admitted programs tend to have higher premium retention levels. This helps create stability in our business amid the cyclicity of the insurance industry. Examples of admitted programs we underwrite include coverages for the food service industry, educators, physicians, agricultural businesses and public entities. The largest line of business for our standard market products is workers' compensation.

Main Street Excess and Surplus Lines: The excess and surplus lines business we write include broad classes of Main Street commercial risks that are generally ineligible for coverage by the standard market. Generally, the average account premium for our excess and surplus lines risks is approximately \$2,500. The excess and surplus lines regulatory environment allows rate and form freedom, which gives us the flexibility to design tailored coverage forms that are often more restrictive than those available in the admitted market. The high degree of flexibility contributes to heightened competition during soft markets and creates the potential for rapid expansion during hard markets. Examples of our excess and surplus lines business we underwrite include coverages for restaurants, bars/taverns, apartments, hotels/motels, and contractors' liability. These examples and sub-classes can change as underwriting circumstances dictate.

Non-Admitted Programs: The non-admitted programs we write have characteristics that are similar to our admitted programs; however, the commercial risks we provide coverage for are generally ineligible for coverage by the standard or admitted market. With this focus on non-admitted program underwriting, we are able to provide coverage for start-up organizations and relatively low volume programs that other markets are unable or unwilling to serve. Examples of non-admitted programs we offer include coverages for pet-sitters, oil and gas contractors, and professional liability.

Specialty Market Products: We also offer specialty market products, where specific and unique underwriting expertise is required. We develop product solutions designed for specific specialty lines and market segments that may leverage either our admitted market or non-admitted market product capabilities, or both, depending on the market need. The specific and unique underwriting expertise that is required to write business in the segments we serve creates barriers to entry for new competitors. Examples of specialty markets we serve are the excess workers' compensation, environmental, and marine markets.

As part of delivering our insurance programs and products, we are actively involved in a range of activities as described below:

Program and Product Design. Before implementing a new program on behalf of a client, we generally review: (1) financial projections for the contemplated program, (2) historical loss and actuarial experience, (3) actuarial studies of the underlying risks, (4) the credit worthiness of the potential agent or client, and (5) the availability of reinsurance. Our senior management team and associates representing each of the risk-management disciplines work together to design, market, and implement new programs. Our due diligence process is structured to provide an underwriting risk assessment of the program and how the program fits within our client's entity wide business plan and our overall risk profile.

Underwriting Risk Selection and Policy Issuance. Our underwriting personnel help develop the proper criteria for selecting risks, while actuarial and reinsurance personnel evaluate and recommend the appropriate levels of rate and risk retention. The program is then tailored according to the requirements and qualifications of each client. With managed programs, we may also perform underwriting services based upon the profile of the specific program for a fee.

*Claims Administration and Handling.* We provide substantially all claims management and handling services for workers' compensation and most other lines, such as property, automobile liability, professional liability, and general liability. Our claims handling is managed by our field offices. Our corporate claims department monitors the results through self-audits, corporate claim audits, internal controls, and other executive oversight reports. With the exception of Midwest Financial Holdings, LLC ( MFH ), for which we have direct access to their paid and case reserve loss data and perform corporate claims audits, we handle substantially all claims functions for the majority of the programs we underwrite. Our involvement in claims administration and handling provides benchmarks and valuable feedback to program managers in assessing the client's risk environment and the overall structure of the program.

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Loss Prevention and Control. We provide loss control services which are designed to help clients prevent or limit the impact of certain loss events. Through an evaluation of the client's workplace environment, our loss control specialists assist the client in planning and implementing a loss prevention program and, in certain cases, provide educational and training programs. With our managed programs, we provide these same services for a fee based upon the profile of the specific program.

Reinsurance. Meadowbrook's Insurance Company Subsidiaries cede insurance to other insurers under pro rata and excess-of-loss contracts. These reinsurance arrangements diversify the Company's business and mitigate its losses arising from large risks or from hazards of an unusual nature. We maintain reinsurance treaties for our workers' compensation, liability, aviation, marine, surety and property programs. In addition, facultative reinsurance is obtained as required for individual risks on a policy-by-policy basis. Meadowbrook also has the ability to cede insurance through captives, rent-a-captives, large deductible programs, and indemnification agreements, and assume insurance from other insurers.

The Company's philosophy around reinsurance buying has not changed fundamentally and remains rooted in long-term relationships with highly rated reinsurers. These reinsurance partners are generally focused on the longer term profitability of their relationship with the Company.

We also provide the following services to our fee-for-service and agency clients:

Administration of Risk-Bearing Entities. We generate fee revenue by assisting in the formation and administration of risk-bearing entities for clients and agents. We provide administrative services to self-insured groups, municipal pools and trusts. Additionally, through our subsidiary in Washington D.C., we are able to provide administrative services for certain captives and/or rent-a-captives.

Agency. We earn commission revenue through the operation of our independent retail insurance agencies, located in Michigan, California, Massachusetts, Kansas and Florida. These agencies produce commercial, personal lines, life and accident and health insurance that is placed primarily with unaffiliated insurance carriers.

#### *Distribution*

We market our specialty property and casualty insurance products on both an admitted and non-admitted basis through a broad and diverse network of independent retail agents, wholesalers, program administrators and general agents (referred to as, agents or producers ). On a limited basis, some of our producers provide certain policy issuance functions on our behalf.

Unlike traditional standard market companies that sell a full menu of insurance products through their distribution network, we selectively determine distribution and target agents that meet the specific product focus and needs for each of our targeted programs for our admitted business. We seek program agents with a primary focus and established niche expertise and where our relationship is a significant if not a majority source of their revenues.

Our largest producer in 2014 was Midwest General Insurance Agency, LLC ( Midwest General ), which, in combination with its affiliates, accounted for 14.6% of our gross written premium. We have a 28.5% equity interest in Midwest General Agency's parent, MWFH. Our second largest producer in 2014 was Food Service Management, which in combination with its affiliates, accounted for 10.9% of our gross written premium. No other producer was responsible for more than 10% of our gross written premium.

We seek to offer incentives to our distribution network in a manner that aligns our distributors' financial interests with our balanced business model. We believe that risk-sharing motivates participants to focus on underwriting selection, loss prevention, risk control measures and adherence to stricter underwriting guidelines. Risk sharing structures are designed based on the particular risk management goals of our clients, market conditions and our assessment of the opportunity for generating operating profit. We categorize risk sharing into two categories: profit sharing and quota sharing.

Profit-Sharing: In addition to the initial commission allowed to the program agent, we at times offer various program dependent, profit-sharing commission contracts. These are tailored to the specific product and its attributes.

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**Quota Sharing:** A second way we offer incentives to our producers is through quota-share reinsurance structures. In these scenarios, producers of the business determine which risks to submit to us for underwriting. For risks submitted, Meadowbrook underwrites individual primary insurance policies for members of a group or association, or a specific industry. We share in the operating results with the producer through a quota share reinsurance agreement with an insurance company (owned, or affiliated with the producer) or a captive or rent-a-captive.

We believe our selective approach to distribution also serves to align the agents' financial interests with our balanced business model. Our selective approach reduces channel conflict and allows our agencies to generate franchise value. This is a mutually beneficial approach to enhancing the value of our distribution relationships.

#### *Technology*

We seek to leverage our business technology platform in order to achieve a high level of customer service and enhance operating efficiencies. We provide a select set of internet-based business processing systems to our producers to automate their capability to rate, quote, bind and service insurance policies in a timely and efficient manner. Advantage is a processing system for quoting and binding workers' compensation insurance policies. Century On-Line ( COL ) is a processing system for quoting, binding, and issuing policies for general liability, property and garage insurance policies underwritten by our excess and surplus lines company, Century. Further, we provide additional systems on a network-accessible basis for processing select package and commercial automobile programs. In addition to reducing our internal administrative processing costs, these systems enhance underwriting practices by automating risk selection criteria.

#### *Competition and Pricing*

We are part of a highly competitive industry that is cyclical and historically characterized by periods of high premium rates and shortages of underwriting capacity followed by periods of intense competition and excess underwriting capacity resulting in lower pricing and relaxed eligibility standards including broadening of coverages. We compete with other providers of specialty insurance programs, products, and risk management services, as well as with traditional providers of commercial insurance. Some of our competitors may have greater financial resources than we do.

Pricing is a primary means of competition in the commercial insurance market. Competition is also based on the availability and quality of products, quality and speed of service (including claims service), financial strength, ratings, distribution systems and technical expertise. In addition to the factors noted above, the insurance industry also competes on commission rates.

Principal competitive factors for providing risk management services include the costs of self-insuring relative to the cost of purchasing insurance from an insurance carrier, the availability and pricing of excess reinsurance coverage, cash flow needs, and the expected quality and consistency of the services to be provided.

We believe that we are able to compete based on our experience, the combined quality of our products and services, the high level of our employees' professional expertise, our processing technology platforms, and our program-oriented approach. However, our ability to successfully compete is dependent upon a number of factors, including market and competitive conditions, many of which are outside of our control.

#### **Geographic Diversity and Mix of Business**

Our revenues are diversified geographically by class and line of business, type of insured and agency distribution. Within the workers' compensation line of business, we have a regional focus in California and New England. Within the other liability, commercial automobile liability, excess worker's compensation, and commercial multiple peril liability lines of business, we have a regional focus in the Southeast and California. Our fee-for-service business is managed on a regional basis with an emphasis in the Midwest, New England, and Southeast regions of the United States.

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The following table summarizes our gross written premium distribution by state for the years ended December 31, 2014, 2013, and 2012 (in thousands). We include only states that were top ten gross written premium production states in 2014:

<b>Gross Written Premium</b>	<b>2014</b>	<b>%</b>	<b>2013</b>	<b>%</b>	<b>2012</b>	<b>%</b>
California	\$ 261,305	35.2 %	\$ 325,215	34.5 %	\$ 351,805	33.0 %
Florida	61,114	8.2 %	70,005	7.4 %	98,127	9.2 %
Texas	42,795	5.8 %	54,643	5.8 %	67,068	6.3 %
New York	41,350	5.6 %	44,460	4.7 %	40,177	3.8 %
New Jersey	27,500	3.7 %	36,754	3.9 %	44,582	4.2 %
Missouri	24,967	3.4 %	23,936	2.5 %	24,526	2.3 %
Michigan	20,700	2.8 %	39,316	4.2 %	40,952	3.8 %
Pennsylvania	15,791	2.1 %	20,576	2.2 %	22,290	2.1 %
Illinois	15,304	2.1 %	21,056	2.2 %	28,969	2.7 %
Louisiana	13,260	1.7 %	19,719	2.1 %	21,168	2.0 %
All Other States	218,378	29.4 %	288,331	30.5 %	326,969	30.6 %
Total	\$ 742,464	100.0 %	\$ 944,011	100.0 %	\$ 1,066,633	100.0 %

Gross written premium decreased in 2014, which primarily reflects the impact of business that was targeted to be terminated during the fourth quarter of 2012 and planned premium reductions in specific underperforming areas. The terminations were on all new business, and upon renewal of existing business. The decrease was partially offset by achieved rate increases and the maturation of existing programs. Our most significant geographic concentration remains the state of California. Our current book of business in California is largely related to our relationship with a general agent who specializes in non-contractor workers' compensation, and our relationship with a general agent that primarily focuses on the food service industry.

We manage our business to reduce geographic concentration of risk that could increase our exposure to losses from natural or intentionally caused catastrophic events. We also monitor the regulatory environment within our concentrated regions. We believe we have been able to strategically increase our California exposure, while maintaining a geographically diverse premium base throughout the United States.

The following table summarizes gross written premiums, net earned premiums, and net written premiums by line of business for the years ended December 31, 2014, 2013, and 2012 (in thousands):

**Meadowbrook Insurance Group, Inc.**  
**Summary of GWP, NEP, and NWP**

<b>Gross Written Premium</b>	<b>2014</b>	<b>%</b>	<b>2013</b>	<b>%</b>	<b>2012</b>	<b>%</b>
Workers' Compensation	\$ 335,612	45.2 %	\$ 420,100	44.5 %	\$ 429,259	40.2 %
Other Liability	104,583	14.1 %	147,900	15.7 %	179,487	16.8 %
Commercial Auto Liability	60,706	8.2 %	75,638	8.0 %	109,758	10.3 %
Commercial Multi-Peril Property	48,992	6.6 %	66,886	7.1 %	78,399	7.4 %
Excess Workers' Compensation	55,934	7.5 %	63,290	6.7 %	81,171	7.6 %

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Commercial Multi-Peril Liability	38,390	5.2 %	47,931	5.1 %	59,986	5.6 %
All Other Lines	98,247	13.2 %	122,266	13.0 %	128,573	12.1 %
<b>Total</b>	<b>\$ 742,464</b>	<b>100.0 %</b>	<b>\$ 944,011</b>	<b>100.0 %</b>	<b>\$ 1,066,633</b>	<b>100.0 %</b>
<b>Net Earned Premium</b>	<b>2014</b>	<b>%</b>	<b>2013</b>	<b>%</b>	<b>2012</b>	<b>%</b>
Workers' Compensation	\$ 307,548	47.8 %	\$ 328,978	47.2 %	\$ 358,243	41.9 %
Other Liability	87,710	13.6 %	117,208	16.8 %	134,224	15.7 %
Commercial Auto Liability	56,521	8.8 %	47,902	6.9 %	97,723	11.4 %
Commercial Multi-Peril Property	46,023	7.1 %	34,990	5.0 %	62,991	7.4 %
Excess Workers' Compensation	30,696	4.8 %	48,166	6.9 %	50,510	5.9 %
Commercial Multi-Peril Liability	39,609	6.2 %	50,317	7.2 %	54,536	6.4 %
All Other Lines	75,164	11.7 %	69,856	10.0 %	96,032	11.3 %
<b>Total</b>	<b>\$ 643,271</b>	<b>100.0 %</b>	<b>\$ 697,417</b>	<b>100.0 %</b>	<b>\$ 854,259</b>	<b>100.0 %</b>



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<b>Net Written Premium</b>	<b>2014</b>	<b>%</b>	<b>2013</b>	<b>%</b>	<b>2012</b>	<b>%</b>
Workers' Compensation	\$ 297,361	49.5 %	\$ 331,647	48.0 %	\$ 344,992	43.3 %
Other Liability	78,763	13.1 %	104,024	15.0 %	133,520	16.7 %
Commercial Auto Liability	55,906	9.3 %	52,244	7.6 %	78,868	9.9 %
Commercial Multi-Peril Property	40,578	6.8 %	42,792	6.2 %	48,330	6.1 %
Excess Workers' Compensation	27,813	4.6 %	39,127	5.7 %	52,421	6.6 %
Commercial Multi-Peril Liability	35,014	5.8 %	42,853	6.2 %	57,317	7.2 %
All Other Lines	65,802	10.9 %	78,950	11.4 %	82,054	10.3 %
<b>Total</b>	<b>\$ 601,237</b>	<b>100.0 %</b>	<b>\$ 691,637</b>	<b>100.0 %</b>	<b>\$ 797,502</b>	<b>100.0 %</b>

As noted above, gross written premium decreased in 2014 due primarily to business that was targeted to be terminated during the fourth quarter of 2012 and planned premium reductions in specific underperforming areas. The decrease was partially offset by achieved rate increases and the maturation of existing programs. During 2014, we achieved overall average written rate increases of approximately 6.5%. The average written rate increases for our workers' compensation line of business in 2014 was approximately 6.3%.

**Reserves**

The following table shows the development of reserves for unpaid losses and loss adjustment expenses ( LAE ) from 2005 through 2014 for our Insurance Company Subsidiaries

Development of the ProCentury acquired reserves is not included for the years prior to 2008, because our merger with ProCentury (the ProCentury Merger ) was not effective until August 1, 2008. The lower portion of the table reflects the impact of reinsurance for the years 2005 through 2014 reconciling the net reserves shown in the upper portion of the table to gross reserves.

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Additional information relating to our reserves is included within the *Losses and Loss Adjustment Expenses and Reinsurance Recoverables* section of Note 1 ~ *Summary of Significant Accounting Policies* and Note 4 ~ *Liability for Losses and Loss Adjustment Expenses* of the Notes to the Consolidated Financial Statements, as well as to the *Critical Accounting Policies* section and the *Reserves* section of Item 7, *Management's Discussion and Analysis*.

**Analysis of Loss and Loss Adjustment Expense Development**

2005	2006	2007	2008	Years Ended December 31,					2013
				2009	2010	2011	2012	(in thousands)	
271,423	\$ 302,655	\$ 341,541	\$ 625,331	\$ 682,376	\$ 784,202	\$ 879,093	\$ 1,074,075	\$ 1,111,090	
271,423	\$ 302,655	\$ 341,541	\$ 625,331	\$ 682,376	\$ 784,202	\$ 879,093	\$ 1,074,075	\$ 1,111,090	
83,271	81,779	95,393	173,525	187,818	269,913	331,440	396,480	366,161	
133,809	140,308	155,745	279,221	338,925	458,376	560,826	653,666		
170,226	180,197	197,558	369,313	441,938	598,254	712,692			
195,242	204,802	233,421	425,223	520,024	684,161				
210,993	228,284	255,627	469,293	568,904					
226,048	241,737	279,743	500,465						
235,193	258,360	292,460							
245,528	267,043								
252,232									
268,704	295,563	330,416	596,661	651,373	791,514	964,608	1,142,475	1,109,349	
263,069	286,647	327,862	566,878	654,641	844,001	1,014,009	1,177,366		
261,319	292,516	331,034	568,751	684,621	874,804	1,035,542			
265,448	293,897	339,931	580,023	704,163	889,193				
268,007	303,948	346,790	598,137	712,583					
276,374	305,504	360,406	601,542						

276,130	316,316	356,972						
285,106	313,031							
283,451								
<b>(12,028 )</b>	<b>\$ (10,377 )</b>	<b>\$ (15,431 )</b>	<b>\$ 23,788</b>	<b>\$ (30,207 )</b>	<b>\$ (104,991 )</b>	<b>\$ (156,449 )</b>	<b>\$ (103,292 )</b>	<b>\$ 1,741</b>
<b>-4.4 %</b>	<b>-3.4 %</b>	<b>-4.5 %</b>	<b>3.8 %</b>	<b>-4.4 %</b>	<b>-13.4 %</b>	<b>-17.8 %</b>	<b>-9.6 %</b>	<b>0.2 %</b>
<b>271,423</b>	<b>302,655</b>	<b>341,541</b>	<b>625,331</b>	<b>682,376</b>	<b>784,202</b>	<b>879,093</b>	<b>1,074,075</b>	<b>1,111,090</b>
187,254	198,422	198,461	260,366	266,801	280,854	315,884	381,905	505,431
458,677	501,077	540,002	885,697	949,177	1,065,056	1,194,977	1,455,980	1,616,521
<b>283,451</b>	<b>313,031</b>	<b>356,972</b>	<b>601,542</b>	<b>712,583</b>	<b>889,193</b>	<b>1,035,542</b>	<b>1,177,366</b>	<b>1,109,349</b>
215,406	213,164	212,002	260,168	278,196	305,646	337,401	403,943	513,465
498,858	526,196	568,974	861,710	990,780	1,194,839	1,372,943	1,581,310	1,622,814

(40,181 ) \$ (25,119 ) \$ (28,972 ) \$ 23,986 \$ (41,602 ) \$ (129,783 ) \$ (177,966 ) \$ (125,330 ) \$ (6,293

The following table sets forth the difference between United States Generally Accepted Accounting Principles ( GAAP ) reserves for loss and loss adjustment expenses and statutory reserves for loss and loss adjustment expenses at December 31, (in thousands):

	<b>2014</b>	<b>2013</b>
GAAP reserves for loss and LAE	1,590,359	1,616,521
Reinsurance recoverables for unpaid losses	(519,530 )	(505,431 )
ASC 944 adjustment*	(5,217 )	(5,827 )
Statutory reserves for loss and LAE	1,065,612	1,105,263

100% Quota Share Reinsurance Agreement related to a worker's compensation novation policy, with reinsurance provisions recognized as retroactive reinsurance on a GAAP basis, in accordance with ASC 944- Financial Services- Insurance and recognized as prospective reinsurance on a statutory basis, in accordance with SSAP 62R- Property and Casualty Reinsurance.

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### **MEADOWBROOK INSURANCE GROUP, INC.**

For the year ended December 31, 2014, we reported an increase of \$6.3 million in gross ultimate loss estimates for accident years 2013 and prior, or 0.4% of \$1,616.5 million of gross loss and LAE reserves at January 1, 2014. We reported a \$1.7 million decrease in net ultimate loss and LAE estimates for accident years 2013 and prior, or 0.2% of \$1,111.1 million of net loss & LAE reserves at January 1, 2014.

For the year ended December 31, 2013, we reported an increase of \$81.1 million in gross ultimate loss estimates for accident years 2012 and prior, or 5.6% of \$1,456.0 million of gross loss and LAE reserves at January 1, 2013. We reported a \$68.4 million increase in net ultimate loss and LAE estimates for accident years 2012 and prior, or 6.4% of \$1,074.1 million of net loss & LAE reserves at January 1, 2013.

### **Reinsurance**

Information relating to our reinsurance structure and treaty information is included within Note 6 ~ *Reinsurance* of the Notes to the Consolidated Financial Statements.

### **Investments**

Information relating to our investment portfolio is included within Note 3 ~ *Investments* of the Notes to the Consolidated Financial Statements and the *Investments* section of Item 7, *Management's Discussion and Analysis*, as well as Item 7A *Quantitative and Qualitative Disclosures about Market Risk*.

### **Regulation**

#### *Insurance Company Regulation*

Our Insurance Company Subsidiaries are subject to regulation in the states where they conduct business. State insurance regulations generally are designed to protect the interests of policyholders, state insurance consumers or claimants rather than shareholders or other investors. The nature and extent of such state regulation varies by jurisdiction, but generally involves:

- prior approval of the acquisition of control of an insurance company or of any company controlling an insurance company, including the acquisition by Fosun;
- regulation of certain transactions entered into by such Insurance Company Subsidiary with any of its affiliates;
- approval of premium rates, forms and policies used for many lines of insurance;
- standards of solvency and minimum amounts of capital and surplus that must be maintained;
- establishment of reserves required to be maintained for unearned premium, loss and loss adjustment expense, or for other purposes;
- limitations on types and amounts of investments;
- underwriting and claims settlement practices;
- restrictions on the size of risks that may be insured by a single company;
- licensing of insurers and agents;
- deposits of securities for the benefit of policyholders; and
- the filing of periodic reports with respect to financial condition and other matters.

In addition, state regulatory examiners perform periodic examinations of our Insurance Company Subsidiaries. The results of these examinations can give rise to regulatory orders requiring remedial, injunctive or other corrective action.

*Insurance Holding Company Regulation*

We operate as an insurance holding company and are subject to regulation in the jurisdictions in which we conduct business. These regulations require that each of our Insurance Company Subsidiaries in the system register with the insurance department of its state of domicile and furnish information concerning the operations

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### **MEADOWBROOK INSURANCE GROUP, INC.**

of companies within the holding company system that may materially affect the operations, management or financial condition of the insurers within the system which are domiciled in that state. The insurance laws similarly provide that all transactions among members of a holding company system must be fair and reasonable. Certain types of transactions between our Insurance Company Subsidiaries and the Company and our other affiliates generally must be disclosed to the state regulators, and prior approval of the applicable state insurance regulator generally is required for any material or extraordinary transaction. In addition, a change of control of a domestic insurer or of any controlling person requires the prior approval of the state insurance regulator.

#### *Various State and Federal Regulation*

Insurance companies are also affected by a variety of state and federal legislative and regulatory measures and judicial decisions that define and extend the risks and benefits for which insurance is sought and provided. In addition, for some classes of insureds individual state insurance departments may prevent premium rates for some classes of insureds from reflecting the level of risk assumed by the insurer for those classes. Such developments may adversely affect the profitability of various lines of insurance. In some cases, if permitted by applicable regulations, these adverse effects on profitability can be minimized through repricing of coverages or limitations or cessation of the affected business.

#### *Reinsurance Intermediary*

Our reinsurance intermediaries are also subject to regulation. Under applicable regulations, an intermediary is responsible, as a fiduciary, for funds received on account of the parties to the reinsurance transaction. The intermediaries are required to hold such funds in appropriate bank accounts subject to restrictions on withdrawals and prohibitions on commingling.

#### *Licensing and Agency Contracts*

We, or certain of our designated employees, must be licensed to act as agents by state regulatory authorities in the states in which we conduct business. Regulations and licensing laws vary in individual states and are often complex.

Insurance licenses are issued by state insurance regulators upon application and may be of perpetual duration or may require periodic renewal. We must apply for and obtain appropriate new licenses before we can expand into a new state on an admitted basis or offer new lines of insurance that require separate or additional licensing.

Insurers operating on an admitted basis must file premium rate schedules and policy or coverage forms for review and approval by the insurance regulators. In many states, rates and policy forms must be approved prior to use, and insurance regulators have broad discretion in judging whether an insurer's rates are adequate, not excessive and not unfairly discriminatory.

The applicable licensing laws and regulations in all states are subject to amendment or reinterpretation by state regulatory authorities, and such authorities are vested in most cases with relatively broad discretion as to the granting, revocation, suspension and renewal of licenses. We, or our employees, could be excluded, or temporarily suspended, from continuing with some or all of our activities in, or otherwise subjected to penalties by, a particular state.

#### *Insurance Regulation Concerning Change or Acquisition of Control*

Star, Williamsburg, Ameritrust, and PIC are domestic property and casualty insurance companies organized under the insurance laws (the Insurance Codes ) of Michigan, while Savers, Century and PROPIC are organized under the Insurance Codes of Missouri, Ohio, and Washington D.C., respectively. The Insurance Codes provide that acquisition or change of control of a domestic insurer or of any person that controls a domestic insurer (including the proposed transaction with Fosun) cannot be consummated without the prior approval of the relevant insurance regulatory authority. A person seeking to acquire control, directly or indirectly, of a domestic insurance company or of any person controlling a domestic insurance company must generally file with the relevant insurance regulatory authority an application for change of control (commonly known as a Form A )

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### **MEADOWBROOK INSURANCE GROUP, INC.**

containing information required by statute and published regulations and provide a copy of such Form A to the domestic insurer. Control is generally presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote or holds proxies representing ten percent or more of the voting securities of the company.

In addition, many state insurance regulatory laws contain provisions that require pre-notification to state agencies of a change in control of a non-domestic admitted insurance company in that state. While such pre-notification statutes do not authorize the state agency to disapprove the change of control, such statutes do authorize issuance of a cease and desist order with respect to the non-domestic admitted insurer if certain conditions exist, such as undue market concentration.

#### *Membership in Insolvency Funds and Associations and Mandatory Pools*

Most states require admitted property and casualty insurers to become members of insolvency funds or associations, which generally protect policyholders against the insolvency of insurers. Members of the fund or association must contribute to the payment of certain claims made against insolvent insurers. Maximum contributions required by law in any one year vary between 1% and 2% of the annual premium written by a member in that state. For 2014, 2013, and 2012, assessments from insolvency funds were \$5.3 million, \$7.0 million, and \$6.8 million, respectively. Most of these payments are recoverable through future policy surcharges and premium tax reductions.

Our Insurance Company Subsidiaries are also required to participate in various mandatory insurance facilities or in funding mandatory pools, which are generally designed to provide insurance coverage for consumers who are unable to obtain insurance in the voluntary insurance market. Among the pools participated in are those established in certain states to provide windstorm and other similar types of property coverage. These pools typically require all companies writing applicable lines of insurance in the state for which the pool has been established to fund deficiencies experienced by the pool based upon each company's relative premium writings in that state, with any excess funding typically distributed to the participating companies on the same basis. To the extent that reinsurance treaties do not cover these assessments, they may have an adverse effect on the Company. For 2014, 2013, and 2012, total assessments paid to all such facilities were \$3.9 million, \$4.2 million, and \$4.9 million, respectively.

#### *Restrictions on Dividends and Risk-Based Capital*

For information on Restrictions on Dividends and Risk-based Capital that affect us please refer to Note 8 ~ *Regulatory Matters and Rating Issues* of the Notes to the Consolidated Financial Statements and the *Regulatory and Rating Issues* section within Item 7, *Management's Discussion and Analysis*.

#### *NAIC-IRIS Ratios*

The National Association of Insurance Commissioners' ( NAIC ) Insurance Regulatory Information System ( IRIS ) was developed by a committee of state insurance regulators and is primarily intended to assist state insurance departments in executing their statutory mandates to oversee the financial condition of insurance companies operating in their respective states. IRIS identifies thirteen industry ratios and specifies usual values for each ratio. Departure from the usual values on four or more ratios generally leads to inquiries or possible further review from individual state insurance commissioners. Refer to the *Regulatory and Rating Issues* section within Item 7, *Management's Discussion and Analysis*.

#### *Effect of Federal Legislation*



The Terrorism Risk Insurance Act, ( TRIA ), was enacted in November 2002. After several extensions, Congress enacted the Terrorism risk Insurance Program Reauthorization of 2015 ( Act ). The 2015 Act extends the Federal Terrorism Insurance Program until December 31, 2020. The Act continues to require insurance companies to offer terrorism coverage and provides compensation for insured losses resulting from acts of certified terrorism, subject to a program event trigger of \$100.0 million for 2015, which will increase by 20.0 million each year until it reaches \$200.0 million in 2020, after the insurer retains loss equal to 20% of its direct earned premium as permitted by the Act. There was no change to the insurer deductible under the Act. Insurers covered by the Act are also responsible for a 15% coinsurance of loss in excess of their stated retention

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### **MEADOWBROOK INSURANCE GROUP, INC.**

in 2015, such coinsurance will increase by 1 percentage point each year until it reaches 20% in 2020. Over 6 years the Company's co-participation of the federal insurance quota share will increase from 15% to 20%. The Company currently purchases \$140.0 million of terrorism protection under its workers' compensation treaties to satisfy these obligations. The Company implemented a conservative strategy during 2014 addressing the possible non-renewal of the statute in relation to its exposure, which is specifically connected to employee concentrations in certain large hospitals. The Company imposed aggregate limits on certain workers' compensation policies where previously statutory limits were extended as permitted; and/or non-renewed certain specific risks where other alternatives were not commercially feasible. The Company is actively engaged in evaluating alternatives and monitoring its aggregation exposures to terrorism on a regular basis, we will implement a strategy that conservatively addresses the increasing retentions under the Act.

### **Employees**

At February 18, 2015, we employed 904 associates to service our clients and provide management services to our Insurance Company Subsidiaries as described below. We believe we have good relationships with our associates.

### **Available Information**

Our Internet address is [www.meadowbrook.com](http://www.meadowbrook.com), where we make available, free of charge, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Statements of Beneficial Ownership (Forms 3, 4, and 5), and any amendments to those reports, as soon as reasonably practicable after we electronically file such material with, or furnish to, the SEC. You may read and copy materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington D.C., 20549. You may obtain information about the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site that contains reports, proxy statements, and other information that we file at [www.sec.gov](http://www.sec.gov). Our SEC reports can also be accessed through the investor relations section of our website. The information found on our website is not part of this or any other report we file with, or furnish to the SEC. The Charters of the Governance and Nominating Committee, the Compensation Committee, the Audit Committee and the Capital Strategy and Investment Committee, as well as the Board of Directors Governance Guidelines are also available on our website, or available in print to any shareholder who requests this information. In addition, our Compliance Code of Conduct and Business Ethics policy is available on our website, or in print to any shareholder who requests this information.

### **Glossary of Selected Insurance Terms**

#### **GAAP Terms**

Book value per share

Total common shareholders' equity divided by the number of common shares outstanding.

Case reserves

Claim department estimates of anticipated future payments to be made on each specific individual reported claim.

Deferred acquisition costs

Primarily commissions and premium-related taxes that vary with, and are primarily related to, the production of new contracts and are deferred and amortized to achieve a matching of revenues and expenses when reported in financial statements prepared in accordance GAAP.

Deficiency

With regard to reserves for a given liability, a deficiency exists when it is estimated or determined that the reserves are insufficient to pay the ultimate settlement value of the related liabilities. Where the deficiency is the result of an

estimate, the estimated amount of deficiency (or even the finding of whether or not a deficiency exists) may change as new information becomes available.

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**MEADOWBROOK INSURANCE GROUP, INC.**

Expense ratio

See Underwriting expense ratio.

Incurred but not reported (IBNR) reserves

Reserves for estimated losses and LAE that have been incurred but not yet reported to the insurer. This includes amounts for unreported claims, development on known cases, and re-opened claims.

Loss

An occurrence that is the basis for submission and/or payment of a claim. Losses may be covered, limited or excluded from coverage, depending on the terms of the policy.

Loss adjustment expenses (LAE)

The expenses of settling claims, including legal and other fees and the portion of general expenses allocated to claim settlement costs.

Loss and LAE ratio

For GAAP, it is the ratio of incurred losses and loss adjustment expenses to net earned premiums. For SSAP, it is the ratio of incurred losses and loss adjustment expenses to net earned premiums.

Loss reserves

Liabilities established by insurers and reinsurers to reflect the estimated cost of claims incurred that the insurer or reinsurer will ultimately be required to pay in respect of insurance or reinsurance it has written. Reserves are established for losses and for LAE, and consist of case reserves and IBNR reserves. As the term is used in this document, loss reserves is meant to include reserves for both losses and LAE, unless stated otherwise.

Loss reserve development

The increase or decrease in incurred claims and claim adjustment expenses as a result of the re-estimation of claims and claim adjustment expense reserves at successive valuation dates for a given group of claims. Loss reserve development may be related to prior year or current year development.

Losses incurred

The total losses sustained by an insurance company under a policy or policies, whether paid or unpaid. Incurred losses include a provision for IBNR.

Redundancy

With regard to reserves for a given liability, a redundancy exists when it is estimated or determined that the reserves are greater than what will be needed to pay the ultimate settlement value of the related liabilities. Where the redundancy is the result of an estimate, the estimated amount of redundancy (or even the finding of whether or not a redundancy exists) may change as new information becomes available.

Underwriting expense ratio

For GAAP, it is the ratio of GAAP underwriting expenses incurred to net earned premiums. For SSAP, it is the ratio of Statutory underwriting expenses incurred to net written premiums.

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**MEADOWBROOK INSURANCE GROUP, INC.**

**Non-GAAP Terms**

**Accident year**

The annual calendar accounting period in which loss events occurred, regardless of when the losses are actually reported, booked or paid.

**Accident year combined ratio**

The accident year combined ratio is a non-GAAP measure that excludes changes in net ultimate loss estimates from prior accident year loss reserves. The accident year combined ratio provides management with an assessment of the specific policy year's profitability (which matches policy pricing with related losses) and assists management in their evaluation of product pricing levels and quality of business written. Management uses accident year combined ratio as one component to assess the Company's current year performance and as a measure to evaluate, and if necessary, adjust current year pricing and underwriting.

**A.M. Best's Capital Adequacy Ratio (BCAR)..**

An integrated review of underwriting, financial and asset leverage. BCAR calculates the net required capital to support the financial risks of the company associated with the exposure of assets and underwriting to adverse economic and market conditions, and compares it to economic capital.

**Combined Ratio (GAAP)**

The statutory combined ratios modified to reflect GAAP accounting, as management evaluates the performance of our underwriting operations using the GAAP combined ratio. Specifically, the GAAP combined ratio is the sum of the loss and LAE ratio, plus the ratio of GAAP underwriting expenses (which include the change in deferred policy acquisition costs) to net premiums earned (expense ratio)

**Combined Ratio (Statutory)**

The combined loss and expense ratio (or combined ratio), expressed as a percentage, is the key measure of underwriting profitability traditionally used in the property and casualty insurance business. The combined ratio is a statutory (non-GAAP) accounting measurement, which represents the sum of (i) the ratio of losses and loss expenses to net premiums earned (loss ratio), plus (ii) the ratio of underwriting expenses to net premiums written (expense ratio).

**Combined Ratio (Overall)**

When the combined ratio is under 100%, underwriting results are generally considered profitable; when the combined ratio is over 100%, underwriting results are generally considered unprofitable.

**NAIC-IRIS ratios**

Financial ratios calculated by the NAIC to assist state insurance departments in monitoring the financial condition of insurance companies.

**Operating income (loss)**

Net income (loss) excluding the after-tax impact of net realized investment gains (losses) and cumulative effect of changes in accounting principles when applicable.

**Operating income (loss) per share**

Operating income (loss) on a per share basis.

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**MEADOWBROOK INSURANCE GROUP, INC.**

Premium leverage ratio (Gross / Net)

The ratio of gross / net written premium to consolidated statutory surplus.

Policyholders' surplus

As determined under SSAP, the amount remaining after all liabilities, including loss reserves, are subtracted from all admitted assets. Admitted assets are assets of an insurer prescribed or permitted by a state to be recognized on the statutory balance sheet. Policyholders' surplus is also referred to as surplus or statutory surplus for statutory accounting purposes.

Risk-based capital (RBC)

A measure adopted by the NAIC and enacted by states for determining the minimum statutory policyholders' surplus requirements of insurers. Insurers having total adjusted capital less than that required by the RBC calculation will be subject to varying degrees of regulatory action depending on the level of capital inadequacy.

Statutory accounting practices (SSAP)

The practices and procedures prescribed or permitted by domiciliary state insurance regulatory authorities in the United States for recording transactions and preparing financial statements. Statutory accounting practices generally reflect a modified going concern basis of accounting.

Underwriting gain or loss

Net earned premiums claims and claim adjustment expenses and insurance-related expenses.

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### **MEADOWBROOK INSURANCE GROUP, INC.**

#### **ITEM 1A. RISK FACTORS**

In addition to the other information set forth in this report, including the information regarding forward-looking statements set forth in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, you should carefully consider the following risk factors, categorized by Risks Related to Our Being Acquired by Fosun, Risks Related to Our Business, Risks Related to Our Industry and Risks Related to Our Common Stock, which could materially affect our business, financial condition or results of operations in future periods.

#### **Risks Related to Our Being Acquired by Fosun**

*The announcement and pendency of our agreement to be acquired by Fosun may have an adverse impact on our business.*

On December 30, 2014, we entered into a merger agreement pursuant to which we will be acquired by Fosun through the merger of us with a subsidiary of Fosun. Under the terms of the transaction, our shareholders will receive \$8.65 per share of our common stock, consisting of all cash. The transaction is expected to close in the second half of 2015. Various events, regulatory factors or other circumstances related to the merger agreement could have an impact on our results of operations, including:

- the occurrence of any event, change or other circumstance that could give rise to the termination of the merger agreement, including a termination under circumstances that could require us to pay a termination fee;
- the inability or the failure to satisfy conditions to complete the merger, including insurance regulatory approvals, and negative impacts associated with actions required to be taken by us in order to obtain requisite regulatory approvals;
- the failure of the merger to close for any other reason;
- risks that the proposed transaction disrupts current plans and operations and the potential difficulties in employee retention as a result of the merger;
- adverse outcomes of pending or threatened litigation or government investigations relating to such transaction;
- diversion of management's attention from ongoing business concerns;
- the effect of the announcement of the merger on our business relationships, operating results and our business generally, including effects on our relationships with agents, wholesalers, suppliers, customers, policyholders and regulators;
- actions taken or conditions imposed by the governmental or regulatory authorities;
- the impact of competition in the industries and in the specific markets in which we operate; and
- the possibility that the merger may be more expensive to complete than anticipated, including as a result of unexpected factors or events.

#### **Risks Related to Our Business**

**Actual loss and loss adjustment expenses may exceed our reserve estimates, which would negatively impact our profitability and financial position.**

In many cases, several years may elapse between the occurrence of an insured loss, the reporting of the loss to us and our payment of the loss. To recognize liabilities for unpaid losses, we establish reserves as balance sheet liabilities representing estimates of amounts needed to pay reported and unreported losses and the related loss adjustment expenses. Loss reserves are an estimate of what we anticipate the ultimate costs to be and therefore do not represent an

exact calculation of liabilities. Estimating loss reserves is a difficult and complex process involving many variables and subjective judgments. As part of the reserving process, we review historical data and consider the impact of various factors such as:

- actuarial and statistical projections of the cost of settlement and administration of claims reflecting facts and circumstances then known;



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**MEADOWBROOK INSURANCE GROUP, INC.**

- historical claims information and loss emergence patterns;
- assessments of currently available data;
- estimates of future trends in claims severity and frequency;
- economic factors such as inflation;
- judicial theories of liability;
- estimates and assumptions regarding social, judicial and legislative trends, and actions such as class action lawsuits and judicial interpretation of coverages or policy exclusions; and
- the level of insurance fraud.

This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future results. It also assumes that adequate historical or other data exists upon which to make these judgments. There is no precise method, however, for evaluating the impact of any specific factor on the adequacy of reserves and actual results are likely to differ from original estimates.

If the actual amount of insured losses is greater than our reserve estimates, our profitability, capital and financial position could suffer. In addition, if our loss reserves are inadequate to cover the actual amount of insured losses, our financial strength rating or the financial strength ratings of our Insurance Company Subsidiaries could be impacted or downgraded. An increase in reserves may also require us to write off a portion of our deferred acquisition costs asset, which would also negatively impact our operating results and financial position.

In 2013, we experienced material reserve strengthening because of significant adverse loss development, and for the year ended December 31, 2013, we reported an increase in net ultimate loss estimates for accident years 2012 and prior of \$68.4 million, or \$63.1 million excluding an adverse arbitration award. The adverse development did impact our financial strength ratings of our Insurance Company Subsidiaries as discussed under *A decrease in our A.M. Best rating could negatively affect our business* below.

Additional unforeseen losses, the type and magnitude of which we cannot predict, may emerge in the future. These additional losses could arise from changes in the legal environment, laws and regulations, climate change, catastrophic events, increases in loss severity or frequency, or other causes. Such future losses could be substantial. Inflationary scenarios may cause the cost of claims, especially medical claims, to rise, impacting reserve adequacy and our results of operations. There can be no assurance that we will not in the future experience significant adverse loss developments that could result in reserve strengthening and additional material charges to earnings.

Additional information relating to our reserves is included within the *Losses and Loss Adjustment Expenses and Reinsurance Recoverables* section of Note 1 ~ *Summary of Significant Accounting Policies* and Note 4 ~ *Liability for Losses and Loss Adjustment Expenses* of the Notes to the Consolidated Financial Statements, as well as to the *Critical Accounting Policies* section and the *Reserves* section of Item 7, *Management's Discussion and Analysis*.

**A decrease in our A.M. Best rating could negatively affect our business.**

Financial ratings are an important factor influencing the competitive position of insurance companies. Insurance companies are subject to financial strength ratings produced by external rating agencies. Higher ratings generally indicate greater financial stability and a stronger ability to pay claims. Ratings are assigned by rating agencies to insurers based upon factors they believe are important to policyholders. Ratings evaluations are not directed to potential purchasers of our common stock and are not recommendations to buy, hold, or sell our securities and should not be relied upon as such.

Our ability to write business is most influenced by our rating from A.M. Best ( A.M. Best ). A.M. Best ratings are designed to assess an insurer's financial strength and ability to meet continuing obligations to policyholders. On August 2, 2013, A.M. Best lowered Meadowbrook's issuer credit rating, as well its financial strength ratings and downgraded the Company's Insurance Company Subsidiaries' financial strength rating from A- (Excellent) with a negative outlook to B++ (Good) with a stable outlook. Subsequently, on

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**MEADOWBROOK INSURANCE GROUP, INC.**

February 21, 2014, A.M. Best lowered Meadowbrook's issuer credit rating from bbb+ to bbb. A.M. Best affirmed the B++ financial strength rating of our Insurance Company Subsidiaries, but lowered the outlook for this rating from stable to negative. On January 5, 2015, A.M. Best placed under review with positive implications the issuer credit rating of bb of Meadowbrook, and also placed the financial strength rating of B++ (Good) and the ICRs of bbb under review with positive implications for our Insurance Company Subsidiaries.

Our results of operations could be materially and adversely impacted by the foregoing ratings. The adverse impact could include loss of current and potential independent agents and insureds who may choose to transact their business with more highly rated competitors. In addition, we may face a significant reduction in the number of insurance contracts we write and the loss of substantial business to our competitors that maintain higher ratings, which would cause premiums and earnings to decrease. The rating changes could negatively impact our ability to raise capital and have a negative impact on our overall liquidity. Because lenders and reinsurers will use our A.M. Best ratings as a factor in deciding whether to transact business with us, the current ratings of our Insurance Company Subsidiaries or their failure to maintain the current ratings may dissuade a financial institution or reinsurance company from conducting any business with us or may increase our interest or reinsurance costs. There can be no assurance that the Company will not be further downgraded.

In response to the downgrade by A.M. Best, on August 4, 2013, the Insurance Company Subsidiaries entered into a 100% quota share reinsurance agreement(s) with State National Insurance Company, National Specialty Insurance Company and United Specialty Insurance Company (collectively, SNIC), which provides the Insurance Company Subsidiaries the use of an A rated policy of insurance for a portion of its business where an A rated policy issuer is required. The costs associated with these agreements could negatively impact our results of operations. A further downgrade of the Company could increase the cost for this agreement, as well as require us to post additional collateral. In addition, a change in the A.M. Best rating of the policy issuance company could have a material adverse impact upon our business. There can be no assurance that the Company will not need to enter into additional policy issuance agreements.

**We may require additional capital in the future, which may not be available or may only be available on unfavorable terms.**

Our future capital requirements depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. To the extent that our present capital is insufficient to meet future operating requirements and/or cover losses, we may need to raise additional funds through financings. If we had to raise additional capital, equity or debt financing may not be available or may be on terms that are not favorable to us in our current environment. In the case of equity financings, dilution to our shareholders could result, and in any case such securities may have rights, preferences and privileges that are senior to those of the shares currently outstanding. If we cannot obtain adequate capital on favorable terms or at all, our business, operating results and financial condition could be adversely affected.

**We face competitive pressures in our business that could cause our revenues to decline and adversely affect our profitability.**

We compete with a large number of other companies in our selected lines of business. Many of our competitors are substantially larger and may enjoy better name recognition, substantially greater financial resources, higher financial strength ratings by rating agencies, broader and more diversified product lines and more widespread agency relationships than us. Insurers in our markets generally compete on the basis of price, consumer recognition, coverages offered, claims handling, financial stability, customer service and geographic coverage. Although pricing is

influenced to some degree by that of our competitors, it is not in our best interests to compete solely on price, and we may from time-to-time experience a loss of market share during periods of intense price competition. A number of new, proposed or potential legislative or industry developments could further increase competition in our industry including, but not limited to:

- the formation of new insurers and an influx of new capital in the marketplace as existing companies attempt to expand their business as a result of better pricing and/or terms or the offering of similar or better products at or below our prices;
- programs in which state-sponsored entities provide property insurance in catastrophe-prone areas, other alternative market types of coverage, or other non-property insurance; and

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- changing practices created by the Internet, which has increased competition within the insurance business. New competition resulting from these and other developments could make the property and casualty insurance marketplace more competitive by increasing the supply of insurance capacity. In that event, the current market may soften further, and it may negatively influence our ability to maintain or increase rates. Consequently, our profitability could be adversely impacted by increased competition.

#### **The failure of any of the loss limitation methods we employ could have a material adverse effect on our results of operations and financial condition.**

Various provisions of our policies, such as limitations or exclusions from coverage or choice of forum, have been negotiated to limit our exposure to certain types of risks and expanding theories of legal liability. In addition, many of our policies limit the period during which a policyholder may bring a claim under the policy, which period in many cases is shorter than the statutory period under which these claims can be brought by our policyholders. While these exclusions and limitations help us assess and control our loss exposure, it is possible that a court or regulatory authority could nullify or void an exclusion, or legislation could be enacted that modifies or voids the use of such endorsements and limitations in a way that could have a materially adverse impact on our financial condition and operating results. Such actions could result in higher than anticipated losses and LAE by extending coverage beyond our underwriting intent or increasing the number or size of claims, which could have a material adverse effect on our operating results. In some instances, these changes may not become apparent until sometime after we have issued the insurance policies that are affected by the changes and litigation relating to the insurance policy interpretation has been resolved. As a result, the full extent of liability under our insurance contracts may not be known for many years after a policy is issued.

#### **Our geographic concentration ties our performance to the business, economic, natural perils, man-made perils, and regulatory conditions within our most concentrated region.**

Our revenues and profitability are subject to the prevailing regulatory, legal, economic, political, demographic, competitive, weather and other conditions in the principal states in which we do business. Changes in any of these conditions could make it less attractive for us to do business in such states and would have a more pronounced effect on us compared to companies that are more geographically diversified. In addition, our exposure to severe losses from localized perils, such as earthquakes, hurricanes, tropical storms, tornadoes, wind, ice storms, hail, fires, terrorism, riots and explosions, is increased in those areas where we have written significant numbers of insurance policies.

One of our predominate lines of business is workers' compensation (47.8% of net earned premiums in 2014), which has a high concentration in California. Accordingly, unfavorable business, economic or regulatory conditions in this state could negatively impact our business. California is also exposed to climate and environmental changes, natural perils such as earthquakes, water supplies, and the possibility of pandemics or terrorist acts. Because our business is concentrated in this manner, we may be exposed to economic and regulatory risks or risk from natural perils that are greater than the risks associated with greater geographic diversification. Refer to Note 5 ~ *Reinsurance* for further information regarding our reinsurance structure related to workers' compensation business.

#### **Our success depends on our ability to appropriately price the risks we underwrite.**

Our financial results depend on our ability to underwrite and collect adequate premium rates for a wide variety of risks. Rate adequacy is necessary to generate sufficient premiums to pay losses, loss expenses, and underwriting expenses and to earn a profit. To price our products accurately, we must collect and properly analyze a substantial amount of data, develop, test and apply appropriate rating formulas, monitor and react to changes in trends and project

both severity and frequency of losses with reasonable accuracy. These activities are subject to a number of risks and uncertainties that are outside our control, including:

- availability of sufficient reliable data and our ability to properly analyze available data;
- uncertainties that inherently characterize estimates and assumptions;
- selection and application of appropriate rating and pricing techniques;

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- changes in legal standards, claim settlement practices, medical care expenses and restoration costs;
- changes in mandated rates or benefits set by the state regulators; and
- legislative actions.

Consequently, we could underprice risks, which would negatively affect our profit margins, or we could overprice risks, which could reduce our sales volume and competitiveness. In either event, our profitability could be materially and adversely affected.

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

As part of our overall risk and capacity management strategy, we purchase reinsurance for significant amounts of risk underwritten by our Insurance Company Subsidiaries, especially for the excess-of-loss and severity risks. We purchase reinsurance by transferring part of the risk we have written (known as ceding) to a reinsurance company in exchange for part of the premium we receive in connection with the risk under pro-rata and excess-of-loss contracts. These reinsurance arrangements are intended to diversify our business and reduce our exposure to large losses or from hazards of an unusual nature.

Market conditions beyond our control determine the availability and cost of the reinsurance we purchase, which may affect the level of our business and profitability. Our reinsurance facilities are generally subject to annual renewal. We may be unable to maintain our current reinsurance facilities or to obtain other reinsurance in adequate amounts and at favorable rates. Increases in the cost of reinsurance would adversely affect our profitability. In addition, if we are unable to renew our expiring facilities or to obtain new reinsurance on favorable terms, either our net exposure to risk would increase or, if we are unwilling to bear an increase in net risk exposures, we would have to reduce the amount of risk we underwrite.

#### **Our reinsurers may not pay on losses in a timely fashion, or at all, which may cause a substantial loss and increase our costs.**

Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred, the ceding of insurance does not discharge us of our primary liability to our policyholder. As a result, ceded reinsurance arrangements do not limit our ultimate obligations to policyholders to pay claims. Therefore, we are subject to credit risk with respect to the obligations of our reinsurers. We are also subject to the risk that their reinsurers may dispute their obligations to pay our claims. In addition, our reinsurance agreements are subject to specified limits and we would not have reinsurance coverage to the extent that it exceeds those limits. Should an unlikely event occur that exceeds our reinsurance coverage, then the amounts in excess of our reinsurance coverage could adversely impact our financial condition or results of operations. In order to minimize our exposure to significant losses from reinsurer insolvencies, we evaluate the financial condition of our reinsurers and monitor the economic characteristics of the reinsurers on an ongoing basis and, if appropriate, we may require trust agreements to collateralize reinsurers' financial obligation to us. Nevertheless, if our reinsurers fail to pay us or fail to pay on a timely basis, our financial results and financial condition could be adversely affected.

#### **We may be adversely affected by interest rate changes.**

Our investment portfolio is predominantly comprised of fixed income securities. These securities are sensitive to changes in interest rates. An increase in interest rates typically reduces the fair market value of fixed income securities. In addition, if interest rates decline, investment income earned from future investments in fixed income securities will be lower. We generally hold our fixed income securities to maturity, so our interest rate exposure does

not usually result in realized losses. However, as noted above, rising interest rates could result in a significant reduction of our book value. A low investment yield environment could adversely impact our net earnings, as a result of fixed income securities maturing and being replaced with lower yielding securities which impact investing results.

Interest rates are highly sensitive to many factors beyond our control including general economic conditions, governmental monetary policy, and political conditions. As discussed above, fluctuations in interest rates may adversely impact our business. See *Item 7A. Qualitative and Quantitative Disclosures About Market Risk* for further discussion on interest rate risk.



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**Difficult conditions in the global capital markets and the economy potentially could materially and adversely affect our business and results of operations.**

Our results of operations are materially affected by conditions in the global capital markets and the United States economy generally, both in the United States and elsewhere around the world. Recently, concerns over the slow economic recovery, the level of United States national debt, inflation levels, energy costs and geopolitical issues have contributed to increased volatility and diminished expectations for the economy and global capital markets going forward. These factors, combined with volatile oil prices, reduced business and consumer confidence and continued high unemployment, have negatively impacted the United States economy. Although liquidity has improved, the market for fixed income instruments continues to experience some price volatility, credit downgrade events and elevated probabilities of default.

Factors such as consumer spending, business investment, government spending, the volatility and strength of the capital markets, investor and consumer confidence and inflation levels all affect the business and economic environment and, ultimately, the amount and profitability of our business. In an economic downturn characterized by higher unemployment, lower family income, lower corporate earnings, lower business investment, negative investor sentiment and lower consumer spending, the demand for our insurance products could be adversely affected. Our policyholders may choose to defer paying insurance premiums or stop paying insurance premiums altogether. In addition, we may experience an elevated incidence of claims and lapses or surrenders of policies. Adverse changes in the economy could negatively affect our net income and could have a material adverse effect on our business, results of operations and financial condition.

In addition, continuing market turmoil has resulted in, and may continue to raise the possibility of, legislative, regulatory and governmental actions. We cannot predict whether or when such actions may occur, or what impact, if any, such actions could have on our business, results of operations and financial condition.

Even in the absence of a market downturn, our insurance products, as well as our investment returns and our access to and cost of financing, are sensitive to equity, fixed income, real estate and other market fluctuations and general economic and political conditions. These fluctuations and conditions could materially and adversely affect our results of operations, financial condition and liquidity.

**Our investment portfolio is subject to market and credit risks, which could affect our financial results and ability to conduct business.**

Our investment portfolio is subject to overall market risk and credit risk of the individual issuers of securities. The value of investments in marketable securities is subject to impairment as a result of deterioration in the creditworthiness of the issuer. Although we try to manage this risk by diversifying our portfolio and emphasizing credit quality, our investments are subject to losses as a result of a general downturn in the economy. A severe economic downturn could have a material adverse impact on our results from operations and our financial condition.

**We could be forced to sell investments to meet our liquidity requirements.**

We invest the premiums we receive from customers until they are needed to pay policyholder claims or until they are recognized as profits. Consequently, we seek to match the duration of our investment portfolio with the duration of our loss and loss adjustment expense reserves to ensure strong liquidity and avoid having to liquidate securities to fund claims. As an example, we ladder the maturities of our investment portfolio to ensure we have adequate liquidity to fund anticipated liabilities that are coming due. Risks such as inadequate loss and loss adjustment reserves or

unfavorable trends in litigation could potentially result in the need to sell investments to fund these liabilities. Such sales could result in significant realized losses depending on the conditions of the general market, interest rates and credit issues with individual securities.

**If we are unable to successfully introduce new products or services or fail to keep pace with advances in technology, our business, financial condition and results of operations will be adversely affected.**

The successful implementation of our business model depends on our ability to adapt to evolving technologies and industry standards and introduce new products and services. We cannot assure you that we will be able to introduce new products or services, or that any new products will achieve market acceptance.

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Moreover, competitors may develop competitive products that could adversely affect our results of operations. A failure by us to introduce planned products or other new products could have an adverse effect on our business, financial condition and results of operations.

If we cannot adapt to changing technologies, our products and services may become obsolete, and our business could suffer. Our success will depend, in part, on our ability to continue to enhance our existing products and services, develop new technology that addresses the increasingly sophisticated and varied needs of our prospective customers and respond to technological advances on a timely and cost-effective basis. We may not be successful in using new technologies effectively or adapting our proprietary technology to evolving customer requirements, and, as a result, our business could suffer.

#### **Changes in federal regulation could impose significant burdens on us and otherwise adversely impact our results.**

While the U.S. federal government has not historically regulated the insurance business, in 2010 the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) established a Federal Insurance Office (the FIO) within the U.S. Department of the Treasury. The FIO has limited regulatory authority and is empowered to gather data and information regarding the insurance industry and insurers. In December 2013, the FIO released a report recommending ways to modernize and improve the system of insurance regulation in the United States. While the report did not recommend full federal regulation of insurance, it did suggest an expanded federal role in some circumstances. In addition, the report suggested that Congress should consider direct federal involvement to fill regulatory gaps identified in the report, should those gaps persist, for example, by considering either establishing a federal coordinating body or a direct regulator of select aspects of the industry, such as large complex institutions or institutions that seek a federal charter, if a law is passed to allow a federal charter. It is not clear as to the extent, if any, the report will lead to regulatory changes or how any such changes would impact the Company.

As a result of the foregoing, the Dodd-Frank Act, or other additional federal regulation that is adopted in the future, could impose significant burdens on us, including impacting the ways in which we conduct our business, increasing compliance costs and duplicating state regulation, and could result in a competitive disadvantage, particularly relative to other insurers that may not be subject to the same level of regulation. Changes in the U.S. regulatory framework could impact the overall competitive environment by imposing additional burdens on us and allowing other competitors not subject to these same burdens to enter or expand their insurance businesses.

Even if we are not subject to additional regulation by the federal government, significant financial sector regulatory reform, including the Dodd-Frank Act, could have a significant impact on us. For example, regulatory reform could have an unexpected impact on our rights as a creditor or on our competitive position.

Other potential changes in U.S. federal legislation, regulation and/or administrative policies, including the potential repeal of the McCarran-Ferguson Act (which exempts insurance from most federal regulation) and potential changes in federal taxation, could also significantly harm the insurance industry, including us.

#### **Our ability to meet ongoing cash requirements and pay dividends may be limited by our holding company structure and regulatory constraints restricting dividends or other distributions by our Insurance Company Subsidiaries.**

We are a holding company that transacts the majority of our business through our Insurance Company Subsidiaries. Our ability to meet our obligations on our outstanding debt, and to pay our expenses and shareholder dividends,

depends upon the dividend paying capacity of our Insurance Company Subsidiaries. We will be limited by the earnings of our Insurance Company Subsidiaries, and the distribution or other payment of such earnings to it in the form of dividends, loans, advances or the reimbursement of expenses. Payments of dividends to us by our Insurance Company Subsidiaries are subject to various business considerations and restricted by state insurance laws, including laws establishing minimum solvency and liquidity thresholds, and could be subject to revised restrictions in the future. The ability to pay ordinary and extraordinary dividends must be reviewed in relation to the impact on key financial measurement ratios, including RBC ratios and BCAR. The Insurance Company Subsidiaries' ability to pay future dividends without advance regulatory approval is dependent upon maintaining a positive level of unassigned surplus, which in turn, is dependent upon the

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Insurance Company Subsidiaries generating net income. As a result, at times, we may not be able to receive dividends from our Insurance Company Subsidiaries in amounts necessary to meet our debt obligations, to pay shareholder dividends on our capital stock or to pay corporate expenses. Therefore, the inability of our Insurance Company Subsidiaries to pay dividends or make other distributions could have a material adverse effect on our business and financial condition.

**Our Insurance Company Subsidiaries are subject to minimum capital and surplus requirements. Failure to meet these requirements could subject us to regulatory action.**

Our Insurance Company Subsidiaries are subject to minimum capital and surplus requirements (which we are in compliance with as of December 31, 2014) imposed under the laws of their respective states of domicile and each state in which they issue policies. Any failure by one of our Insurance Company Subsidiaries to meet minimum capital and surplus requirements imposed by applicable state law will subject it to corrective action. This may include requiring adoption of a comprehensive financial plan, revocation of its license to sell insurance products or placing the subsidiary under state regulatory control. A decline in the risk based capital ratios of our Insurance Company Subsidiaries could limit their ability to make a dividend to us and could be a factor in causing rating agencies to downgrade our ratings. Any new minimum capital and surplus requirements adopted in the future may require us to increase the capital and surplus of our Insurance Company Subsidiaries, which we may not be able to do.

**Our reliance upon producers subjects us to their credit risk.**

With respect to agency-billed premiums and premiums generated by brokers, producers collect premiums from the policyholders and forward them to us. We rely, and will continue to rely, heavily on these producers to attract new business. Independent producers generally have the ability to bind insurance policies and collect premiums on our behalf, actions over which we have a limited ability to exercise preventative control. In the event that an independent agent exceeds its authority by binding us to a risk that does not comply with our underwriting guidelines, we may be at risk for that policy until we effect a cancellation. Any improper use of such authority may result in losses that could have a material adverse effect on our business, results of operations and financial condition.

In certain jurisdictions, when the insured pays premium for these policies to producers for payment, the premium might be considered to have been paid under applicable insurance laws and the insured will no longer be liable to us for those amounts, whether or not we have actually received the premium from the producer. Consequently, we assume a degree of credit risk associated with producers. Although producers' failures to remit premiums to us have not caused a material adverse impact on us to date, there may be instances for which producers collect premium but do not remit it to us, and we may nevertheless be required under applicable law to provide the coverage set forth in the policy. Because the possibility of these events is dependent in large part upon the financial condition, cash flows, and internal operations of our producers, we may not be able to quantify any potential exposure presented by the risk. If we are unable to collect premium from our producers in the future, our financial condition and results of operations could be materially and adversely affected.

**Two of our core selected producers accounts for a large portion of our premium volume, loss of business provided by this entity could adversely affect us.**

Our largest producers in 2014 were Midwest General Insurance Agency, LLC, which in combination with its affiliates, accounted for 14.6% of our gross written premium and our food service industry producer which accounted for 10.9% of gross written premium. All other producers were less than 10% of our gross written premium. We do not have an exclusive relationship with either agency, and there can be no assurance that this relationship will continue in

the future. If either agency reduces their marketing of our products or moves some or all of its business to another carrier, then our business, financial condition, results of operations and cash flows may be adversely affected.

**Our performance is dependent on the continued services and performance of our senior management and other key personnel.**

The success of our business is dependent on our ability to retain and motivate our senior management and key management personnel and their efforts. The loss of the services of any of our executive officers or other key employees could have a material adverse effect on our business, financial condition, results of operations,

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and cash flows. We have existing employment or severance agreements with Robert S. Cubbin, Christopher J. Timm, Karen M. Spaun, Michael G. Costello, James M. Mahoney and other senior executives. We maintain a key person life insurance policy on Robert S. Cubbin, our President and CEO. The loss of any of these officers or other key personnel could cause our ability to implement our business strategies to be delayed or hindered.

Our future success also will depend on our ability to attract, train, motivate and retain other highly skilled technical, managerial, marketing, and customer service personnel. Competition for these employees is strong and we may not be able to successfully attract, integrate or retain sufficiently qualified personnel in our current environment. In addition, our future success depends on our ability to attract, retain and motivate our agents and other producers. Our failure to attract and retain the necessary personnel and producers could have a material adverse effect on our business, financial condition, results of operations, and cash flows.

**Increased information technology security threats and more sophisticated computer crime pose a risk to our systems, networks, products and services.**

Our business is dependent upon the uninterrupted functioning of our information technology and telecommunication systems. We rely upon our systems, as well as the systems of our vendors, to underwrite and process our business; make claim payments; provide customer service; provide policy administration services, such as endorsements, cancellations and premium collections; comply with insurance regulatory requirements; and perform actuarial and other analytical functions necessary for pricing and product development. We have established security policies, processes and layers of defense designed to help identify and protect against intentional and unintentional misappropriation or corruption of our systems and information and disruption of our operations. Our security measures are focused on the prevention, detection and remediation of damage from computer viruses, natural disasters, unauthorized access, cyber attack and other similar disruptions.

Despite these efforts, our systems may be damaged, disrupted, or shut down due to attacks by unauthorized access, malicious software, undetected intrusion, hardware failures, or other events, and in these circumstances our disaster recovery planning may be ineffective or inadequate. Information technology security threats from user error to cybersecurity attacks are increasing in frequency and sophistication. Cybersecurity attacks may range from random attempts to coordinated and targeted attacks, including sophisticated computer crime and advanced threats. These threats pose a risk to the security of our systems and networks and the confidentiality, availability and integrity of our data. No cybersecurity attack has had a material impact on our financial condition, results of operations or liquidity. However, the potential consequences of a material cybersecurity attack include reputational damage, litigation with third parties, and increased cybersecurity protection and remediation costs. A sustained business interruption or system failure could adversely impact our ability to process our business, provide customer service, pay claims in a timely manner or perform other necessary business functions. We could also be subject to fines and penalties from a security breach. The cost to remedy a severe breach could be substantial.

**Managing technology initiatives and obtaining the efficiencies anticipated with technology implementation may present significant challenges.**

While technological enhancements and initiatives can streamline several business processes and ultimately reduce the costs of operations, these initiatives can present short-term costs and implementation risks. Projections of associated costs, implementation timelines, and the benefits of those results may be inaccurate and such inaccuracies could increase over time. In addition, there are risks associated with not achieving the anticipated efficiencies from technology implementation that could impact our financial condition, results of operations, and cash flows.

**Our internal controls are not fail-safe.**

We continually enhance our operating procedures and internal controls to effectively support our business and comply with our regulatory and financial reporting requirements. As a result of the inherent limitations in all control systems, no system of controls can provide absolute assurance that all control objectives have been or will be met, and that every instance of error or fraud has been or will be detected. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the



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control system are met. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by individual acts or by collusion of two or more persons. The design of any system of controls is based in part upon assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Internal controls may also become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Further, the design of a control system must reflect resource constraints, and the benefits of controls must be considered relative to their costs. As a result of the inherent limitations in a cost-effective control system, misstatement due to error or fraud may occur and not be detected. Accordingly, our internal controls and procedures are designed to provide reasonable, not absolute, assurance that the control objectives are met.

### **Risks Related to Our Industry and Our Regulatory and Litigation Environment**

**The property and casualty insurance industry is cyclical in nature, which may affect our overall financial performance.**

Historically, the financial performance of the property and casualty insurance industry has tended to fluctuate in cyclical periods of price competition, excess capacity and lower levels of profitability (known as a soft market) followed by periods of high premium rates, shortages of underwriting capacity, and higher levels of profitability (known as a hard market). Although an individual insurance company's financial performance is dependent on its own specific business characteristics, the profitability of most property and casualty insurance companies tends to follow this cyclical market pattern. Specific factors that can drive the industry's profitability include:

- rising levels of actual costs that are not known by companies at the time they price their products;
- volatile and unpredictable developments, including man-made, weather-related and other natural catastrophes or terrorist attacks;
- changes in loss reserves resulting from the general claims and legal environments as different types of claims arise and judicial interpretations relating to the scope of insurer's liability develop;
- fluctuations in interest rates, inflationary pressures and other changes in the investment environment, which affect returns on invested assets and may impact the ultimate payout of losses; and
- increases in medical costs beyond historic or expected annual inflationary levels.

Because the cyclicity of our industry is due in large part to the actions of competitors and general economic conditions, we cannot predict with certainty the timing or duration of changes in the market cycle.

**Severe weather conditions and other catastrophes are inherently unpredictable and could cause us to suffer material financial losses.**

The majority of our property business is exposed to the risk of severe weather conditions and other catastrophes. Catastrophes can be caused by various events, including natural events, such as hurricanes, winter weather, tornadoes, windstorms, earthquakes, hailstorms, severe thunderstorms and fires, and other events, such as explosions, terrorist attacks and riots. The incidence and severity of catastrophes and severe weather conditions are inherently unpredictable. Generally, these losses result in an increase in the number of claims incurred as well as the amount of compensation sought by claimants.

One or more catastrophic or other events could result in claims that substantially exceed our expectations, which could have an adverse effect on our results of operations or financial condition. Along with other insurers in the industry, we use models in assessing our exposure to catastrophe losses that assume various conditions and probability scenarios.

However, these models do not necessarily accurately predict future losses or accurately measure losses currently incurred. Catastrophe models use historical information about various catastrophes and detailed information about our in-force business. While we use this information in connection with our pricing and risk management activities, there are limitations with respect to their usefulness in predicting losses in any reporting period. Such limitations lead to questionable predictive capability and post-event measurements that

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have not been well understood or proven to be sufficiently reliable. In addition, the models are not necessarily reflective of our or state-specific policy language, demand surge for labor and materials or loss settlement expenses, all of which are subject to wide variation by catastrophe.

#### **Litigation may have an adverse effect on our business**

We are subject at times to various claims, lawsuits and proceedings relating principally to alleged errors or omissions in the placement of insurance, claims administration, consulting services and other business transactions arising in the ordinary course of business as further disclosed in Note 15 ~ *Commitments and Contingencies*. Where appropriate, we vigorously defend such claims, lawsuits and proceedings. Some of these claims, lawsuits and proceedings seek damages, including consequential, exemplary or punitive damages, in amounts that could, if awarded, be significant. Most of the claims, lawsuits and proceedings arising in the ordinary course of business are covered by the policy of insurance at issue. We account for such activity through the establishment of unpaid loss and loss expense reserves. We also maintain errors and omissions insurance and extra-contractual coverage under reinsurance treaties related to the policy of insurance at issue or other appropriate insurance. In terms of any retentions or deductibles associated with such insurance, we have established accruals for such retentions or deductibles, when necessary, based upon current available information. In accordance with accounting guidance, if it is probable that an asset has been impaired or a liability has been incurred as of the date of the financial statements and the amount of loss is reasonably estimable; then an accrual for the costs to resolve these claims is recorded in the accompanying consolidated balance sheets. Period expenses related to the defense of such claims are included in the accompanying consolidated statements of income. With the assistance of outside counsel, we adjust such provisions according to new developments or changes in the strategy in dealing with such matters. On the basis of current information, we do not believe that there is a reasonable possibility that, other than with regard to the arbitration disclosed in Note 15 ~ *Commitments and Contingencies*, any material loss exceeding amounts already accrued, if any, will result from any of the claims, lawsuits and proceedings to which the Company is subject to, either individually, or in the aggregate. However, it is possible that future results of operations or cash flows for any particular quarter or annual period could be materially affected by an unfavorable resolution of any such matters.

#### **Because we are heavily regulated by the states in which we operate, we may be limited in the way we operate.**

We are subject to extensive supervision and regulation in the states in which we operate. The supervision and regulation relate to numerous aspects of our business and financial condition. The primary purpose of the supervision and regulation is to maintain compliance with insurance regulations and to protect policyholders. The extent of regulation varies, but generally is governed by state statutes. These statutes delegate regulatory, supervisory and administrative authority to state insurance departments. This system of regulation covers, among other things:

- standards of solvency, including risk-based capital measurements;
- restrictions on the nature, quality and concentration of investments;
- restrictions on the types of terms that we can include in the insurance policies we offer;
- restrictions on our ability to withdraw from unprofitable lines of insurance or unprofitable market areas;
- required methods of accounting;
- required reserves for unearned premiums, losses and other purposes;
- permissible underwriting and claims settlement practices;
- assessments for the provision of funds necessary for the settlement of covered claims under certain insurance policies provided by impaired, insolvent or failed insurance companies;
- approval of policy forms and rates; and
- restrictions on transactions between our Insurance Company Subsidiaries and their affiliates.

The regulations of the state insurance departments may affect the cost or demand for our products and may impede us from obtaining rate increases or taking other actions we might wish to take to increase our

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profitability. Furthermore, we may be unable to maintain all required licenses and approvals and our business may not fully comply with the wide variety of applicable laws and regulations or the relevant authority's interpretation of the laws and regulations. Also, regulatory authorities have relatively broad discretion to grant, renew or revoke licenses and approvals. If we do not have the requisite licenses and approvals, or do not comply with applicable regulatory requirements, the insurance regulatory authorities could stop or temporarily suspend us from conducting some or all of our activities or monetarily penalize us. In addition, state regulators and the NAIC regularly examine existing laws and regulations applicable to insurance companies. Changes in these laws and regulations or the interpretations thereof could adversely impact our business.

Although the United States federal government does not directly regulate the insurance business, changes in federal legislation, regulation, and/or administrative policies in several areas, including changes in financial services regulation and federal taxation, can significantly harm the insurance industry.

#### **Most states assess our Insurance Company Subsidiaries to provide funds for failing insurance companies and those assessments could be material.**

Our Insurance Company Subsidiaries are subject to assessments in most states where we are licensed for the provision of funds necessary for the settlement of covered claims under certain policies provided by impaired, insolvent or failed insurance companies. These assessments, which are levied by guaranty associations within the state up to prescribed limits, are imposed on all member insurers in the applicable state on the basis of the proportionate share of the premiums written by member insurers in the lines of business in which the impaired, insolvent or failed insurer was engaged. Accordingly, the assessments levied on us by the states in which we are licensed to write insurance may increase as we increase our premiums written. Maximum contributions required by law in any one year vary by state, and have historically been less than one percent of annual premiums written. In addition, as a condition to the ability to conduct business in certain states, insurance companies are required to participate in mandatory reinsurance funds. We cannot predict with certainty the amount of future assessments or level of participation in mandatory reinsurance funds. Significant assessments and the effect of mandatory reinsurance arrangements, or changes therein, could have a material adverse effect on our financial condition and results of operations.

#### **Risks Related to Our Common Stock**

##### **The price of our common stock may be volatile.**

The trading price of our common stock may fluctuate substantially due to a variety of factors, some of which are beyond our control and may not be related to our operating performance. These fluctuations could be significant and could cause a loss in the amount invested in our shares of common stock. Factors that could cause fluctuations include, but are not limited to, the following:

- Variations in our actual or anticipated operating results or changes in the expectations of financial market analysts with respect to our results;
- Investor perceptions of the insurance industry in general and the Company in particular;
- Market conditions in the insurance industry and any significant volatility in the market;
- Major catastrophic events; and
- Departure of key personnel.
- Perceptions regarding the timing and likelihood of consummating the proposed transaction with Fosun.

**Provisions of the Michigan Business Corporation Act, our articles of incorporation and other corporate governing documents and the insurance laws may discourage takeover attempts.**

The Michigan Business Corporation Act contains anti-takeover provisions. Chapter 7A (the Fair Price Act ) of the Business Corporation Act applies to us and may have an anti-takeover effect and may delay, defer or prevent a tender offer or takeover attempt that a shareholder might consider in their best interest, including those attempts that might result in shareholders receiving a premium over market price for their shares.

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### **MEADOWBROOK INSURANCE GROUP, INC.**

In general, subject to certain exceptions, the Fair Price Act prohibits a Michigan corporation from engaging in a business combination with an interested shareholder for a period of five years following the date that such shareholder became an interested shareholder, unless (i) prior to such date, the board of directors approved the business combination or (ii) on or subsequent to such date, the business combination is approved by at least 90% of the votes of each class of the corporation's stock entitled to vote and by at least two-thirds of such voting stock not held by the interested shareholder or such shareholder's affiliates. The Fair Price Act defines a business combination to include certain mergers, consolidations, dispositions of assets or shares and recapitalizations. An interested shareholder is defined by the Fair Price Act to include a beneficial owner, directly or indirectly, of 10% or more of the voting power of the outstanding voting shares of the corporation.

We are also subject to the laws of Michigan, Ohio, California, Washington D.C., Missouri, and other states, which govern insurance holding companies. Under these laws, a person generally must obtain the applicable Insurance Department's approval to acquire, directly or indirectly, five to ten percent or more of the outstanding voting securities of our Insurance Company Subsidiaries. An Insurance Department's determination of whether to approve an acquisition would be based on a variety of factors, including an evaluation of the acquirer's financial stability, the competence of its management, and whether competition in that state would be reduced. These laws may prevent, delay or defer a change of control of us or our Insurance Company Subsidiaries. The proposed transaction with Fosun is subject to regulatory approval by insurance departments for the states of Michigan, Ohio, Missouri, California and Washington D. C., which could either delay or prevent the execution of the transaction.

#### **Although we have paid cash dividends in the past, we may not pay cash dividends in the future.**

The declaration and payment of dividends is subject to the discretion of our Board of Directors and will depend on our financial condition, results of operations, cash flows, cash requirements, future prospects, regulatory and contractual restrictions on the payment of dividends by our Insurance Company Subsidiaries and other factors deemed relevant by our Board of Directors. There is no requirement that we must, and we cannot assure you that we will, declare and pay any dividends in the future. Our Board of Directors may determine to retain such capital for general corporate or other purposes.

### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not Applicable

### **ITEM 2. PROPERTIES**

We own the land and an approximately 72,000 square foot corporate headquarters building in Southfield, Michigan. We expect that our corporate headquarters building will be adequate for our current and expected future operations.

We lease 60,000 square feet of office space in Westerville, Ohio that expires in 2024.

We are also a party to various leases for other locations in which we have offices. We do not consider any of these leases to be material.

### **ITEM 3. LEGAL PROCEEDINGS**

The Company, and its subsidiaries, are subject at times to various claims, lawsuits and proceedings relating principally to alleged errors or omissions in the placement of insurance, claims administration, consulting services and other

business transactions arising in the ordinary course of business as further disclosed in Note 15 ~ *Commitments and Contingencies*. Where appropriate, the Company vigorously defends such claims, lawsuits and proceedings. Some of these claims, lawsuits and proceedings seek damages, including consequential, exemplary or punitive damages, in amounts that could, if awarded, be significant. Most of the claims, lawsuits and proceedings arising in the ordinary course of business are covered by the policy of insurance at issue. We account for such activity through the establishment of unpaid loss and loss expense reserves. We also maintain errors and omissions insurance and extra-contractual coverage under reinsurance treaties related to the policy of insurance at issue or other appropriate insurance. In terms of any retentions or deductibles associated with such insurance, the Company has established accruals for such retentions or deductibles, when necessary, based upon



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**MEADOWBROOK INSURANCE GROUP, INC.**

current available information. In accordance with accounting guidance, if it is probable that an asset has been impaired or a liability has been incurred as of the date of the financial statements and the amount of loss is reasonably estimable; then an accrual for the costs to resolve these claims is recorded by the Company in the accompanying consolidated balance sheets. Period expenses related to the defense of such claims are included in the accompanying consolidated statements of income. Management, with the assistance of outside counsel, adjusts such provisions according to new developments or changes in the strategy in dealing with such matters. On the basis of current information, the Company does not believe that there is a reasonable possibility that, other than with regard to the arbitration disclosed in Note 15 ~ *Commitments and Contingencies*, any material loss exceeding amounts already accrued, if any, will result from any of the claims, lawsuits and proceedings to which the Company is subject to, either individually, or in the aggregate.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable

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**MEADOWBROOK INSURANCE GROUP, INC.**

**PART II**

**ITEM 5. MARKET PRICE OF AND DIVIDENDS ON THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS**

**Shareholder Information**

**Corporate Headquarters**

26255 American Drive  
Southfield, MI 48034-6112  
Phone: (248) 358-1100

**Transfer Agent & Registrar**

Computershare Shareowner Services LLC  
P.O. Box 43006  
Providence, RI 02940-3006

**Independent Registered  
Public Accounting Firm**

Ernst & Young LLP  
One Kennedy Square, Suite 1000  
777 Woodward Avenue  
Detroit, MI 48226-5495

**Stock Listing**

New York Stock Exchange  
Symbol: MIG

**Corporate Headquarters**

26255 American Drive  
Southfield, MI 48304-6112

**Corporate Counsel**

Sidley Austin LLP  
One South Dearborn Street  
Chicago, IL 60603-2302

**Shareholder Relations and Form 10-K**

A copy of our 2014 Annual Report and Form 10-K, as filed with the Securities and Exchange Commission, may be obtained upon written request to our Financial Reporting Department at our corporate headquarters, or contact:

Karen M. Spaun, Senior Vice President and Chief Financial Officer  
(248) 204-8178; karen.spaun@meadowbrook.com

**Shareholder Investment Plan**

Our Shareholder Investment Plan ( Plan ) offers a simple and systematic way to purchase our common stock without paying brokerage fees or commissions. With the Plan's many flexible features, an account may be customized to reflect individual financial and investment objectives. If you would like additional information including a prospectus and an application, please contact:

Computershare Shareowner Services LLC  
1-800-442-8134

Or visit their website at [www.cpushareownerservices.com](http://www.cpushareownerservices.com)

**Share Price and Dividend Information**

Our common stock is traded on the New York Stock Exchange under the symbol MIG. The following table sets forth the high and low sale prices of our common shares as reported by the NYSE and our quarterly dividends declared for

each period shown:

<b>December 31, 2014</b>	<b>High</b>	<b>Low</b>	<b>Dividends</b>
First Quarter	\$ 7.00	\$ 5.24	\$ 0.02
Second Quarter	7.20	5.27	0.02
Third Quarter	7.28	5.66	0.02
Fourth Quarter	8.63	5.76	0.02

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<b>December 31, 2013</b>	<b>High</b>	<b>Low</b>	<b>Dividends</b>
First Quarter	\$ 7.44	\$ 5.79	\$ 0.02
Second Quarter	8.26	6.84	0.02
Third Quarter	8.90	5.87	0.02
Fourth Quarter	7.46	6.17	0.02

When evaluating the declaration of a dividend, our Board of Directors considers a variety of factors, including but not limited to, our cash flow, liquidity needs, results of operations strategic plans, industry conditions, our overall financial condition and other relevant factors. As a holding company, the ability to pay cash dividends is partially dependent on dividends and other permitted payments from our subsidiaries which may be subject to limitations under applicable insurance regulations. In 2014 and 2013, the Insurance Company Subsidiaries paid dividends to our holding company of \$20.0 million and \$14.0 million, respectively.

For additional information regarding dividend restrictions, refer to the *Liquidity and Capital Resources* section of *Management's Discussion and Analysis*.

**Shareholders of Record**

As of February 18, 2015, there were 221 shareholders of record of our common stock. For purposes of this determination, Cede & Co., the nominee for the Depository Trust Company is treated as one holder.

**Purchase of Equity Securities by the Issuer**

There have been no repurchases of shares of our common stock in 2014 or 2013.

TABLE OF CONTENTS**MEADOWBROOK INSURANCE GROUP, INC.****Performance Graph**

The following graph sets forth, for the five year period ended December 31, 2014, the cumulative total shareholder return for the Company's common stock, the Russell 2000 Index, and a published industry index. The graph assumes the investment of \$100 on December 31, 2009 in Common Stock of the Company, the Russell 2000 Index, and such published index. The stock price performance represented on the following graph is not necessarily indicative of future stock price performance.

The performance graph shall not be deemed soliciting material or to be filed with the Securities and Exchange Commission, nor shall such information be deemed to be incorporated by reference into any future filing of the Company under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent the Company specifically incorporates it by reference into such filing.

<i>Index</i>	<i>Period Ending</i>					
	<b>12/31/09</b>	<b>12/31/10</b>	<b>12/31/11</b>	<b>12/31/12</b>	<b>12/31/13</b>	<b>12/31/14</b>
Meadowbrook Insurance Group, Inc.	100.00	140.61	149.00	82.41	100.34	123.58
Russell 2000	100.00	126.86	121.56	141.43	196.34	205.95
SNL Insurance \$2.5B-\$10B	100.00	115.12	118.14	142.48	187.40	225.53

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SELECTED CONSOLIDATED FINANCIAL DATA**

	<b>For the Years Ended December 31,</b>				
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
	<b>(In thousands, except per share and ratio data)</b>				
<b>Income Statement Data:</b>					
Gross written premiums	\$ 742,464	\$ 944,011	\$ 1,066,633	\$ 904,026	\$ 801,901
Net written premiums	601,237	691,637	797,502	776,253	693,599
Net earned premiums	643,271	697,417	854,259	747,635	659,840
Net commissions and fees	43,173	39,512	34,049	32,115	34,239
Net investment income	45,142	46,473	53,143	54,522	54,173
Net realized gains	10,939	7,769	55,312	2,949	1,817
Total revenue	742,525	791,171	996,763	837,221	750,069
Net losses and LAE	420,808	549,037	677,684	495,351	399,650
Policy acquisition and other underwriting expenses	236,271	225,510	274,066	250,535	228,182
General selling & administrative expenses	31,972	25,789	24,463	24,775	22,494
General corporate expense	6,454	3,997	3,572	400	5,668
Amortization expense	3,988	4,237	7,296	4,973	4,966
Goodwill impairment expense	—	115,397	—	—	—
Interest expense	13,899	12,950	8,429	8,347	9,458
Income (loss) before income taxes and equity earnings	29,133	(145,746 )	1,253	52,840	79,651
Equity earnings of affiliates, net of tax	3,609	3,441	2,652	2,418	2,263
Equity earnings (losses) of unconsolidated subsidiaries, net of tax	21	(965 )	2	(57 )	473
Net income (loss)	28,657	(112,310 )	11,749	43,032	58,973
Earnings (loss) per share - Diluted	\$ 0.57	\$ (2.25 )	\$ 0.23	\$ 0.82	\$ 1.09
Dividends paid per common share	\$ 0.08	\$ 0.08	\$ 0.17	\$ 0.17	\$ 0.13

**Balance Sheet Data:**

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Total investments and cash and cash equivalents	\$ 1,662,521	\$ 1,667,804	\$ 1,651,592	\$ 1,487,680	\$ 1,345,257
Total assets	2,679,774	2,761,842	2,713,274	2,370,098	2,170,943
Loss and LAE reserves	1,590,359	1,616,521	1,455,980	1,194,977	1,065,056
Debt	151,282	160,723	78,500	28,375	37,750
Debentures	80,930	80,930	80,930	80,930	80,930
Shareholders' equity	457,633	413,413	558,279	585,151	540,403
Book value per share	\$ 9.14	\$ 8.29	\$ 11.22	\$ 11.46	\$ 19.15

**Other Data:**

GAAP ratios (insurance companies only):

Net loss and LAE ratio	65.4 %	78.7 %	79.3 %	66.3 %	60.6 %
Expense ratio	36.7 %	32.3 %	32.1 %	33.5 %	34.6 %
Combined ratio (1)	102.1 %	111.0 %	111.4 %	99.9 %	95.2 %
Accident year combined ratio (2)	102.4 %	101.2 %	101.4 %	98.8 %	99.9 %
Total (favorable) adverse development on prior years	\$ (1,741 )	\$ 68,400	\$ 85,515	\$ 7,311	\$ (31,003 )

(1) The combined loss and expense ratio (or combined ratio), expressed as a percentage, is the key measure of underwriting profitability traditionally used in the property and casualty insurance business. The combined ratio is a statutory (non-GAAP) accounting measurement, which represents the sum of (i) the ratio of losses and loss expenses to net premiums earned (loss ratio), plus (ii) the ratio of underwriting expenses to net premiums written (expense ratio). The combined ratios above have been modified to reflect GAAP accounting, as management evaluates the performance of our underwriting operations using the GAAP combined ratio. Specifically, the GAAP combined ratio is the sum of the loss ratio, plus the ratio of GAAP underwriting expenses (which include the change in deferred policy acquisition costs) to net premiums earned (expense ratio). When the combined ratio is under 100% underwriting results are generally considered profitable; when the combined ratio is over 100% underwriting results are generally considered unprofitable.

(2) The accident year combined ratio is a non-GAAP measure that excludes changes in net ultimate loss estimates from prior accident year loss reserves. The accident year combined ratio provides management with an assessment of the specific policy year's profitability (which matches policy pricing with related losses) and assists management in their evaluation of product pricing levels and quality of business written. Management uses accident year combined ratio as one component to assess the Company's current year performance and as a measure to evaluate, and if necessary, adjust current year pricing and underwriting.

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**MEADOWBROOK INSURANCE GROUP, INC.  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

***Forward-Looking Statements***

*This annual report may provide information including certain statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These include statements regarding the intent, belief, or current expectations of management, including, but not limited to, those statements that use the words believes, expects, anticipates, estimates, or similar expressions. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties, and results could differ materially from those indicated by such forward-looking statements. Among the important factors that could cause actual results to differ materially from those indicated by such forward-looking statements are: actual loss and loss adjustment expenses exceeding our reserve estimates; competitive pressures in our business; the failure of any of the loss limitation methods we employ; a failure of additional capital to be available or only available on unfavorable terms; our geographic concentration and the business and economic conditions, natural perils, man made perils, and regulatory conditions within our most concentrated region; our ability to appropriately price the risks we underwrite; goodwill impairment risk employed as part of our growth strategy; actions taken by regulators, rating agencies or lenders, including the impact of the downgrade by A.M. Best of the Company's Insurance Company Subsidiaries' financial strength rating, A.M. Best's downgrade of our issuer credit rating and any other future action by A.M. Best with respect to such ratings; increased risks or reduction in the level of our underwriting commitments due to market conditions; a failure of our reinsurers to pay losses in a timely fashion, or at all; interest rate changes; continued difficult conditions in the global capital markets and the economy generally; market and credit risks affecting our investment portfolio; liquidity requirements forcing us to sell our investments; a failure to introduce new products or services to keep pace with advances in technology; the new federal financial regulatory reform; our holding company structure and regulatory constraints restricting dividends or other distributions by our Insurance Company Subsidiaries; minimum capital and surplus requirements imposed on our Insurance Company Subsidiaries; our reliance upon producers, which subjects us to their credit risk; loss of one of our core selected producers; our dependence on the continued services and performance of our senior management and other key personnel; our reliance on our information technology and telecommunications systems; managing technology initiatives and obtaining the efficiencies anticipated with technology implementation; a failure in our internal controls; the cyclical nature of the property and casualty insurance industry; severe weather conditions and other catastrophes; the effects of litigation, including the previously disclosed arbitration and class action litigation or any similar litigation which may be filed in the future; state regulation; assessments imposed upon our Insurance Company Subsidiaries to provide funds for failing insurance companies, and risks and uncertainties relating to the proposed transaction with Fosun, including the risk that the Company's shareholders do not approve the transaction; uncertainties as to the timing of the transaction; the risk that regulatory or other approvals required for the transaction are not obtained or are obtained subject to conditions that are not anticipated; competitive responses to the transaction; litigation relating to the transaction; disruptions of current plans and operations caused by the announcement and pendency of the proposed transaction; potential difficulties in employee retention as a result of the announcement and pendency of the proposed transaction; and disruption from the proposed transaction making it more difficult to maintain relationships with agents, wholesalers, suppliers, customers, policyholders and regulators.*

*For additional information with respect to certain of these and other factors, refer to Risk Factors above and subsequent filings made with the United States Securities and Exchange Commission. We are not under any obligation to (and expressly disclaim any obligation to) update or alter our forward-looking statements, whether as a result of*



*new information, future events or otherwise.*

## **Critical Accounting Policies**

### ***General***

In certain circumstances, we are required to make estimates and assumptions that affect amounts reported in our consolidated financial statements and related footnotes. We evaluate these estimates and assumptions on an

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MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

on-going basis based on a variety of factors. There can be no assurance, however, the actual results will not be materially different than our estimates and assumptions, and that reported results of operation will not be affected by accounting adjustments needed to reflect changes in these estimates and assumptions. We believe the following policies, along with those disclosed in Note 1 ~ *Summary of Significant Accounting Policies*, are the most sensitive to estimates and judgments.

***Losses and Loss Adjustment Expenses***

Significant periods of time can elapse between the occurrence of a loss, the reporting of the loss to the insurer, and the insurer's payment of that loss. To recognize liabilities for unpaid losses and LAE, insurers establish reserves as balance sheet liabilities representing estimates of amounts needed to pay reported and unreported net losses and LAE.

We establish a liability for losses and LAE, which represents case based estimates of reported unpaid losses and LAE and actuarial estimates of IBNR and LAE. Such liabilities, by necessity, are based upon estimates and, while we believe the amount of our reserves is adequate, the ultimate liability may be greater or less than the estimate. As of December 31, 2014 and 2013, we have accrued \$1,590.4 million and \$1,616.5 million of gross loss and LAE reserves, respectively.

Components of Losses and Loss Adjustment Expense

The following table sets forth our gross and net reserves for losses and LAE based upon an underlying source of data, at December 31, 2014 (in thousands):

	<b>Case</b>	<b>IBNR</b>	<b>Total</b>
Direct	\$ 539,888	\$ 788,186	\$ 1,328,074
Assumed-Directly Managed (1)	55,316	151,885	207,201
Assumed-Residual Markets (2)	10,152	12,842	22,994
Assumed-MFH	10,383	5,707	16,090
Assumed-Other	5,650	10,350	16,000
Gross	621,389	968,970	1,590,359
Less Ceded	143,728	375,802	519,530
Net	\$ 477,661	\$ 593,168	\$ 1,070,829

(1) Directly Managed represents business managed and processed by our underwriting, claims, and loss control departments, utilizing our internal systems and related controls.

(2) Residual Markets represent mandatory pooled workers' compensation business allocated to individual insurance company writers based on the insurer's market share in a given state.

The reserves referenced in the above table related to our direct and assumed-directly managed business are established through transactions processed through our internal systems and related controls. Likewise, business assumed from Midwest Insurance Company is defined as assumed business related to our partial ownership of Midwest Financial Holding, LLC ( MFH ), where we have direct access to their paid and case reserve loss data. Accordingly, case reserves are established on a current basis, therefore, there is no delay or lag in reporting of losses from a ceding company, and IBNR is determined utilizing various actuarial methods based upon historical data. Ultimate reserve estimates related to assumed business from residual markets are provided by individual states on a two quarter lag between the date of

the evaluation and the receipt of the estimate from the National Council on Compensation Insurance ( NCCI ), and include an estimated reserve determined based upon internal actuarial methods for this lag. Relative to assumed business from other sources, we receive case and paid loss data within a forty-five day reporting period and develop our estimates for IBNR based on both current and historical data.

The completeness and accuracy of data received from cedants on assumed business that we do not manage directly is verified through monthly reconciliations to detailed statements, inception-to-date roll-forwards of claim data, actuarial estimates of historical trends, field audits, and a series of management oversight reports on a program basis.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

The following table sets forth our net case and IBNR reserves for losses and LAE by line of business at December 31, 2014 (in thousands):

	<b>Net Case</b>	<b>Net IBNR</b>	<b>Total</b>
Workers' Compensation	\$ 233,145	\$ 235,943	\$ 469,088
Residual Markets	10,682	14,218	24,900
Commercial Multiple Peril/General Liability	160,680	283,644	444,324
Commercial Automobile	55,613	48,304	103,917
Other	17,541	11,059	28,600
Total	\$ 477,661	\$ 593,168	\$ 1,070,829

Claim Reserving Process and Methodology

When a claim is reported to one of our Insurance Company Subsidiaries or our affiliate MFH, for the majority of claims, our claims personnel within our risk management subsidiary will establish a case reserve for the estimated amount of the ultimate payment. The amount of the reserve is primarily based upon a case-by-case evaluation of the type of claim involved, the circumstances surrounding each claim, and the policy provisions relating to the type of losses. The estimate reflects the informed judgment of such personnel based on general insurance reserving practices, which focus on the ultimate probable cost of each reported claim, as well as the experience and knowledge of the claims person. Until the claim is resolved, these estimates are revised as deemed necessary by the responsible claims personnel based on subsequent developments, new information, or periodic reviews.

In addition to case reserves and in accordance with industry practice, we maintain estimates of reserves for losses and LAE incurred but not yet reported. We project an estimate of ultimate losses and LAE at each reporting date. The difference between the projected ultimate loss and LAE reserves and the case loss reserves and LAE reserves, is carried as IBNR reserves. By using both estimates of reported claims and IBNR determined using generally accepted actuarial reserving techniques, we estimate the ultimate liability for losses and LAE, net of reinsurance recoverables.

In developing claim and claim adjustment expense reserve estimates, we perform a complete and detailed reserve analyses each quarter. To perform this analysis, the data is organized at a reserve category level. A reserve category can be a line of business such as commercial automobile liability, or it may be a particular geographical area within a line of business such as California workers' compensation. The reserves within a reserve category level are characterized as either short tail or long tail. About 98% of our reserves can be characterized as coming from long tail lines of business. For long tail business, several years may lapse between the time the business is written and the time when all claims are settled. Our long-tail exposures include workers' compensation, commercial automobile liability, general liability, professional liability, products liability, aviation liability, excess, and umbrella. Short-tail exposures include property, commercial automobile physical damage, a portion of ocean marine, a portion of aviation, and inland marine. The analyses generally review losses both gross and net of reinsurance.

The standard actuarial methods that we use to project ultimate losses for both long-tail and short-tail exposures include, but are not limited to, the following:

- Paid Development Method
- Incurred Development Method
- Paid Bornhuetter-Ferguson Method

- Reported Bornhuetter-Ferguson Method
- Initial Expected Loss Method
- Paid Roll-forward Technique
- Incurred Roll-forward Technique

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**MEADOWBROOK INSURANCE GROUP, INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

All of these methods are consistently applied to each reserve category for which they are applicable and they create indications for each accident year. We use judgment selecting the best estimate from within these estimates or adjusted estimates. As such, no one method or group of methods is strictly used for any line of business or reserve category within a line of business. The individual selections by year are our best judgments based on the strengths and weaknesses of the method, indications, the inherent variability in the data and the specific modifications to selections for data characteristics.

A brief description of the methods and some discussion of their inherent strengths, weaknesses and uses are as follows:

*Paid Development Method*

This method uses historical, cumulative paid losses by accident year and develops those actual losses to estimated ultimate losses based upon the assumption that each accident year will develop to estimated ultimate cost in a manner that is analogous to prior years, adjusted as deemed appropriate for the expected effects of known changes in the claim payment environment, and to the extent necessary supplemented by analyses of the development of broader industry data.

Selection of the paid loss pattern requires analysis of several factors including the impact of inflation on claims costs, the rate at which claims professionals make claim payments and close claims, the impact of judicial decisions, the impact of underwriting changes, the impact of large claim payments, and other factors. Claim cost inflation itself requires evaluation of changes in the cost of repairing or replacing property, changes in the cost of medical care, changes in the cost of wage replacement, judicial decisions, legislative changes and other factors. Because this method assumes that losses are paid at a consistent rate, changes in any of these factors can impact the results. Since the method does not rely on case reserves, it is not directly influenced by changes in the adequacy of case reserves.

*Incurred Development Method*

This method uses historical, cumulative reported loss dollars by accident year and develops those actual losses to estimated ultimate losses based upon the assumption that each accident year will develop to estimated ultimate cost in a manner that is analogous to prior years, adjusted as deemed appropriate for the expected effects of known changes in the claim payment and case reserving environment, and to the extent necessary supplemented by analyses of the development of broader industry data.

Since the method uses more data (case reserves in addition to paid losses) than the paid development method, the incurred development patterns may be less variable than paid patterns. However, selection of the incurred loss pattern requires analysis of all of the factors listed in the description of the paid development method. In addition, the inclusion of case reserves can lead to distortions if changes in case reserving practices have taken place and the use of case incurred losses may not eliminate the issues associated with estimating the incurred loss pattern subsequent to the most mature point available.

*Paid Bornhuetter-Ferguson Method*

This is a method that assigns partial weight to initial expected losses for each accident year and partial weight to observed paid losses. The weights assigned to the initial expected losses decrease as the accident year matures.

The method assumes that only future losses will develop at the expected loss ratio level. The percent of paid loss to ultimate loss implied from the paid development method is used to determine what percentage of ultimate loss is yet to be paid. The use of the pattern from the paid development method requires consideration of all factors listed in the description of the paid development method. The estimate of losses yet to be paid is added to current paid losses to estimate the ultimate loss for each year. This method will react very slowly if actual ultimate loss ratios are different from expectations due to changes not accounted for by the expected loss ratio calculation.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

*Reported Bornhuetter-Ferguson Method*

This is a method that assigns partial weight to the initial expected losses and partial weight to observed reported loss dollars (paid losses plus case reserves). The weights assigned to the initial expected losses decrease as the accident year matures.

The use of case incurred losses instead of paid losses can result in development patterns that are less variable than paid patterns. However, the inclusion of case reserves can lead to distortions if changes in case reserving have taken place, and the method requires analysis of all the factors that need to be reviewed for the expected loss ratio and incurred development methods.

*Initial Expected Loss Method*

This method is used directly, and as an input to the Bornhuetter-Ferguson methods. Initial expected losses for an accident year are based on adjusting prior accident year projections to the current accident year levels using underlying loss trends, rate changes, benefit changes, reinsurance structure and cost changes and other pertinent adjustments specific to the line of business.

This method may be useful if loss development patterns are inconsistent, losses emerge very slowly, or there is relatively little loss history from which to estimate future losses. The selection of the expected loss ratio requires analysis of loss ratios from earlier accident years or pricing studies and analysis of inflationary trends, frequency trends, rate changes, underwriting changes, and other applicable factors.

*Paid Roll-forward Technique*

This technique adjusts prior estimates of ultimate losses based on the actual paid loss emergence in the quarter compared to the expected emergence. It is useful in evaluating reserves by considering the longer term implications of ordinary fluctuations in the development patterns.

*Incurred Roll-forward Technique*

This technique adjusts prior estimates of ultimate losses based on the actual case incurred loss emergence in the quarter compared to the expected emergence. It may also be useful in evaluating reserves by considering the longer term implications of ordinary fluctuations in the development patterns and generally reacts faster than the paid roll-forward technique.

Claims for short-tail lines of business settle quicker than long-tail lines of business, and in general, loss development factors for short-tail lines are smaller than long-tail lines. For long-tail lines, we tend to rely on initial expected loss methods throughout the current accident year then typically move to development factor based methods for older accident years. Development methods on short-tail lines are generally reliable in the third and fourth quarter of the initial accident year and recorded loss ratios reflect a blend of the development and forecast methods. Short-tail lines represent 2% of our total reserves at December 31, 2014.

The reserve categories for which the above methods are not applicable are few. The largest of these is our workers' compensation residual market reserve category, where we utilize detailed reserve analyses performed by the industry statistical agency NCCI in making our estimates. We adjust these estimates for timing differences in the reporting of



the data. The other reserve categories that deviate from the above methods are smaller; as a group they constitute less than one percent of the total reserves.

Each of the methods listed above requires the selection and application of parameters and assumptions. For all but the initial expected loss method, the key assumptions are the patterns with which our aggregate claims data will be paid or will emerge over time ( development patterns ). These patterns incorporate inherent assumptions of claims cost inflation rates and trends in the frequency of claims, both overall and by severity of claim. These are affected by underlying loss trends, rate changes, benefit changes, reinsurance structure and cost changes, and other pertinent adjustments which are explicit key assumptions underlying the initial expected loss method. Each of these key assumptions is discussed in the following paragraphs.

To analyze the development patterns, we compile, to the extent available, long-term and short-term historical data for our Insurance Company Subsidiaries, organized in a manner which provides an indication of the

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### **MEADOWBROOK INSURANCE GROUP, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

historical development patterns. To the extent that the historical data may provide insufficient information about future patterns—whether due to environmental changes such as legislation or due to the small volume or short history of data for some segments of our business—benchmarks based on industry data, and forecasts made by industry rating bureaus regarding the effect of legislative benefit changes on such patterns, may be used to supplement, adjust, or replace patterns based on our Insurance Company Subsidiaries' historical data.

Actuarial judgment is required in selecting the patterns to apply to each segment of data being analyzed, and our views regarding current and future claim patterns are among the factors that enter into our establishment of the reserve for losses and LAE at each balance sheet date. When short-term averages or external rate bureau analyses indicate the claims patterns are changing from historical company or industry patterns, the new or forecasted information typically is factored into the methodologies. When new claims emergence or payment patterns have appeared in the actual data repeatedly over multiple evaluations, those new patterns are given greater weight in the selection process.

Because some claims are paid over many years, the selection of claim emergence and payment patterns involves judgmentally estimating the manner in which recently occurring claims will develop for many years and at times, decades in the future. When it is likely the actual development will occur in the distant future, the potential for actual development to differ substantially from historical patterns or current projections is increased.

This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events. In particular, the development factor based methods all have as a key assumption that the development of losses in the future will follow a pattern similar to those measured by past experience and as adjusted either explicitly or by actuarial judgment. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of reserves, because the eventual deficiency or redundancy is affected by multiple and varied factors. With respect to the ultimate estimates for losses and LAE, the key methods remained consistent for the years ended December 31, 2014 and 2013. We reviewed the key assumptions that underlie the actuarial standard methods and made the appropriate adjustments to reflect the emergence of claim activity.

#### Variability of Claim Reserve Estimates

By its nature, the estimate of ultimate losses and LAE is subject to variability due to differences between our assumptions and actual events in the future. Although many factors influence the actual cost of claims and our corresponding reserve estimates, we do not measure and estimate values for all of these variables individually. This is due to the fact that many of the factors known to impact the cost of claims cannot be measured directly, such as the impact on claim costs due to economic inflation, coverage interpretations, and jury determinations. In most instances, we rely on our historical experience or industry information to estimate the values for the variables that are explicitly used in our reserve analyses. We assume that the historical effect of these unmeasured factors, which is embedded in our experience or industry experience, is representative of the future effects of these factors. Where we have reason to expect a change in the effect of one of these factors, we perform analyses to perform the necessary adjustments.

One implicit assumption underlying development patterns is that the claims inflation trends will continue into the future similar to their past patterns. To estimate the sensitivity of the estimated ultimate loss and settlement expense payments to an unexpected change in inflationary trends, our actuarial department derives expected payment patterns separately for each major line of business. These patterns were applied to the December 31, 2014 loss and settlement expense reserves to generate estimated annual incremental loss and settlement expense payments for each subsequent calendar year. Then, for the purpose of sensitivity testing, an explicit annual inflationary variance of one percent was

added to the inflationary trend that is implicitly embedded in the estimated payment pattern, and revised incremental loss and settlement expense payments were calculated. General inflation trends have been fairly stable over the past several years but there have been fluctuations of one to two percent over the past ten years and therefore we used a one percent annual inflation variance factor. The effect differed by line of business but overall was a four percent change in reserve adequacy or approximately \$24.9 million effect on after tax net income. A variance of this type would typically be recognized in loss and settlement expense reserves and, accordingly, would not have a material effect on liquidity because the claims have not been paid.

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An explicit assumption used in the analysis is the set of initial expected loss ratios ( IELRs ) used in the current accident year reserve projections and in some of the prior accident year ultimate loss indications. To estimate the sensitivity of the estimated ultimate loss to a change in IELRs, the actuarial department recast the loss reserve indications using a set of IELRs all one percent higher than the final IELRs. The overall impact of a one percent change in IELRs would be a corresponding one percent change in reserve adequacy or a \$5.7 million effect on after tax net income. Often the loss ratios by line of business will vary from the IELR in different directions causing them to partially offset each other. A variance of this type would typically be recognized in loss and settlement expense reserves and, accordingly, would not have a material effect on liquidity because the claims have not been paid.

The other factors having influence upon the loss and LAE reserve levels are too numerous and interdependent to efficiently model and test for sensitivity. Likewise, the development factors by reserve category and age are too numerous to model and test for sensitivity. Instead, ranges are estimated by reserve category considering past history, fluctuations in the development patterns, emerging issues, trends, and other factors. The ranges are compiled and the total range is estimated considering the sensitivity to all of the underlying factors together. The resulting range is our best estimate of the expected ongoing variability in the loss reserves.

Our range of loss and LAE reserves table shows that presently we estimate them as going from favorable development of 10.9% to unfavorable of 10.9%. The range was evaluated based on the ultimate loss estimates from the actuarial methods described above.

**Pre-tax Impact on Earnings from a Variance in Future Loss Payments and Case Reserves as of  
December 31, 2014**

(in thousands)

<b>Line of Business</b>	<b>Minimum Reserve Range</b>		<b>Maximum Reserve Range</b>	
Workers' Compensation	\$ (36,303 )	-7.7 %	\$ 35,483	7.6 %
Residual Markets	(1,744 )	-7.0 %	746	3.0 %
Commercial Multiple Peril / General Liability	(68,863 )	-15.5 %	70,640	15.9 %
Commercial Automobile	(8,345 )	-8.0 %	8,276	8.0 %
Other	(1,765 )	-6.2 %	1,832	6.4 %
Total	\$ (117,020 )	-10.9 %	\$ 116,977	10.9 %

The range of loss and LAE reserves at December 31, 2014 had a minimum reserve estimate of \$953.8 million and a maximum reserve estimate of \$1,187.8 million.

The range of loss and LAE reserves at December 31, 2013 had a minimum reserve estimate of \$971.8 million and a maximum reserve estimate of \$1,210.0 million. At December 31, 2013 we recorded the loss and LAE reserves at \$1,111.1 million. At December 31, 2014, re-estimated loss and LAE reserves for December 31, 2013 were \$1,109.3 million which was within our 2013 loss and LAE estimated reserve range.

The sensitivity around our workers' compensation reserves primarily reflects the size and the maturity of the underlying book of business. Our workers' compensation reserves represent 46% of our total reserves at December 31, 2014.

The sensitivity around our commercial multiple peril and general liability reserves primarily reflects the longer duration of reserves relating to our liability excess program, which started in 2003 and was terminated in 2012, and our construction defect exposure, which together represent approximately 34% of the \$444.3 million reserves in this line of business as of December 31, 2014. These lines of business are subject to greater uncertainty and volatility than the remainder of our book of business.

The sensitivity around our commercial automobile reserves primarily reflects the speed of reporting of the underlying losses, as well as the maturity of the case law surrounding automobile liability.

The sensitivity around the other lines of business primarily reflects the size of the underlying book of business. Our other reserves represent 3% of total reserves at December 31, 2014. A large portion of these

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reserves represent professional liability programs which tend to be claims-made, therefore reducing the volatility that is inherent in a smaller book of business. Another large portion represents property claims, which have a shorter reporting and payout pattern than liability and workers' compensation claims.

All of our reserves are sensitive to changes in the underlying claim payment and case reserving practices, as well as the other sources of variations mentioned above.

***Reinsurance Recoverables***

Reinsurance recoverables represent (1) amounts currently due from reinsurers on paid losses and LAE, (2) amounts recoverable from reinsurers on case basis estimates of reported losses and LAE, and (3) amounts recoverable from reinsurers on actuarial estimates of IBNR losses and LAE. Such recoverables, by necessity, are based upon estimates. Reinsurance does not legally discharge us from our legal liability to our insureds, but it does make the assuming reinsurer liable to us to the extent of the reinsurance ceded. Instead of being netted against the appropriate liabilities, ceded unearned premiums and reinsurance recoverables on paid and unpaid losses and LAE are reported separately as assets in our consolidated balance sheets. Reinsurance recoverable balances are also subject to credit risk associated with the particular reinsurer. In our selection of reinsurers, we continually evaluate their financial stability. While we believe our reinsurance recoverables are collectible, the ultimate ceded reserve recoverable may be greater or less than the amount accrued. At December 31, 2014 and 2013, reinsurance recoverables on paid and unpaid losses were \$535.4 million and \$519.9 million, respectively.

In our risk-sharing programs, we are subject to credit risk with respect to the payment of claims by our clients' captive, rent-a-captive, large deductible programs, indemnification agreements, or on the portion of risk either ceded to the captives, or retained by the clients. The capitalization and credit worthiness of prospective risk-sharing partners is one of the factors we consider upon entering into and renewing risk-sharing programs. We collateralize balances due from our risk-sharing partners through funds withheld trusts or stand-by letters of credit issued by highly rated banks. We have historically maintained an allowance for the potential uncollectibility of certain reinsurance balances due from some risk-sharing partners, some of which may be in dispute. At the end of each quarter, an analysis of these exposures is conducted to determine the potential exposure to uncollectibility. At December 31, 2014, we believe this allowance is adequate. To date, we have not, in the aggregate, experienced material difficulties in collecting balances from our risk-sharing partners. No assurance can be given, however, regarding the future ability of our risk-sharing partners to meet their obligations.

***Legal Contingencies***

The Company, and its subsidiaries, are subject at times to various claims, lawsuits and proceedings relating principally to alleged errors or omissions in the placement of insurance, claims administration, consulting services and other business transactions arising in the ordinary course of business as further disclosed in Note 15 ~ *Commitments and Contingencies*. Where appropriate, the Company vigorously defends such claims, lawsuits and proceedings. Some of these claims, lawsuits and proceedings seek damages, including consequential, exemplary or punitive damages, in amounts that could, if awarded, be significant. Most of the claims, lawsuits and proceedings arising in the ordinary course of business are covered by the policy of insurance at issue. We account for such activity through the establishment of unpaid loss and loss expense reserves. We also maintain errors and omissions insurance and extra-contractual coverage under reinsurance treaties related to the policy of insurance at issue or other appropriate insurance. In terms of any retentions or deductibles associated with such insurance, the Company has established accruals for such retentions or deductibles, when necessary, based upon current available information. In accordance

with accounting guidance, if it is probable that an asset has been impaired or a liability has been incurred as of the date of the financial statements and the amount of loss is reasonably estimable; then an accrual for the costs to resolve these claims is recorded by the Company in the accompanying consolidated balance sheets. Period expenses related to the defense of such claims are included in the accompanying consolidated statements of income. Management, with the assistance of outside counsel, adjusts such provisions according to new developments or changes in the strategy in dealing with such matters. On the basis of current information, the Company does not believe that there is a reasonable possibility that, other than with regard to the arbitration disclosed in Note 15 ~ *Commitments and Contingencies*, any material

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loss exceeding amounts already accrued, if any, will result from any of the claims, lawsuits and proceedings to which the Company is subject to, either individually, or in the aggregate.

**Non-GAAP Financial Measures***Statutory Surplus*

Statutory surplus is a non-GAAP measure with the most directly comparable financial GAAP measure being shareholders' equity. The following is a reconciliation of statutory surplus to shareholders' equity:

**Meadowbrook Insurance Group, Inc.  
Consolidated Statutory Surplus to GAAP Shareholders' Equity  
For Period Ending: December 2014**

<b>Statutory Consolidated Surplus</b>		<b>510,999</b>
<b>Statutory to GAAP differences:</b>		
Deferred policy acquisition costs	60,862	
Unrealized gain on investments	21,414	
Non-admitted assets and other	(15,553 )	
<b>Total Statutory to GAAP differences</b>		<b>66,723</b>
<b>Total Non-Regulated Entities (1)</b>		<b>(120,089 )</b>
<b>GAAP Consolidated Shareholders' Equity</b>		<b>457,633</b>

(1) Total includes \$80,930 of debentures and \$121,282 of debt

***Net Operating Income (Loss) and Net Operating Income (Loss) Per Share***

Net operating income (loss) and net operating income (loss) per share are non-GAAP measures that represent net income (loss) excluding net realized gains, net of tax. The most directly comparable financial GAAP measures to net operating income (loss) and net operating income (loss) per share are net income (loss) and net income (loss) per share, respectively. Net operating income (loss) and net operating income (loss) per share are intended as supplemental information and are not meant to replace net income (loss) nor net income (loss) per share. Net operating income (loss) and net operating income (loss) per share should be read in conjunction with the GAAP financial results. The following is a reconciliation of net operating income (loss) to net income (loss), as well as net operating income (loss) per share to net income (loss) per share:

<b>For the Years Ended December 31,</b>		
<b>2014</b>	<b>2013</b>	<b>2012</b>
<b>(In thousands, except share and per share data)</b>		



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Net operating income (loss) (1)	\$ 21,547	\$ (117,908 )	\$ (28,401 )
Net realized gains, net of tax	7,110	5,598	40,150
Net income (loss)	\$ 28,657	\$ (112,310 )	\$ 11,749
Diluted earnings (loss) per common share:			
Net operating income (loss)	\$ 0.43	\$ (2.36 )	\$ (0.57 )
Net income (loss)	\$ 0.57	\$ (2.25 )	\$ 0.23
Diluted weighted average common shares outstanding	50,063,953	49,871,587	50,177,484

- (1) After-tax non- cash goodwill impairment represented \$101.6 million (or \$2.04 loss per diluted share) of the 2013 net operating loss.

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We use net operating income (loss) and net operating income (loss) per share as components to assess our performance and as measures to evaluate the results of our business. We believe these measures provide investors with valuable information relating to our ongoing performance that may be obscured by the net effect of realized gains and losses as a result of our market risk sensitive instruments, which primarily relate to fixed income securities that are available for sale and not held for trading purposes. Realized gains and losses may vary significantly between periods and are generally driven by external economic developments, such as capital market conditions. In 2014, realized gains before tax were \$10.9 million, compared to \$7.8 million of realized gains in 2013. Realized gains in 2012 were \$55.3 million that were generated by the sale of a large portion of our investment portfolio. Accordingly, net operating income (loss) excludes the effect of items that tend to be highly variable from period to period and highlights the results from our ongoing business operations and the underlying loss or profitability of our business. We believe that it is useful for investors to evaluate net operating income (loss) and net operating income (loss) per share, along with net income (loss) and net income (loss) per share, when reviewing and evaluating our performance.

***Accident Year Loss and LAE Ratio***

The accident year loss and LAE ratio is a non-GAAP measure and represents our net loss and LAE ratio excluding the impact of any changes in net ultimate loss estimates on prior year loss and LAE reserves. The most directly comparable financial GAAP measure to the accident year loss and LAE ratio is the net loss and LAE ratio. The accident year loss and LAE ratio is intended as supplemental information and is not meant to replace the net loss and LAE ratio. The accident year loss and LAE ratio should be read in conjunction with the GAAP financial results. The following is a reconciliation of the accident year loss and LAE ratio to the net loss and LAE ratio:

	<b>For the Years Ended December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
Accident year loss and LAE ratio	65.7 %	68.9 %	69.3 %
Increase in net ultimate loss estimates on prior year loss reserves	(0.3 )%	9.8 %	10.0 %
Net loss & LAE ratio	65.4 %	78.7 %	79.3 %

We use the accident year loss and LAE ratio as one component to assess our current year performance and as a measure to evaluate, and if necessary, adjust our pricing and underwriting. Our net loss and LAE ratio is based on calendar year information. Adjusting this ratio to an accident year loss and LAE ratio allows us to evaluate information based on the current year activity. We believe this measure provides investors with valuable information for comparison to historical trends and current industry estimates. We also believe that it is useful for investors to evaluate the accident year loss and LAE ratio and net loss and LAE ratio separately when reviewing and evaluating our performance.

**Year-to-Date Developments**

On December 30, 2014 Fosun International Limited (HKEx stock code: 00656, together with its subsidiaries, Fosun ) and the Company announced each entered into a definitive agreement under which Fosun will acquire all of the issued and outstanding common stock of the Company. The transaction follows a thorough review of strategic alternatives by the Company's Board of Directors and represents a 24% premium over the Company's closing price on December 29, 2014 and a premium of 39% to the Company's three-month average closing price for the period ending December 29, 2014. The transaction also represents a multiple of approximately 1.04x the Company's tangible book value per share as of September 30, 2014.

The transaction is subject to the approval of the Company's shareholders as well as regulatory approvals and the satisfaction of other specified closing conditions. The transaction is expected to be completed in the second half of 2015.

See Risks Related to Our Being Acquired by Fosun.

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**Results of Operations**

**Executive Overview**

Net income for the year ended December 31, 2014 was \$28.7 million, or \$0.57 per diluted share, compared to a net loss of (\$112.3 million), or (\$2.25) per diluted share, for the year ended December 31, 2013. Net operating income, a non-GAAP measure, for the year ended December 31, 2014 was \$21.5 million, or \$0.43 per diluted share, compared to a net operating loss of (\$117.9 million), or (\$2.36) per diluted share in 2013. The 2014 net income includes \$7.1 million, or \$0.14 per diluted share, of after-tax realized gains, compared to \$5.6 million, or \$0.11 per diluted share, in 2013. The 2013 results were largely impacted by an after-tax goodwill impairment of (\$101.6 million), or (\$2.04) per share.

Our GAAP combined ratio was 102.1% for the year ended December 31, 2014, compared to 111.0% in 2013. Excluding the impact of the Multiple Line Quota Share Treaty with Swiss Reinsurance America Corporation ( Swiss Re ), the GAAP combined ratio was 101.8% for the year ended December 31, 2014, compared to 107.9% for the year ended December 31, 2013. Our accident year combined ratio was 102.4% for the year ended December 31, 2014, compared to 101.2% in 2013.

The year to date 2014 results were impacted by the decrease in net ultimate loss estimates for 2013 and prior accident years, which reduced the GAAP combined ratio by 0.3 percentage points. The year to date 2013 results included an increase in net ultimate loss estimates for 2012 and prior accident years, which increased the GAAP combined ratio by 9.8 percentage points.

**Results of Operations - 2014 compared to 2013:**

The net income for the year ended December 31, 2014 was \$28.7 million, or \$0.57 per dilutive share, compared to net loss of (\$112.3 million), or (\$2.25) per dilutive share, for the comparable period of 2013. Net operating income, a non-GAAP measure, for the year ended December 31, 2014 was \$21.5 million, or \$0.43 per diluted share, compared to net operating loss of (\$117.9 million), or (\$2.36) per diluted share for the year ended December 31, 2013. The 2013 net operating loss, excluding the goodwill impairment, was (\$16.3 million), or (\$0.33) per diluted share; there was no goodwill impairment in 2014. Refer to *Note 14 – Goodwill and Other Intangible Assets* of the Notes to the Consolidated Financial Statements, for additional information specific to the goodwill impairment. Total diluted weighted average shares outstanding for the year ended December 31, 2014, were 50,063,953, compared to 49,871,587 the comparable period in 2013. The increase primarily reflects the impact of share issuances pursuant to our 2013 long term incentive plan.

***Revenues - 2014 compared to 2013***

Revenues for the year ended December 31, 2014 decreased \$48.7 million, or 6.1%, to \$742.5 million, from \$791.2 million for the comparable period in 2013. This decrease primarily reflects reduced premium levels.

The following table sets forth the components of revenues (in thousands):

**For the Years Ended  
December 31,**

	<b>2014</b>	<b>2013</b>
Revenue:		
Net earned premiums	\$ 643,271	\$ 697,417
Management administrative fees	17,891	16,034
Claims fees	6,668	7,065
Commission revenue	18,614	16,413
Net investment income	45,142	46,473
Net realized gains	10,939	7,769
Total revenue	\$ 742,525	\$ 791,171

Net earned premiums decreased \$54.1 million, or 7.8%, to \$643.3 million for the year ended December 31, 2014, from \$697.4 million in the comparable period in 2013. The decrease in premium is attributed to the

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MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

termination of, or premium volume reductions in certain programs where pricing and underwriting did not meet the Company's underwriting standards and was offset by an overall 9.1% earned rate increase, which exceeded the Company's estimated loss ratio trend of 1.9%.

Net commission and fee revenue increased \$3.7 million, or 9.3%, to \$43.2 million for the year ended December 31, 2014, from \$39.5 million for the comparable period in 2013. This increase was driven primarily by commission revenues generated from our subsidiary US Specialty Underwriters ( USSU ) that are no longer considered intercompany and as a result are not eliminated in consolidation as they are now written by SNIC carriers. This increase did not impact the Company's consolidated financial results as there is a corresponding increase in the expenses from net commission and fee operations. The remainder of the increase in commission and fee revenue was the result of increased agency commission revenue attributable to a recently acquired agency.

Net investment income decreased by \$1.4 million, or 3.0%, to \$45.1 million for the year ended December 31, 2014, from \$46.5 million for the comparable period in 2013. The decrease reflects the impact of lower reinvestment rates in 2014.

Net realized gains increased by \$3.1 million, to a \$10.9 million gain for the year ended December 31, 2014, from a \$7.8 million gain for the comparable period in 2013. The increase in realized gains primarily relates to the rebalancing of the equity portfolio in accordance with the Company's investment policy.

***Expenses - 2014 compared to 2013***

Expenses decreased \$223.5 million from \$936.9 million for the year ended December 31, 2013 to \$713.4 million for the year ended December 31, 2014. The decrease primarily is attributed to the \$115.4 million goodwill impairment and \$68.4 million of unfavorable development on prior years that was recorded during 2013.

The following table sets forth the components of expenses (in thousands):

	<b>For the Years Ended December 31,</b>	
	<b>2014</b>	<b>2013</b>
Expense:		
Net losses and loss adjustment expenses	\$ 420,808	\$ 549,037
Policy acquisition and other underwriting expenses	236,271	225,510
General selling & administrative expenses	31,972	25,789
General corporate expenses	6,454	3,997
Amortization expense	3,988	4,237
Goodwill impairment expense	—	115,397
Interest expense	13,899	12,950
Total expenses	\$ 713,392	\$ 936,917

Net loss and loss adjustment expenses ( LAE ) decreased \$128.2 million to \$420.8 million for the year ended December 31, 2014, from \$549.0 million for the same period in 2013. Our loss and LAE ratio was 65.4% for the year ended December 31, 2014 and 78.7% for the year ended December 31, 2013. The loss and LAE ratio for the year ended

December 31, 2014 includes a 0.3 percentage point decrease from net ultimate loss estimates for accident years 2013 and prior, whereas the 2013 results include a 9.8 percentage point increase from net ultimate loss estimates for accident years 2012 and prior. The accident year loss and LAE ratio was 65.7% for the year ended December 31, 2014, down from 68.9% in the comparable period in 2013. Additional discussion of our reserve activity is described below within the Other Items ~ Reserves section.

Policy acquisition and other underwriting expenses increased \$10.8 million, to \$236.3 million for the year ended December 31, 2014, from \$225.5 million for the same period in 2013. Our expense ratio increased 4.4 percentage points to 36.7% for the year ended December 31, 2014, from 32.3% for the same period in 2013. Excluding the impact of the quota share surplus relief treaty, the year to date expense ratio was 37.0% for 2014

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compared to 33.3% for 2013. The 3.7% increase primarily reflects the cost associated with the use of an unaffiliated A rated insurance company for policy issuance which added 1.7 percentage points; a shift in the mix of business which includes business with a higher average commission rate; deleveraging impact of the anticipated reduction in earned premium associated with the Company's efforts to terminate unprofitable business; and the impacts of a special incentive bonus.

General, selling and administrative expenses increased \$6.2 million, to \$32.0 million in 2014 from \$25.8 million in 2013. The increase was driven by the USSU commission expense, which is no longer considered intercompany expense, and by increased agency commission expense attributable to a recently acquired agency. The increase attributed to the USSU commission expense did not impact our consolidated financial results, as there is a corresponding increase in the commission revenues.

Federal income tax expense for the year ended December 31, 2014 was \$4.0 million, or 13.8% of income before taxes, compared to a benefit of \$31.1 million, or 21.3% of income before taxes for the same period in 2013. Income tax expense on net capital gains and the change in our valuation allowance on deferred tax assets was \$3.8 million for the year ended December 31, 2014, compared to \$2.1 million for the year ended December 31, 2013. The 2013 tax rate is primarily due to the large tax benefit generated from underwriting losses resulting from adverse loss development offset by the tax expense on net investment income and realized gains. The effective tax rate on net investment income in 2014 was 20.5%, driven by the level of tax exempt investments, compared to 20.8% for the year ended December 31, 2013. The 2014 effective tax rate on underwriting results and profits from net commissions and fees was 33.5% compared to 2013 of 21.5%. The 2014 effective tax rate on realized gains was 35.0% compared to 27.9% in 2013. The proportion of these three components of 2014 net income resulted in the 13.8% overall effective tax rate.

**Results of Operations - 2013 compared to 2012:**

The net loss for the year ended December 31, 2013 was (\$112.3 million), or (\$2.25) per dilutive share, compared to net income of \$11.7 million, or \$0.23 per dilutive share, for the comparable period of 2012. Net operating loss, a non-GAAP measure, for the year ended December 31, 2013 was (\$117.9 million), or (\$2.36) per diluted share, compared to net operating loss of (\$28.4 million), or (\$0.57) per diluted share for the year ended December 31, 2012. The 2013 net operating loss, excluding the goodwill impairment, was (\$16.3 million), or (\$0.21) per diluted share. Total diluted weighted average shares outstanding for the year ended December 31, 2013, were 49,871,587, compared to 50,177,484 the comparable period in 2012. The decrease reflects the impact of share repurchases made pursuant to our Share Repurchase Plan in 2012.

**Revenues - 2013 compared to 2012**

Revenues for the year ended December 31, 2013, decreased \$205.6 million, or 20.6%, to \$791.2 million, from \$996.8 million for the comparable period in 2012. This decrease primarily reflects reduced premium levels and a decrease in net realized gains.

The following table sets forth the components of revenues (in thousands):

<b>For the Years Ended December 31,</b>	
<b>2013</b>	<b>2012</b>



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Revenue:

Net earned premiums	\$ 697,417	\$ 854,259
Management administrative fees	16,034	11,676
Claims fees	7,065	6,444
Commission revenue	16,413	15,929
Net investment income	46,473	53,143
Net realized gains	7,769	55,312
Total revenue	\$ 791,171	\$ 996,763

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Net earned premiums decreased \$156.8 million, or 18.4%, to \$697.4 million for the year ended December 31, 2013, from \$854.3 million in the comparable period in 2012. The decrease in premium is attributed to the termination of, or premium volume reductions in certain programs where pricing and underwriting did not meet the Company's underwriting standards and was offset by an overall 12% rate increase, which exceeded the Company's estimated loss ratio trend of 1.7%.

Net commission and fee revenue increased \$5.5 million, or 16.0%, to \$39.5 million for the year ended December 31, 2013, from \$34.0 million for the comparable period in 2012. This increase was driven primarily by commission revenues generated from our subsidiary USSU that are no longer considered intercompany and as a result are not eliminated in consolidation, as they are now written by SNIC carriers. This increase did not impact the Company's consolidated financial results as there is a corresponding increase in the expenses from net commission and fee operations.

Net investment income decreased by \$6.7 million, to \$46.5 million for the year ended December 31, 2013, from \$53.1 million for the comparable period in 2012. The decrease reflects the impact of lower reinvestment rates in 2013 from the proceeds of the fourth quarter 2012 sale of a portion of our bond portfolio offset by the investment of the proceeds from the cash convertible senior notes.

Net realized gains decreased by \$47.5 million, to a \$7.8 million gain for the year ended December 31, 2013, from a \$55.3 million gain for the comparable period in 2012. The decrease in realized gains relates to the fourth quarter 2012 sale of a portion of our bond portfolio in order to generate realized gains and enhance the statutory surplus of our Insurance Company Subsidiaries.

***Expenses - 2013 compared to 2012***

Expenses decreased \$58.6 million from \$995.5 million for the year ended December 31, 2012 to \$936.9 million for the year ended December 31, 2013.

The following table sets forth the components of expenses (in thousands):

	<b>For the Years Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Expense:		
Net losses and loss adjustment expenses	\$ 549,037	\$ 677,684
Policy acquisition and other underwriting expenses	225,510	274,066
General selling & administrative expenses	25,789	24,463
General corporate expenses	3,997	3,572
Amortization expense	4,237	7,296
Goodwill impairment expense	115,397	—
Interest expense	12,950	8,429
Total expenses	\$ 936,917	\$ 995,510

Net loss and loss adjustment expenses ( LAE ) decreased \$128.6 million to \$549.0 million for the year ended December 31, 2013, from \$677.7 million for the same period in 2012. Our loss and LAE ratio was 78.7% for the year ended December 31, 2013 and 79.3% for the year ended December 31, 2012. The loss and LAE ratio for the year ended December 31, 2013 includes a 9.8 percentage point increase from net ultimate loss estimates for accident years 2012 and prior, whereas the 2012 results include a 10.0 percentage point increase from net ultimate loss estimates for accident years 2011 and prior. The accident year loss and LAE ratio was 68.9% for the year ended December 31, 2013, down from 69.3% in the comparable period in 2012. Additional discussion of our reserve activity is described below under Other Items ~ Reserves .

Policy acquisition and other underwriting expenses decreased \$48.6 million, to \$225.5 million for the year ended December 31, 2013, from \$274.1 million for the same period in 2012. Our expense ratio increased 0.2 percentage points to 32.3% for the year ended December 31, 2013, from 32.1% for the same period in 2012. The 2013 expense ratio, excluding the impact of the quota share reinsurance treaty, was 33.3% compared to

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32.1% in 2012, or an increase of 1.2 percentage points. This increase reflects the effect of the arbitration award expense of 0.3 percentage points and 0.4 percentage points relating to a reallocation of corporate overhead costs from our fee-for-service operations to Insurance Company Subsidiaries' operations. The reallocation reflects a shift of corporate resources used to support capital and operating enhancements focused on strengthening statutory surplus and returning the Insurance Company Subsidiaries to an underwriting profit and a corresponding decrease to general selling and administrative costs. This reallocation had no net income effect. In addition, the expense ratio included a 0.4 percentage point increase relating to the use of an unaffiliated A rated insurance company for policy issuance purposes. The remaining 0.1 percentage point reflects the impact of deleveraging fixed costs.

Amortization expense decreased \$3.1 million to \$4.2 million for the year ended December 31, 2013, from \$7.3 million for the same period in 2012. The decrease is primarily due to the \$1.8 million write off of an intangible asset related to the public entity excess liability program that we terminated in the fourth quarter of 2012.

Goodwill impairment expense increased by \$115.4 million from \$0 in 2012 due to the \$115.4 million impairment recognized in the second quarter of 2013. Refer to *Note 14 – Goodwill and Other Intangible Assets* of the Notes to the Consolidated Financial Statements, for additional information specific to the goodwill impairment.

Interest expense increased by \$4.5 million to \$12.9 million for the year ended December 31, 2013 from \$8.4 million for the same period in 2012. The increase is primarily due to the interest incurred on the \$100 million cash convertible senior notes entered into in the first quarter of 2013.

Federal income tax benefit for the year ended December 31, 2013 was \$31.1 million, or 21.3% of income before taxes, compared to an expense of \$8.1 million, or -794.3% of income before taxes for the same period in 2012. Income tax expense on net capital gains and the change in our valuation allowance on deferred tax assets was \$2.1 million for the year ended December 31, 2013, compared to \$15.2 million for the year ended December 31, 2012. The unusual 2012 tax rate is primarily due to the large tax benefit generated from underwriting losses resulting from adverse loss development and storm losses offset by the tax expense on net investment income and realized gains. The effective tax rate on net investment income in 2013 was 20.8%, driven by the level of tax exempt investments, compared to 25.7% for the year ended December 31, 2012. The 2013 effective tax rate on underwriting results and profits from net commissions and fees was 21.5% compared to 2012 of 34.3%. The 2013 effective tax rate on realized gains was 27.9% compared to 27.4% in 2012. The proportion of these three components of 2013 net income resulted in the 21.3% overall effective tax rate.

***Other Items - Results of Operations******Equity earnings of affiliated, net of tax***

In July 2009, our subsidiary, Star, purchased a 28.5% ownership interest in an affiliate, MFH, for \$14.8 million in cash. We are not required to consolidate this investment as we are not the primary beneficiary of the business nor do we control the entity's operations. Our ownership interest is significant, but is less than a majority ownership and, therefore, we are accounting for this investment under the equity method of accounting. Star recognizes 28.5% of the profits and losses as a result of this equity interest ownership. We recognized equity earnings, net of tax, from MFH of \$2.5 million, or \$0.05 per dilutive share, for the year ended December 31, 2014, compared to \$2.8 million, or \$0.06 per dilutive share, for the comparable period of 2013, and \$3.0 million, or \$0.06 per dilutive share, for the comparable period of 2012. We received dividends from MFH in 2014, 2013 and 2012, for \$3.2 million, \$2.0 million and \$4.0 million, respectively.

In November 2012, our subsidiary, Century, committed to a \$10 million contribution to the Aquiline Financial Services Fund II L.P. as a strategic investment. As of December 31, 2014, approximately \$6.7 million of the commitment had been satisfied with \$3.3 million of unfunded commitment remaining. Our ownership interest is approximately 1.3% of the fund, which does not constitute significant influence. Therefore, we are accounting for this investment under the equity method of accounting. Century recognizes 1.3% of the Fund's

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profits and losses as a result of this equity interest ownership. We recognized equity earnings, net of tax, from the Aquiline Financial Services Fund II L.P. of \$1.1 million, or \$0.02 per dilutive share and \$0.6 million, or \$0.01 per dilutive share, for the years ended December 31, 2014 and 2013, respectively.

**Reserves**

At December 31, 2014, our best estimate for the ultimate liability for loss and LAE reserves, net of reinsurance recoverables, was \$1.1 billion. We established a reasonable range of reserves of approximately \$953.8 million to \$1.2 billion. This range was established primarily by considering the various indications derived from standard actuarial techniques and other appropriate reserve considerations. The following table sets forth this range by line of business (in thousands):

<b>Line of Business</b>	<b>Minimum Reserve Range</b>	<b>Maximum Reserve Range</b>	<b>Selected Reserves</b>
Workers' Compensation	\$ 432,785	\$ 504,571	\$ 469,088
Residual Markets	23,156	25,646	24,900
Commercial Multiple Peril / General Liability	375,461	514,964	444,324
Commercial Automobile	95,572	112,193	103,917
Other	26,835	30,432	28,600
Total Net Reserves	\$ 953,809	\$ 1,187,806	\$ 1,070,829

Reserves are reviewed and established by our internal actuaries for adequacy and peer reviewed by our third-party actuaries. When reviewing reserves, we analyze historical data and estimate the impact of numerous factors such as (1) per claim information; (2) industry and our historical loss experience; (3) legislative enactments, judicial decisions, legal developments in the imposition of damages, and changes in political attitudes; and (4) trends in general economic conditions, including the effects of inflation. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of reserves, because the eventual deficiency or redundancy is affected by multiple factors.

The key assumptions used in our selection of ultimate reserves included the underlying actuarial methodologies, a review of current pricing and underwriting initiatives, an evaluation of reinsurance costs and retention levels, and a detailed claims analysis with an emphasis on how aggressive claims handling may be impacting the paid and incurred loss data trends embedded in the traditional actuarial methods. With respect to the ultimate estimates for losses and LAE, the key methods remained consistent for the year ended December 31, 2014, and the year ended December 31, 2013. We reviewed the key assumptions that underlie the actuarial standard methods and made the appropriate adjustments to reflect the emergence of claim activity.

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For the year ended December 31, 2014, we reported a decrease in net ultimate loss estimates for accident years 2013 and prior of \$1.7 million, or -0.2% of \$1.1 billion of beginning net loss and LAE reserves at January 1, 2014. At December 31, 2013 we recorded the loss and LAE reserves at 1,111.1 million. At December 31, 2014, re-estimated loss and LAE reserves for December 31, 2013 were \$1,109.3 million which was within our 2013 loss and LAE estimated reserve range. The change in net ultimate loss estimates reflected revisions in the estimated reserves as a result of actual claims activity in calendar year 2014 that differed from the projected activity. The major components of this change in ultimates are as follows (in thousands):

Line of Business	Incurred Losses				Paid Losses			Reserves at December 31, 2014
	Reserves at December 31, 2013	Current Year	Prior Years	Total Incurred	Current Year	Prior Years	Total Paid	
Workers' Compensation	\$ 477,413	\$ 205,843	\$ (31,518 )	\$ 174,325	\$ 34,188	\$ 148,462	\$ 182,650	\$ 469,088
Residual Markets	22,577	10,288	(1,175 )	9,113	2,082	4,708	6,790	24,900
Commercial Multiple Peril / General Liability	459,950	104,458	18,546	123,004	8,723	129,907	138,630	444,324
Commercial Automobile	118,375	53,275	8,207	61,482	17,251	58,689	75,940	103,917
Other	32,775	48,685	4,199	52,884	32,663	24,396	57,059	28,600
Net Reserves	1,111,090	\$ 422,549	\$ (1,741 )	\$ 420,808	\$ 94,907	\$ 366,162	\$ 461,069	1,070,829
Reinsurance Recoverable	505,431							519,530
Consolidated	\$ 1,616,521							\$ 1,590,359

The following table shows the re-estimated December 31, 2013 held reserves by line as of December 31, 2014 (in thousands):

Line of Business	Reserves at December 31, 2013	Re-estimated Reserves for December 31, 2013 at December 31, 2014	Development as a percentage of prior year reserves
Workers' Compensation	\$ 477,413	\$ 445,895	-6.6 %
Commercial Multiple Peril / General Liability	459,950	478,496	4.0 %
Commercial Automobile	118,375	126,582	6.9 %
Other	32,775	36,974	12.8 %
Sub-total	1,088,513	1,087,947	-0.1 %

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Residual Markets	22,577	21,402	-5.2 %
Total Net Reserves	\$ 1,111,090	\$ 1,109,349	-0.2 %

*Workers' Compensation Excluding Residual Markets*

The net ultimate loss estimates for accident years 2013 and prior in the workers' compensation line of business decreased \$31.5 million, or 6.6%. This decrease, which was primarily related to the 2013 accident year, was led by the California-dominated business segments for which substantial rate and underwriting improvements have been enacted over the last few years.

*Commercial Multiple Peril / General Liability*

The net ultimate loss estimates for accident years 2013 and prior in the commercial multi-peril/general liability line of business increased \$18.5 million, or 4.0%. The increase was driven by a \$15.1 million increase



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related to the 2009-2012 accident years combined. Accident year 2011 has the highest loss & ALAE ratio of that group peaking at 67%. Accident year 2013 is at a 57% loss & ALAE ratio and accident year 2014 is even lower. The improvement in the recent accident year loss ratios reflects the rate increase, underwriting actions, and termination of unprofitable business undertaken since 2012.

*Commercial Automobile*

The \$8.2 million increase, or 6.9%, in net ultimate loss estimates for the commercial automobile line of business was primarily driven by the 2009-2012 accident years which developed unfavorably by \$11.2 million. Of the 2009-2012 unfavorable development, 75% was on terminated business and almost 45% was on a single terminated transportation program.

*Other*

The \$4.2 million increase, or 12.8%, in net ultimate loss estimates in other lines of business is primarily from an increase in accident year 2012 related to a cancelled surety program.

*Residual Markets*

The workers' compensation residual market line of business had a decrease in net ultimate loss estimate of \$1.2 million, or 5.2% of net reserves. This decrease reflects a reduction in the net ultimate loss estimates for various accident years. We record loss reserves as reported by the NCCI, plus a provision for the reserves incurred but not yet analyzed and reported to us due to a two quarter lag in reporting. These changes reflect a difference between our estimate of the lag incurred but not reported and the amounts reported by the NCCI in the year.

The following combined ratios and development figures are before the impact of the Quota Share Reinsurance Treaty which was terminated as of October 1, 2013.

The following table shows the calendar year combined ratio by line and calendar year:

<b>Calendar Year Combined Ratio</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011*</b>	<b>2010*</b>
Workers' Compensation	91.6 %	102.1 %	108.8 %	102.3 %	101.5 %
Residual Market	97.1 %	148.6 %	146.7 %	214.8 %	103.6 %
CMP/GL	115.3 %	111.9 %	108.1 %	90.9 %	83.7 %
Auto	116.4 %	121.6 %	126.5 %	110.3 %	97.7 %
Other	99.7 %	103.6 %	109.3 %	96.2 %	92.7 %
<b>Total</b>	<b>101.8 %</b>	<b>107.9 %</b>	<b>111.4 %</b>	<b>99.7 %</b>	<b>95.0 %</b>

Uses expense ratios originally reported in calendar year statement. These expense ratios have been restated in statement years 2012 and subsequent in accordance with accounting guidance retrospectively adopted on January 1, 2012. The impact on the expense ratio for any given year of the guidance was 0.2 points or less.

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For the table above, the calendar year combined ratios increased to over 100% in calendar year 2012 and 2013, primarily driven by adverse development on prior accident year Loss & Loss Adjustment Expense ( LAE ). The 2014 combined ratio, which includes \$1.7 million of favorable development, is also over 100%. This is due in part to the expense ratio which includes a policy issuance expense associated with use of an A-rated insurance carrier. This prior year development is shown allocated to the related accident years in the following table:

**Prior Year Development - Loss & LAE (in thousands)**

<b>Accident Year</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
2009 & Prior	8,420	19,543	29,980	3,267	(31,003 )
2010	5,969	11,260	22,508	4,044	
2011	7,144	18,598	33,027		
2012	13,358	18,999			
2013	(37,472 )				
<b>Total excluding Swiss Re</b>	(2,581 )	68,400	85,515	7,311	(31,003 )
<b>Swiss Re Accident Year</b>					
2013	840				
<b>Total including Swiss Re</b>	(1,741 )	68,400	85,515	7,311	(31,003 )

The following table reconciles the calendar year combined ratios to the accident year combined ratios as they were originally reported for the related 12 month period:

**Reconciliation of Calendar Year Combined Ratios to Accident Year Combined Ratios**

	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>Calendar year Combined Ratio</b>	101.8 %	107.9 %	111.4 %	99.7 %	95.0 %

**Prior Year Development — Loss & LAE  
(% of Related NEP)****Accident Year**

2009 & Prior	1.2 %	2.3 %	3.5 %	0.5 %	-4.7 %
2010	0.9 %	1.3 %	2.6 %	0.5 %	
2011	1.1 %	2.2 %	3.9 %		
2012	2.0 %	2.3 %			
2013	-5.6 %				
<b>Total</b>	<b>-0.4 %</b>	<b>8.1 %</b>	<b>10.0 %</b>	<b>1.0 %</b>	<b>-4.7 %</b>

**Accident Year Combined Ratio**

<b>Originally Reported</b>	102.2 %	99.8 %	101.4 %	98.7 %	99.7 %
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The accident year combined ratio provides management with an assessment of a specific accident period's profitability (which matches policy pricing with related losses) and assists management in their evaluation of product pricing levels and quality of business written in individual years. The current accident year's combined ratio plus the current calendar year development on prior accident year's reserves (as a percent of net earned premium) equals the current

calendar year's combined ratio. Prior accident year development is thus appropriately assigned and added to the accident years that triggered such liability. Therefore, each accident year's developed combined ratio includes all development adjustments that have been recorded in all calendar periods to-date. The net earned premium and expenses remain fixed in the calendar period in which they were recorded and thus the sole difference between the calendar and accident year combined ratio is the allocation of the Loss & LAE to appropriate accident year. The incurred Loss & LAE inception-to-date does not change in total, but only in such accident year allocation.

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Allocation of Loss & LAE to accident year is a more appropriate match of revenue (net earned premium) and expenses (Loss & LAE) than calendar year. Accident year combined ratios furthermore allow management to monitor changes over time in the profitability of the business written year-over-year and the impact of operational changes such as rate increases, underwriting actions, etc.

The following table shows the accident year combined ratio by line and year as originally reported:

	<b>Accident Year Combined Ratio Originally Reported</b>				
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Workers' Compensation	101.9 %	98.1 %	100.8 %	99.3 %	99.2 %
Residual Market	112.9 %	141.9 %	173.3 %	354.5 %	331.8 %
CMP/GL	103.9 %	96.6 %	94.3 %	93.3 %	96.0 %
Auto	106.3 %	106.6 %	110.4 %	105.7 %	106.5 %
Other	96.4 %	102.2 %	106.1 %	96.9 %	96.2 %
<b>Total</b>	<b>102.2 %</b>	<b>99.8 %</b>	<b>101.4 %</b>	<b>98.7 %</b>	<b>99.7 %</b>

The following table shows prior year development allocated to the related accident years:

<b>Development Year</b>	<b>Accident Year Prior Year Development - Loss &amp; LAE (in thousands)</b>			
	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
2011				4,044
2012			33,027	22,508
2013		18,999	18,598	11,260
2014	(37,472 )	13,358	7,144	5,969
<b>Total</b>	<b>(37,472 )</b>	<b>32,357</b>	<b>58,769</b>	<b>43,781</b>

The following table reconciles the originally reported accident year combined ratios to those with the ultimate evaluated at 12/31/14:

<b>Accident Year Combined Ratio</b>	<b>Reconciliation of Accident Year Combined Ratios Originally Reported to Accident Year Combined Ratios - Ultimate Evaluated at 12/31/2014</b>				
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>Originally Reported</b>	102.2 %	99.8 %	101.4 %	98.7 %	99.7 %

**Total Prior Year Development - Loss & LAE**

(% of Related NEP)

**Development Year**

2011					0.6 %
2012				4.4 %	3.4 %
2013			2.2 %	2.5 %	1.7 %

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2014		-4.4 %	1.6 %	1.0 %	1.0 %
<b>Total</b>		<b>-4.4 %</b>	<b>3.8 %</b>	<b>7.9 %</b>	<b>6.7 %</b>
<b>Accident Year Combined Ratio - Ultimate Evaluated at 12/31/2014</b>	102.2 %	95.4 %	105.2 %	106.6 %	106.4 %

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The table below shows accident year combined ratios in which the prior accident year development has been reallocated to the appropriate accident year:

**Accident Year Combined Ratio - Ultimate Evaluated at 12/31/2014**

	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Workers' Compensation	101.9 %	91.0 %	101.4 %	103.8 %	111.1 %
Residual Market	112.9 %	82.9 %	151.1 %	313.8 %	244.5 %
CMP/GL	103.9 %	94.8 %	98.3 %	105.4 %	95.2 %
Auto	106.3 %	104.8 %	124.3 %	119.1 %	118.0 %
Other	96.4 %	102.7 %	109.0 %	101.6 %	97.4 %
<b>Total</b>	<b>102.2 %</b>	<b>95.4 %</b>	<b>105.2 %</b>	<b>106.6 %</b>	<b>106.4 %</b>

The developed (to ultimate) accident year combined ratio measurement allows management to observe profitability associated with business earned in each year and take appropriate actions. Management records its best estimate of reserves at each accounting date.

**Other-Than-Temporary Impairments (OTTI)**

Refer to Note 2 ~ *Investments* of the Notes to the Consolidated Financial Statements, for additional information specific to OTTI and their fair value and amount of unrealized losses segregated by the time period the investment has been in an unrealized loss position.

**LIQUIDITY AND CAPITAL RESOURCES**

Our principal sources of funds are insurance premiums, investment income, proceeds from the maturity and sale of invested assets from our Insurance Company Subsidiaries, and risk management fees and agency commissions from our non-regulated subsidiaries. Funds are primarily used for the payment of claims, commissions, salaries and employee benefits, other operating expenses, shareholder dividends, share repurchases, capital expenditures, and debt service.

A significant portion of our consolidated assets represents assets of our Insurance Company Subsidiaries that may not be transferable to the holding company in the form of dividends, loans or advances in accordance with state insurance laws. These laws generally specify that dividends can be paid only from unassigned surplus and only to the extent that all dividends in the current twelve months do not exceed the greater of 10% of total statutory surplus as of the end of the prior fiscal year or 100% of the statutory net income for the prior year, less any dividends paid in the prior twelve months. Using these criteria, the available ordinary dividend available to be paid from the Insurance Company Subsidiaries during 2014 was \$48.8 million without prior regulatory approval. Of this \$48.8 million, ordinary dividends of \$20.0 million were declared and paid as of December 31, 2014. In addition to ordinary dividends, the Insurance Company Subsidiaries had the capacity to pay \$149.9 million of extraordinary dividends in 2014, subject to prior regulatory approval. The ability to pay ordinary and extraordinary dividends must be reviewed in relation to the impact on key financial measurement ratios, including RBC ratios (all of which were above any regulatory action levels, refer to Note 8 ~ *Regulatory Matters and Rating Issues* for further details) and BCAR. The Insurance Company Subsidiaries' ability to pay future dividends without advance regulatory approval is dependent upon maintaining a positive level of unassigned surplus, which in turn, is dependent upon the Insurance Company Subsidiaries generating net income. Total ordinary dividends paid from our Insurance Company Subsidiaries to our holding company were

\$20.0 million and \$14.0 million for the years ended December 31, 2014 and 2013, respectively. As of December 31, 2014, we had non-regulated cash and cash equivalents of \$7.9 million. As of December 31, 2014, on a trailing twelve month statutory consolidated basis, the gross and net premium leverage ratios were 1.4 to 1.0 and 1.2 to 1.0, respectively.

We also generate operating cash flow from non-regulated subsidiaries in the form of commission revenue, outside management fees, and intercompany management fees. These sources of income are used to meet debt service, shareholders' dividends, and other operating expenses of the holding company and non-regulated subsidiaries. Earnings before interest, taxes, depreciation, and amortization from non-regulated subsidiaries were approximately \$11.2 million for the year ended December 31, 2014.

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Based on our subsidiaries' membership in the Federal Home Loan Bank of Indianapolis ( FHLBI ), we have the ability to borrow on a collateralized basis at relatively low borrowing rates, providing a source of liquidity. As of December 31, 2014 and December 31, 2013, we had borrowed \$30.0 million from the FHLBI. The proceeds were used to fund purchases of high quality bonds with maturities that match the maturity of the FHLBI credit facility. We have the ability to increase our borrowing capacity through additional investments and pledging additional securities.

Cash flows used in operations were \$11.5 million for the year ended December 31, 2014. Cash provided by operations were \$2.0 million for the year ended December 31, 2013. The decrease in operating cash flows reflects a decrease in premium collected related to the termination of, or premium volume reductions in, certain programs where pricing and underwriting did not meet the Company's underwriting standards.

**Other Items – Liquidity and Capital Resources**

*Credit Facilities*

On August 29, 2012, the Company executed \$130.0 million in senior credit facilities (the Credit Facilities ). The Credit Facilities included a \$30.0 million term loan facility and a \$100.0 million revolving credit facility.

On September 19, 2013, the Company amended the Credit Facilities pursuant to a Second Amendment to Credit Agreement and Waiver (the Amendment ). Under the Amendment, the term loan facility continues to have a four year term and the same amortization period. As of December 31, 2014, the outstanding balance on the Company's term loan facility was \$16.5 million. The Amendment reduced available borrowing under the revolving credit facility from \$100.0 million to \$30.0 million with further periodic reductions to \$21.0 million as of March 31, 2016, less any optional reductions to the revolving commitments. The Amendment also established an amortization schedule for the revolving credit facility beginning on September 30, 2014. The Company has \$15.0 million outstanding under its revolving credit facility and \$0.1 million in letters of credit as of December 31, 2014. The undrawn portion of the revolving credit facility, which was \$8.4 million as of December 31, 2014, is available to finance working capital and for other general corporate purposes, including but not limited to, surplus contributions to its Insurance Company Subsidiaries to support premium growth or strategic acquisitions. On December 30, 2014, in connection with the proposed transaction with Fosun, the parties to the Credit Agreement entered into a letter agreement amending the definition of Change of Control therein by removing from such definition the entry by Meadowbrook into a contract that would result in an acquisition of Meadowbrook.

The principal amount outstanding under the Credit Facilities provides for interest at either the Alternative Base Rate ( ABR ) or the London interbank offered rate ( LIBOR ). ABR borrowings under the Credit Facilities will bear interest at the greatest of (a) the Administrative Agent's prime rate, (b) the federal funds effective rate plus 0.5%, or (c) the adjusted LIBOR for a one-month period plus 1.0%, in each case, plus a margin that is adjusted on the basis of Company's consolidated leverage ratio. Eurodollar borrowings under the Credit Facilities will bear interest at the adjusted LIBOR for the interest period in effect plus a margin that is adjusted on the basis of Company's consolidated leverage ratio. In addition, the Credit Facilities provide for an unused facility fee ranging between twenty-five basis points and thirty-seven and a half basis points, based on the Company's consolidated leverage ratio as defined by the Credit Facilities. At December 31, 2014, the interest rate on the Company's term loan was 2.81%, which consisted of a variable rate of 0.31%, plus an applicable margin of 2.50%. At December 31, 2014, the interest rate on the Company's revolving credit facility was approximately 0.27%, plus a 2.50% margin.



Additionally, under the Amendment, the financial covenants applicable to the Credit Facilities consist of: (1) minimum consolidated net worth of \$365,697,000 as of the effective date of the Amendment, with quarterly increases thereafter of the sum of (a) seventy-five percent of positive net income and (b) seventy-five percent of increases in shareholders' equity by reason of the issuance and sale of equity interests, if any, (2) minimum Risk Based Capital Ratio for all material Insurance Company Subsidiaries of 1.75 times Company Action Level,

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MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

(3) maximum permitted consolidated leverage ratio of 0.35 to 1.00 at any time on or after September 30, 2014, (4) minimum consolidated fixed charge coverage ratio of 1.25 to 1.00, and (5) minimum A.M. Best rating of B++ for all Insurance Company Subsidiaries. As of December 31, 2014, the Company was in compliance with these debt covenants.

Refer to Note 6 ~ *Debt* of the Notes to the Consolidated Financial Statements, for additional information specific to our credit facilities and debentures.

*Cash Convertible Senior Notes*

On March 18, 2013, the Company issued \$100.0 million of 5.0% cash convertible senior notes (the *Notes*), which mature on March 15, 2020. Interest on the Notes is payable semi-annually in arrears on March 15 and September 15 of each year, commencing September 15, 2013. Until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their Notes solely into cash at any time on or after September 15, 2019 or earlier under certain circumstances determined by: (i) the market price of the Company's stock, (ii) the trading price of the Notes, or (iii) the occurrence of specified corporate transactions, including change in control. The Notes are not convertible into Meadowbrook common stock or any other securities under any circumstances. The initial conversion rate is 108.8732 shares of common stock per \$1,000 principal amount of the Notes (equivalent to an initial conversion price of approximately \$9.18 per share), subject to adjustment upon the occurrence of certain events. Additionally, in the event of a fundamental change, the holders may require the Company to repurchase the Notes for a cash price equal to 100% of the principal, plus any accrued and unpaid interest. The proceeds from the issuance of the Notes were bifurcated into a debt component and an embedded conversion option component.

Due to the bifurcation, the debt component reflects an original issue discount ( *OID* ) of \$12.9 million which will be amortized into interest expense over the term of the Notes. After considering the contractual interest payments and amortization of the *OID*, the Notes' effective interest rate is 7.4%.

The following table shows the amounts recorded for the debt component of the Notes as of December 31, 2014 and December 31, 2013 (in thousands):

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
Outstanding principal	\$ 100,000	\$ 100,000
Unamortized <i>OID</i>	(10,218 )	(11,777 )
Total debt component	\$ 89,782	\$ 88,223

Deferred issuance costs of \$3.7 million will also be amortized into interest expense over the term of the Notes. Interest expense on the Notes, including amortization of deferred issuance costs, recognized on the notes was \$7.0 million and \$5.4 million for the years ended December 31, 2014 and 2013, respectively.

As the conversion feature is structured under the cash settlement method, the embedded conversion option is reported as a derivative liability.

In connection with the offering of the Notes, the Company also entered into cash convertible senior notes hedge transactions (the *Note Hedges* ) and warrant transactions (the *Warrants* ) with respect to its common stock with certain

counter-parties. Upon conversion, the Note Hedges are intended to offset potential cash payments in excess of the principal amount of the Notes. The Note Hedges and Warrants are separate transactions, entered into by the Company with certain counter-parties and are not part of the terms of the Notes.

The Company paid \$12.9 million for the Note Hedges, which are exercisable upon conversion of the Notes. The Note Hedges are structured under the cash settlement method and are accounted for as a derivative asset.

The Company received \$3.0 million for the Warrants sold to certain counter-parties. The Warrants have a strike price of \$11.69 and will be net share settled, meaning the Company will issue a number of shares per Warrant corresponding to the difference between its share price on each Warrant exercise date and the exercise price. The Warrants meet the definition of derivatives under the guidance in Accounting Standards Codification

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**MEADOWBROOK INSURANCE GROUP, INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

(ASC) 815; however, because these instruments have been determined to be indexed to the Company's own stock and meet the criteria for equity classification under ASC 815-40, the Warrants have been accounted for as an adjustment to the Company's paid-in-capital.

If the market value per share of the Company's common stock exceeds the strike price of the Warrants, the Warrants will have a dilutive effect on the Company's net income per share and the Company will use the treasury stock method in calculating the dilutive effect on earnings per share.

*Interest Rate Swaps*

We have entered into interest rate swap transactions to mitigate our interest rate risk on our existing debt obligations. These interest rate swap transactions have been designated as cash flow hedges and are deemed highly effective hedges. These interest rate swap transactions are recorded at fair value on the balance sheet and the effective portion of the changes in fair value are accounted for within other comprehensive income. The interest differential to be paid or received is accrued and recognized as an adjustment to interest expense.

Refer to Note 7 ~ *Derivative Instruments* of the Notes to the Consolidated Financial Statements, for additional information specific to our interest rate swaps.

*Investment Portfolio*

As of December 31, 2014 and December 31, 2013, the recorded values of our investment portfolio, including cash and cash equivalents, were \$1.7 billion for both years.

In general, we believe our overall investment portfolio is conservatively invested. The effective duration of the investment portfolio at December 31, 2014 and 2013, was 4.3 years and 5.0 years, respectively. Our pre-tax book yield, excluding cash and cash equivalents at December 31, 2014 was 2.9% compared to 3.0% in 2013. The tax equivalent yield, excluding cash and cash equivalents was 3.5% at December 31, 2014, compared to 3.7% at December 31, 2013. Approximately 99.9% of our fixed income investment portfolio is investment grade.

*Shareholders' Equity*

Refer to Note 12 ~ *Shareholders' Equity* of the Notes to the Consolidated Financial Statements.

TABLE OF CONTENTS**MEADOWBROOK INSURANCE GROUP, INC.  
MANAGEMENT'S DISCUSSION AND ANALYSIS - continued****Contractual Obligations and Commitments**

The following table is a summary of our contractual obligations and commitments as of December 31, 2014 (in thousands):

**Contractual Obligations and Commitments**

## Credit Lines and Long-Term Debt

	Total	Payments due by period			
		Less than one year	One to three years	Three to five years	More than five years
<b><u>Non-regulated companies:</u></b>					
Term Loan	16,500	6,000	10,500	—	—
Lines of Credit (1)	15,000	—	15,000	—	—
Federal Home Loan Bank of Indianapolis (2)	30,000	—	30,000	—	—
Convertible Debt (3)	100,000	—	—	—	100,000
<b><u>Debentures (4):</u></b>					
Senior debentures due 2034: issued \$13.0 million,	13,000	—	—	—	13,000
Senior debentures due 2034: issued \$12.0 million,	12,000	—	—	—	12,000
Junior subordinated debentures due 2035; issued \$20.6 million	20,620	—	—	—	20,620
Junior subordinated debentures due 2033; issued \$10.3 million	10,310	—	—	—	10,310
Junior subordinated debentures due 2032; issued \$15.0 million (5)	15,000	—	—	—	15,000
Junior subordinated debentures due 2033; issued \$10.0 million (5)	10,000	—	—	—	10,000
<b>Total Debt</b>	<b>242,430</b>	<b>6,000</b>	<b>55,500</b>	<b>—</b>	<b>180,930</b>
Interest on Term Loan (6)	683	464	219	—	—
Interest on Line of Credit	743	443	300	—	—

Federal Home Loan Bank of Indianapolis	856	381	475	—	—
Convertible Debt	32,500	5,000	10,000	10,000	7,500
<b><u>Interest on Debentures:</u></b>					
Senior debentures due 2034: issued \$13.0 million,	5,688	813	1,625	1,625	1,625
Senior debentures due 2034: issued \$12.0 million,	5,358	765	1,531	1,531	1,531
Junior subordinated debentures due 2035; issued \$20.6 million	8,810	1,259	2,517	2,517	2,517
Junior subordinated debentures due 2033; issued \$10.3 million	4,532	647	1,295	1,295	1,295
Junior subordinated debentures due 2032; issued \$15.0 million (5)	6,584	941	1,881	1,881	1,881
Junior subordinated debentures due 2033; issued \$10.3 million (5)	4,396	628	1,256	1,256	1,256
<b>Total Interest Payable</b>	<b>70,150</b>	<b>11,341</b>	<b>21,099</b>	<b>20,105</b>	<b>17,605</b>
Operating lease obligations (7)	20,229	3,508	6,513	4,974	5,234
<b><u>Regulated companies:</u></b>					
Loss and loss adjustment expense (8)	1,590,359	418,292	493,583	229,871	448,613
Aquiline Investment (9)	3,308	3,308	—	—	—
Michigan Growth Investment (10)	1,560	1,560	—	—	—
<b>Total</b>	<b>1,928,036</b>	<b>444,009</b>	<b>576,695</b>	<b>254,950</b>	<b>652,382</b>

(1) Relates to our revolving line of credit.

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MANAGEMENT’S DISCUSSION AND ANALYSIS - continued**

Relates to the proceeds received from the Federal Home Loan Bank of Indianapolis facility for which the  
(2) Company used the full proceeds to purchase bonds. The Company achieves a margin on the assets above the cost of the debt and therefore treats this as operating leverage.

Relates to the cash convertible senior notes, refer to *Note 6 ~ Debt*. The current carrying value on the Balance  
(3) Sheet considering the original issue discount is \$89.8 million. This will accrete to par value of \$100 million due in 2020.

Five year call feature associated with debentures, estimated seven year repayment. For a description of our  
(4) debentures and related interest rate terms, as well as actual rates in accordance with our interest rate swap transactions, refer to *Note 6 ~ Debt* and *Note 7 ~ Derivative Instruments*.

(5) Relates to the junior subordinated debentures acquired in conjunction with the ProCentury Merger.  
(6) For a description of our term loan and its interest rate terms, as well as actual rates in accordance with our interest rate swap transaction, refer to *Note 6 ~ Debt* and *Note 7 ~ Derivative Instruments*.

(7) Consists of rental obligations under real estate leases related to branch offices. In addition, includes amounts related to equipment leases.

The loss and loss adjustment expense payments do not have contractual maturity dates and the exact timing of payments cannot be predicted with certainty. However, based upon historical payment patterns, we have included an estimate of our gross losses and loss adjustment expenses. In addition, we have anticipated cash receipts on  
(8) reinsurance recoverables on unpaid losses and loss adjustment expenses of \$519.5 million, of which we estimate that these payments to be paid for losses and loss adjustment expenses for the periods less than one year, one to three years, three to five years, and more than five years, to be \$88.2 million, \$120.0 million, \$76.1 million, and \$235.2 million, respectively, resulting in net losses and loss adjustment expenses of \$330.1 million, \$373.6 million, \$153.8 million, and \$213.4 million, respectively.

In November 2012, Century committed to a \$10.0 million contribution to the Aquiline Financial Services Fund II L.P. as a strategic investment. As of December 31, 2014, approximately \$6.7 million of the commitment had been  
(9) satisfied with \$3.3 million of unfunded commitment remaining. The remainder of the capital commitment will most likely be called in 2015; however, the exact date is not known as it is at the discretion of the fund managers based on the timing of the fund’s investments.

In May 2014, ProCentury committed to a \$2.0 million contribution to the Michigan Income & Principal-Protected Growth Fund, L.P. as a strategic investment. As of December 31, 2014, \$440,000 of the commitment had been  
(10) satisfied with \$1.56 million of unfunded commitment remaining. The remainder of the capital commitment will most likely be called in 2015; however, the exact date is not known as it is at the discretion of the fund managers based on the timing of the fund’s investments.

**Variable Compensation**

Our variable compensation plans have been established as an incentive for performance of our management team and consist of an Annual Bonus Plan ( Bonus Plan ) and a Long-Term Incentive Plan ( LTIP ). The Bonus Plan is a discretionary cash bonus plan premised upon a targeted growth in net after-tax earnings on a year over year basis. Each year, the Compensation Committee and our Board of Directors establish new targets based upon prior year performance and the forecasted performance levels anticipated for the following year. The amount of the bonus pool is established by aggregating the individual targets for each participant, which is a percentage of salary. An employee’s actual bonus may be plus or minus his or her target based upon the Company and individual’s performance at the end of the year. The Compensation Committee and the Board of Directors review our performance in relation to performance targets and then establish the total bonus pool to be utilized to pay cash bonuses to the management team based upon overall corporate and individual participant goals.

The LTIP is intended to provide an incentive to management to improve our performance over a period of time and remain with the Company, thereby increasing shareholder value. The LTIP is paid entirely in stock based upon the performance of the Company and the participant's service during the applicable period. A participant's target annual opportunity as a percentage of salary is established by the Compensation Committee and the Board of Directors in advance of any LTIP award.

Our Compensation Committee also is authorized to issue restricted stock awards when the Company achieves various financial, operational and strategic goals and objectives.

All of our plans are administered by the Compensation Committee of the Board of Directors and all awards are reviewed and approved by the Board of Directors at both inception and at distribution.

Refer to Note 11 ~ *Variable Compensation* of the Notes to the Consolidated Financial Statements, for additional information relating to our variable compensation.

### **Regulatory and Rating Issues**

Following the release of our 2013 fourth quarter results, on February 21, 2014, A.M. Best downgraded the issuer credit rating for our Insurance Company Subsidiaries to bbb from bbb+ while affirming their



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**MEADOWBROOK INSURANCE GROUP, INC.  
MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

financial strength rating of B++ (Good). A.M. Best also downgraded Meadowbrook's issuer credit rating to bb from bb+ and revised the outlook for the Insurance Company Subsidiaries to negative from stable .

On January 5, 2015, A.M. Best placed under review with positive implications the issuer credit rating of bb of Meadowbrook, and also placed the financial strength rating of B++ (Good) and the ICRs of bbb under review with positive implications for our Insurance Company Subsidiaries. Our results of operations could be materially and adversely impacted a negative rating change.

The National Association of Insurance Commissioners ( NAIC ) has a RBC formula to be applied to all property and casualty insurance companies. The formula measures required capital and surplus based on an insurance company's products and investment portfolio and is used as a tool to evaluate the capital of regulated companies. The RBC formula is used by state insurance regulators to monitor trends in statutory capital and surplus for the purpose of initiating regulatory action. In general, an insurance company must submit a calculation of its RBC formula to the insurance department of its state of domicile as of the end of the previous calendar year. These laws require increasing degrees of regulatory oversight and intervention as an insurance company's RBC declines. The level of regulatory oversight ranges from requiring the insurance company to inform and obtain approval from the domiciliary insurance commissioner of a comprehensive financial plan for increasing its RBC to mandatory regulatory intervention requiring an insurance company to be placed under regulatory control in a rehabilitation or liquidation proceeding.

At December 31, 2014, each of our Insurance Company Subsidiaries was in excess of any minimum threshold at which corrective action would be required. Refer to Note 8 ~ *Regulatory Matters and Rating Issues* for further details of RBC.

Insurance operations are subject to various leverage tests (e.g., premium to statutory surplus ratios), which are evaluated by regulators and rating agencies. As of December 31, 2014, on a trailing twelve month statutory consolidated basis, the gross and net premium leverage ratios were 1.4 to 1.0 and 1.2 to 1.0, respectively.

The NAIC's Insurance Regulatory Information System ( IRIS ) was developed by a committee of state insurance regulators and is primarily intended to assist state insurance departments in executing their statutory mandates to oversee the financial condition of insurance companies operating in their respective states. IRIS identifies thirteen industry ratios and specifies usual values for each ratio. State insurance regulators review the IRIS ratio results in coordination with a company's Statutory Annual Statement filings to determine if an insurer is in need of further regulatory scrutiny or action. While the ratios, individually and collectively, are effective tools for identifying companies that may be experiencing financial difficulty, they are only a guide for regulators and should not be considered an absolute indicator of a Company's financial condition.

A given ratio result may or may not reflect financial difficulty, depending on the underlying circumstances. Therefore, any unusual values generated by IRIS tests should be reviewed and analyzed in coordination with the overall financial condition of a company. Analysis of a company's Statutory Annual Statement and familiarity with its operations and history are important in reviewing each ratio result and its significance to the company's financial condition.

Departure from the usual values on four or more ratios, at an individual company, generally leads to inquiries or possible further review operations and financial condition from state insurance commissioners. In reviewing the financial information in the Statutory Annual Statements in coordination with the IRIS ratio results, a state regulator may determine that a company's departure from usual values is significant enough to indicate a strong concern with the financial condition of a company. When such a determination is made, state regulatory requirements may include

but not be limited to: specific restrictions on premium writings and surplus levels of a company, additional analysis of other key financial ratios of a company, or requiring an action plan be filed by the Company with specific actions outlined to bring the ratios back into the usual range.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

In 2014, our Insurance Company Subsidiaries generated ratios that varied from the usual value range. The variations and additional details for the reasons are set forth below:

<b>Ratio</b>	<b>Usual Range</b>	<b>Value</b>
<b>Company: Star</b>		
Investment Yield	Between 3.0% and 6.5%	2.8% (1)
Adjusted Liabilities to Liquid Assets	Equal to or Under 100%	111.0% (2)
<b>Company: Century</b>		
Two-Year Overall Operating Ratio	Equal to or Under 100%	102.0% (3)
Investment Yield	Between 3.0% and 6.5%	2.4% (1)
<b>Company: Savers</b>		
Two-Year Overall Operating Ratio	Equal to or Under 100%	102.0% (3)
Investment Yield	Between 3.0% and 6.5%	2.5% (1)
Two-Year Reserve Development to Policyholders' Surplus	Equal to or Under 20%	22.0% (4)
<b>Company: ProCentury</b>		
Two-Year Overall Operating Ratio	Equal to or Under 100%	103.0% (3)
Investment Yield	Between 3.0% and 6.5%	2.4% (1)
Two-Year Reserve Development to Policyholders' Surplus	Equal to or Under 20%	23.0% (4)
<b>Company: Ameritrust</b>		
Two-Year Overall Operating Ratio	Equal to or Under 100%	102.0% (3)
Investment Yield	Between 3.0% and 6.5%	2.7% (1)
Two-Year Reserve Development to Policyholders' Surplus	Equal to or Under 20%	20.0% (4)
<b>Company: Williamsburg</b>		
Two-Year Overall Operating Ratio	Equal to or Under 100%	103.0% (3)
Investment Yield	Between 3.0% and 6.5%	2.7% (1)
Two-Year Reserve Development to Policyholders' Surplus	Equal to or Under 20%	21.0% (4)

- (1) Investment Yield is a measure of the return on invested assets. It is calculated on a pre-tax basis and includes statutory net investment income, but excludes realized and unrealized capital gains/(losses). Because pre-tax investment income is used in the calculation, the ratio does not take into account lower yield rates on tax-exempt bonds. All six insurance subsidiaries generated unusual values for this ratio in 2014. In general, we believe our overall investment portfolio is conservatively invested. On a consolidated basis, our overall tax equivalent yield, excluding cash and cash equivalents was 3.5% at December 31, 2014, compared to 3.7% at December 31, 2013. As a comparison, the risk free rate on the 10 Year treasuries decreased during 2014 from 3.0% to 2.2% continuing

- to reflect historical lows. Approximately 99.9% of our fixed income investment portfolio is investment grade. The Adjusted Liabilities to Liquid Assets evaluates an entity's ability to meet obligations as they become due. While all liabilities are included in the ratio, only assets considered liquid by NAIC definition are included in the denominator of the ratio. For 2014, this ratio is outside the usual range on Star, primarily as a result of our Intercompany Reinsurance Pooling Agreement. The Adjusted Liabilities include the gross amount of reinsurance
- (2) payables related to the pool and does not allow an offset to those payables for any reinsurance recoverables related to the pool. In addition, the reinsurance recoverables are not included in the Liquid Assets portion of the formula. This causes the ratio results to appear much higher due to the timing of the settlement of the pool balances. Pool balances between the entities are settled subsequent to year-end. Once the balances are settled, the ratio is below 100% for Star and within the usual value.
- The Two-Year Overall Operating ratio measures the overall profitability of an entity over a two-year period. For
- (3) 2014, this ratio is above 100% for five of six Insurance Subsidiaries. This was driven by the adverse prior year development experienced in calendar year 2013.
- Two-Year Reserve Development to Policyholders' Surplus measures the deficiency/(redundancy) of reserves reported to date on loss/ALAE costs reported in the second prior year, in relation to policyholders' surplus as of
- (4) year-end. Four of the six Insurance Subsidiaries generated Two-Year Reserve Development to Policyholders' Surplus ratios greater than the usual value of 20%. The results of this ratio are driven by the adverse prior year development experienced in calendar year 2013.

### **Reinsurance Considerations**

We seek to manage the risk exposure of our Insurance Company Subsidiaries and our clients through the purchase of excess-of-loss and quota share reinsurance. Our reinsurance requirements are analyzed on both a specific program and line of business basis to determine the appropriate retention levels and reinsurance coverage limits. We secure this reinsurance based on the availability, cost, and benefits of various reinsurance alternatives.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

Reinsurance does not legally discharge an insurer from its primary liability for the full amount of risks assumed under insurance policies it issues, but it does make the assuming reinsurer liable to the insurer to the extent of the reinsurance ceded. Therefore, we are subject to credit risk with respect to the obligations of our reinsurers.

In regard to our excess-of-loss reinsurance, we manage our credit risk on reinsurance recoverables by reviewing the financial stability, A.M. Best rating, capitalization, and credit worthiness of prospective or existing reinsurers. We generally do not seek collateral where the reinsurer is rated A- or better by A.M. Best, has \$500 million or more in surplus, and is admitted in the state of Michigan. The following table sets forth information relating to our five largest unaffiliated excess-of-loss reinsurers based upon ceded premium as of December 31, 2014:

<b>Reinsurer</b>	<b>Reinsurance Premium Ceded December 31, 2014 (In thousands)</b>	<b>Reinsurance Recoverable December 31, 2014 (In thousands)</b>	<b>A.M. Best Rating</b>
Maiden Reins NA	\$ 17,670	\$ 35,536	A-
Hannover Rueck SE	16,001	66,260	A+
Swiss Reinsurance America Corporation	11,768	73,385	A+
Lloyd's Syndicate Number 2003	9,095	52,263	A
Lloyd's Syndicate Number 4472	5,598	30,114	A

In regard to our risk-sharing partners (client captive or rent-a-captive quota-share non-admitted reinsurers), we manage credit risk on reinsurance recoverables by reviewing the financial stability, capitalization, and credit worthiness of prospective or existing reinsurers or partners. We customarily collateralize reinsurance balances due from non-admitted reinsurers through funds withheld trusts or stand-by letters of credit issued by highly rated banks. To date, we have not, in the aggregate, experienced material difficulties in collecting reinsurance recoverables.

Effective December 31, 2012, we entered into a Multiple Line Quota Share Treaty with Swiss Reinsurance America Corporation ( Swiss Re ). This agreement was terminated on a run-off basis for business effective October 1, 2013 and after. Effective December 31, 2012, we ceded 50% of our unearned premium on a select portion of business. In return, we received a provisional ceding commission. The business included in the agreement was subject to specific limitations and ceded certain business based upon an in-force, new and renewal basis. We ceded 25% of direct written premium on this selected business commencing January 1, 2013, until the contract termination date of September 30, 2013, the remaining unearned premium and losses will continue to run-off. The ceded earned premium associated with this agreement was \$23.2 million, ceded loss and LAE was \$11.4 million and the ceding commission benefit was \$10.2 million for the year ended December 31, 2014.

**Off-Balance Sheet Arrangements**

As of December 31, 2014, we have no off-balance sheet arrangements as defined in Item 303(a) (4) of Regulation S-K.

**Related Party Transactions**

Refer to Note 17 ~ *Related Party Transactions* of the Notes to the Consolidated Financial Statements.

**Recent Accounting Standards**

Refer to Note 1 ~ *Summary of Significant Accounting Policies* of the Notes to the Consolidated Financial Statements.

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Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates as well as other relevant market rate or price changes. The volatility and liquidity in the markets in which the underlying assets are traded directly influence market risk. The following is a discussion of our primary risk exposures and how those exposures are currently managed as of December 31, 2014. Our market risk sensitive instruments are primarily related to fixed income securities, which are available for sale and not held for trading purposes.

Interest rate risk is managed within the context of an asset and liability management strategy where the target duration for the fixed income portfolio is based on the estimate of the liability duration and takes into consideration our surplus. The investment policy guidelines provide for a fixed income portfolio duration of between three and a half and five and a half years. At December 31, 2014, our fixed income portfolio had an effective duration of 4.3 years compared to 5.0 years at December 31, 2013.

At December 31, 2014, the fair value of our investment portfolio, excluding cash and cash equivalents, was \$1.6 billion. Our market risk to the investment portfolio is primarily interest rate risk associated with debt securities. Our exposure to equity price risk is related to our investments in high dividend equities, these investments comprise of 7.0% of our investment portfolio.

Our investment philosophy is one of maximizing after-tax earnings and has historically included significant investments in tax-exempt bonds. For our investment portfolio, there were no significant changes in our primary market risk exposures or in how those exposures are managed compared to the year ended December 31, 2013. We do not anticipate significant changes in our primary market risk exposures or in how those exposures are managed in future reporting periods based upon what is known or expected to be in effect.

A sensitivity analysis is defined as the measurement of potential loss in future earnings, fair values, or cash flows of market sensitive instruments resulting from one or more selected hypothetical changes in interest rates and other market rates or prices over a selected period. In our sensitivity analysis model, a hypothetical change in market rates is selected that is expected to reflect reasonable possible near-term changes in those rates. Near term means a period of up to one year from the date of the consolidated financial statements. In our sensitivity model, we use a hypothetical change to measure our potential loss in fair value of debt securities assuming an upward and downward parallel shift in interest rates. The table below presents our model's estimate of changes in fair values given a change in interest rates. Dollar values are in thousands.

	<b>Rates Down 100bps</b>	<b>Rates Unchanged</b>	<b>Rates Up 100bps</b>
Fair Value	\$1,524,711	\$1,464,376	\$1,402,196
Yield to Maturity or Call	1.3%	2.1%	3.0%
Effective Duration	4.2	4.3	4.3

The other financial instruments, which include cash and cash equivalents, equity securities, premium receivables, reinsurance recoverables, line of credit and other assets and liabilities, when included in the sensitivity model, do not produce a material change in fair values.

Our debentures are subject to variable interest rates. Thus, our interest expense on these debentures is directly correlated to market interest rates. At December 31, 2014 and 2013, we had debentures of \$80.9 million. At this level,

a 100 basis point (1%) change in market rates would change annual interest expense by \$809,000.

Our term loan is subject to variable interest rates. Thus, our interest expense on our term loan is directly correlated to market interest rates. At December 31, 2014, we had an outstanding balance under our term loan of \$16.5 million. At this level, a 100 basis point (1%) change in market rates would change annual interest expense by \$165,000. At December 31, 2013, we had an outstanding balance under our term loan of \$22.5 million. At this level, a 100 basis point (1%) change in market rates would change annual interest expense by \$225,000.

We have entered into interest rate swap transactions to mitigate our interest rate risk on our existing debt obligations. These interest rate swap transactions have been designated as cash flow hedges and are deemed highly effective hedges. These interest rate swap transactions are recorded at fair value on the balance sheet and the effective portion of the changes in fair value are accounted for within other comprehensive income. The



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### **MEADOWBROOK INSURANCE GROUP, INC.**

interest differential to be paid or received is accrued and recognized as an adjustment to interest expense. Refer to Note 7 ~ *Derivative Instruments* for further detail relating to our interest rate swap transactions.

In addition, our revolving line of credit under which we can borrow up to \$23.5 million is subject to variable interest rates. Thus, our interest expense on the revolving line of credit is directly correlated to market interest rates. At December 31, 2014, we had \$15 million outstanding under our line of credit. At this level, a 100 basis point (1%) change in market rates would change annual interest expense by \$150,000. At December 31, 2013, we had \$20.0 million outstanding on this revolving line of credit. At this level, a 100 basis point (1%) change in market rates would have changed interest expense by \$200,000. In addition, at December 31, 2014 the letter of credit was \$145,000 and \$500,000 at December 31, 2013.

### **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

Refer to list of Financial Statement Schedules (including the Reports of Independent Registered Public Accounting Firm referenced therein) set forth in Item 15 of this Annual Report on Form 10-K and Note 18 ~ *Quarterly Financial Data (Unaudited)* of the Notes to the Consolidated Financial Statements.

### **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

### **ITEM 9A. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

Our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, the Exchange Act ), which we refer to as disclosure controls, are controls and procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Exchange Act, such as this annual report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any control system. A control system, no matter how well conceived and operated, can provide only reasonable assurance that its objectives are met. No evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our Company have been detected.

As of December 31, 2014, an evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective to ensure that material information relating to us is made known to management, including our Chief Executive Officer and Chief Financial Officer, particularly during the period when our periodic reports are being prepared.

#### **Management's Report on Internal Control over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Because of its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may be inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal controls

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**MEADOWBROOK INSURANCE GROUP, INC.**

over financial reporting as of December 31, 2014. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ) in Internal Control—Integrated Framework (2013 framework) . Based on our assessment, we concluded that, as of December 31, 2014, our internal controls over financial reporting were effective based on those criteria.

The attestation report of Ernst & Young LLP, our independent registered public accounting firm, regarding internal control over financial reporting is set forth in Item 15 of this Annual Report on Form 10-K under the caption Report of Independent Registered Public Accounting Firm on Internal Control over financial Reporting and incorporated herein by reference.

**Changes in Internal Control over Financial Reporting**

There have been no changes in our internal control over financial reporting during the most recent quarter ended December 31, 2014, which have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.

TABLE OF CONTENTS**MEADOWBROOK INSURANCE GROUP, INC.****PART III**

Certain information required by Part III is omitted from this Report in that the Registrant will file a definitive Proxy Statement pursuant to Regulation 14A (the Proxy Statement ) not later than 120 days after the end of the fiscal year covered by this report and certain information included therein is incorporated herein by reference. Only those sections of the Proxy Statement that specifically address the items set forth herein are incorporated by reference.

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE**

The information required by this item is included under the captions *Information about the Nominees, the Incumbent Directors and Other Executive Officers, Corporate Governance, Code of Conduct, Report of the Audit Committee, and Section 16(a) Beneficial Ownership Reporting Compliance* of the Proxy Statement, which such information is hereby incorporated by reference. Our Code of Conduct can be found on our website [www.meadowbrook.com](http://www.meadowbrook.com).

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this item is included under the captions *Compensation of Executive Officers, Director Compensation, Report of the Compensation Committee of the Board on Executive Compensation, Employment Agreements, Other Senior Executive Employment Agreements, and Compensation Committee Interlocks and Insider Participation* of the Proxy Statement, which such information is hereby incorporated by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this item is included under the caption *Security Ownership of Certain Beneficial Owners and Management* of the Proxy Statement, which such information is hereby incorporated by reference.

**Equity Compensation Plan Information**

<b>Plan category</b>	<b>Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)</b>	<b>Weighted-average exercise price of outstanding options, warrants and rights (b)</b>	<b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities in column (a)) (c)</b>
Equity compensation plans approved by security holders (1)	0	\$ 0.00	1,682,621
	—	—	—

Equity compensation plans not approved by security holders

Total	0	\$	0.00	1,682,621
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(1) The 1,682,621 number of shares remaining available for future issuance relates to our 2009 Equity Compensation plan.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

The information required by this item is included under the captions *Certain Relationships and Related Party Transactions* and *Independence Determination* of the Proxy Statement, which such information is hereby incorporated by reference.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this item is included under the caption *The Second Proposal on Which You are Voting on Ratification of Appointment of Independent Registered Public Accounting Firm* of the Proxy Statement, which such information is hereby incorporated by reference.

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**MEADOWBROOK INSURANCE GROUP, INC.**

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

(A) The following documents are filed as part of this Report:

1. List of Financial Statements:	Page
<u>Report of Independent Registered Public Accounting Firm on Financial Statements</u>	<u>70</u>
<u>Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting</u>	<u>71</u>
<u>Consolidated Balance Sheet — December 31, 2014 and 2013</u>	<u>72</u>
<u>Consolidated Statement of Income — For Years Ended December 31, 2014, 2013, and 2012</u>	<u>73</u>
<u>Consolidated Statement of Comprehensive Income — For Years Ended December 31, 2014, 2013, and 2012</u>	<u>74</u>
<u>Consolidated Statement of Shareholders' Equity — For Years Ended December 31, 2014, 2013, and 2012</u>	<u>75</u>
<u>Consolidated Statement of Cash Flows — For Years Ended December 31, 2014, 2013, and 2012</u>	<u>76</u>
<u>Notes to Consolidated Financial Statements</u>	<u>77-111</u>
2. Financial Statement Schedules	
<u>Schedule I Summary of Investments Other Than Investments in Related Parties</u>	<u>112</u>
<u>Schedule II Condensed Financial Information of Registrant</u>	<u>113-116</u>
Schedule III Supplementary Insurance Information – Omitted as not applicable	
<u>Schedule IV Reinsurance</u>	<u>117</u>
<u>Schedule V Valuation and Qualifying accounts</u>	<u>118</u>

3. Exhibits: The Exhibits listed on the accompanying Exhibit Index immediately following the financial statement schedule are filed as part of, or incorporated by reference into, this Form 10-K.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of  
Meadowbrook Insurance Group, Inc.

We have audited the accompanying consolidated balance sheets of Meadowbrook Insurance Group, Inc. as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2014. Our audits also included the financial statement schedules listed in the Index at Item 15(a). These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Meadowbrook Insurance Group, Inc. at December 31, 2014 and 2013, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Meadowbrook Insurance Group, Inc.'s internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 2, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young, LLP

Detroit, Michigan  
March 2, 2015



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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of  
Meadowbrook Insurance Group, Inc.

We have audited Meadowbrook Insurance Group, Inc.'s internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Meadowbrook Insurance Group, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Meadowbrook Insurance Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Meadowbrook Insurance Group, Inc. as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2014 and our report dated March 2, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young, LLP

Detroit, Michigan  
March 2, 2015

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TABLE OF CONTENTS**MEADOWBROOK INSURANCE GROUP, INC.**  
CONSOLIDATED BALANCE SHEET

	<b>December 31,</b>	
	<b>2014</b>	<b>2013</b>
	<b>(In thousands, except share data)</b>	
<b>ASSETS</b>		
Investments		
Debt securities available for sale, at fair value (amortized cost of \$1,427,710 and \$1,455,754 in 2014 and 2013, respectively)	\$ 1,464,376	\$ 1,463,046
Equity securities available for sale, at fair value (cost of \$94,371 and \$95,346 in 2014 and 2013, respectively)	110,614	109,982
Cash and cash equivalents	87,531	94,776
Accrued investment income	14,020	14,266
Premiums and agent balances receivable (net of allowance of \$5,524 and \$5,094 in 2014 and 2013, respectively)	175,766	214,144
Reinsurance recoverable on:		
Paid losses	15,895	14,453
Unpaid losses	519,530	505,431
Prepaid reinsurance premiums	27,925	63,908
Deferred policy acquisition costs	60,862	62,773
Deferred income taxes, net	28,040	41,435
Goodwill	6,857	5,644
Other intangible assets	21,883	24,509
Other assets	146,475	147,475
Total assets	\$ 2,679,774	\$ 2,761,842
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities		
Losses and loss adjustment expenses	\$ 1,590,359	\$ 1,616,521
Unearned premiums	276,350	354,367
Debt	151,282	160,723
Debtures	80,930	80,930
Accounts payable and accrued expenses	29,316	29,712
Funds held and reinsurance balances payable	23,428	29,320
Payable to insurance companies	40,903	45,625
Other liabilities	29,573	31,231
Total liabilities	2,222,141	2,348,429
Shareholders' Equity	501	499

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Common stock, \$0.01 stated value; authorized 75,000,000 shares;  
50,093,390 and 49,887,200 shares issued and outstanding

Additional paid-in capital	277,192	276,410
Retained earnings	145,543	120,894
Note receivable from officer	(683 )	(709 )
Accumulated other comprehensive income	35,080	16,319
Total shareholders' equity	457,633	413,413
Total liabilities and shareholders' equity	\$ 2,679,774	\$ 2,761,842

The accompanying notes are an integral part of the Consolidated Financial Statements.

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TABLE OF CONTENTS**MEADOWBROOK INSURANCE GROUP, INC.**  
CONSOLIDATED STATEMENT OF INCOME

	<b>For the Years Ended December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>(In thousands, except share and per share data)</b>		
<b>Revenues</b>			
Premiums earned			
Gross	\$ 820,481	\$ 1,029,062	\$ 1,013,965
Ceded	(177,210 )	(331,645 )	(159,706 )
Net earned premiums	643,271	697,417	854,259
Net commissions and fees	43,173	39,512	34,049
Net investment income	45,142	46,473	53,143
Realized (losses) gains:			
Total other-than-temporary impairments on securities	(116 )	—	—
Portion of loss recognized in other comprehensive income	—	—	—
Net other-than-temporary impairments on securities recognized in earnings	(116 )	—	—
Net realized gains excluding other-than-temporary impairments on securities	11,055	7,769	55,312
Net realized gains	10,939	7,769	55,312
Total revenues	742,525	791,171	996,763
<b>Expenses</b>			
Losses and loss adjustment expenses	544,332	787,531	806,635
Reinsurance recoveries	(123,524 )	(238,494 )	(128,951 )
Net losses and loss adjustment expenses	420,808	549,037	677,684
Policy acquisition and other underwriting expenses	236,271	225,510	274,066
General selling and administrative expenses	31,972	25,789	24,463
General corporate expense	6,454	3,997	3,572
Amortization expense	3,988	4,237	7,296
Goodwill impairment expense	—	115,397	—
Interest expense	13,899	12,950	8,429
Total expenses	713,392	936,917	995,510
Income (loss) before taxes and equity earnings	29,133	(145,746 )	1,253
Federal and state income tax expense (benefit)	4,106	(30,960 )	(7,842 )
Equity earnings of affiliates, net of tax	3,609	3,441	2,652
Equity (losses) earnings of unconsolidated subsidiaries, net of tax	21	(965 )	2
Net income (loss)	\$ 28,657	\$ (112,310 )	\$ 11,749

Earnings (loss) Per Share

Basic	\$	0.57	\$	(2.25 )	\$	0.23
Diluted	\$	0.57	\$	(2.25 )	\$	0.23

Weighted average number of common shares

Basic	50,063,953	49,871,587	50,177,484
Diluted	50,063,953	49,871,587	50,177,484

The accompanying notes are an integral part of the Consolidated Financial Statements.

TABLE OF CONTENTS**MEADOWBROOK INSURANCE GROUP, INC.****CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

	<b>For the Years Ended December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>(In thousands)</b>		
Net income (loss)	\$ 28,657	\$ (112,310 )	\$ 11,749
Other comprehensive income (loss), net of tax:			
Unrealized gains (losses) on securities	27,484	(31,178 )	15,549
Unrealized gains (losses) in affiliates and unconsolidated subsidiaries	149	(113 )	163
Increase on non-credit other-than-temporary impairments on securities	—	—	741
Net deferred derivative (losses) gains - hedging activity	(1,762 )	3,954	334
Less reclassification adjustment for investment gains included in net income	(7,110 )	(5,032 )	(35,953 )
Other comprehensive gains (losses), net of tax	18,761	(32,369 )	(19,166 )
Comprehensive income (loss)	\$ 47,418	\$ (144,679 )	\$ (7,417 )

The accompanying notes are an integral part of the Consolidated Financial Statements.

TABLE OF CONTENTS**MEADOWBROOK INSURANCE GROUP, INC.**  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

For the Years ended December 31, 2014, 2013, and 2012

(In thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Note Receivable from Officer	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances January 1, 2012	520	279,005	238,539	(767 )	67,854	585,151
Change in unrealized gain or loss on available for sale securities, net of tax	—	—	—	—	(19,854 )	(19,854 )
Change in valuation allowance on deferred tax assets	—	—	—	—	191	191
Net deferred derivative gain - hedging activity	—	—	—	—	334	334
Dividends declared and paid	—	—	(8,542 )	—	—	(8,542 )
Stock award	—	362	—	—	—	362
Long term incentive plan; stock award for 2012 plan year	—	212	—	—	—	212
Repurchase of 1,267,300 shares of common stock	(15 )	(7,107 )	(4,395 )	—	—	(11,517 )
Change in investment in affiliates, net of tax	—	—	—	—	192	192
Change in investment of unconsolidated subsidiaries	—	—	—	—	(29 )	(29 )
Note receivable from an officer	—	—	—	30	—	30
Net income	—	—	11,749	—	—	11,749
Balances December 31, 2012	505	272,472	237,351	(737 )	48,688	558,279
Change in unrealized gain or loss on available for sale securities, net of tax	—	—	—	—	(36,075 )	(36,075 )
Change in valuation allowance on deferred	—	—	—	—	(135 )	(135 )



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tax assets

Net deferred derivative gain - hedging activity	—	—	—	—	3,954	3,954
Dividends declared and paid	—	—	(3,991 )	—	—	(3,991 )
Stock award	1	358	—	—	—	359
Long term incentive plan; stock award for 2012 and 2013 plan years	—	430	—	—	—	430
Change in investment in affiliates, net of tax	—	—	—	—	(113 )	(113 )
Stock warrant issuance	—	3,023	—	—	—	3,023
Other reclass	(7 )	127	(156 )	—	—	(36 )
Note receivable from an officer	—	—	—	28	—	28
Net loss	—	—	(112,310 )	—	—	(112,310 )
Balances December 31, 2013	\$ 499	\$ 276,410	\$ 120,894	\$ (709 )	\$ 16,319	\$ 413,413
Change in unrealized gain or loss on available for sale securities, net of tax	—	—	—	—	20,138	20,138
Change in valuation allowance on deferred tax assets	—	—	—	—	236	236
Net deferred derivative loss - hedging activity	—	—	—	—	(1,762 )	(1,762 )
Dividends declared and paid	—	—	(4,008 )	—	—	(4,008 )
Stock award	2	106	—	—	—	108
Long term incentive plan; stock award for 2012 and 2013 plan years	—	676	—	—	—	676
Change in investment in affiliates, net of tax	—	—	—	—	164	164
Change in investment of unconsolidated subsidiaries	—	—	—	—	(15 )	(15 )
Note receivable from an officer	—	—	—	26	—	26
Net income	—	—	28,657	—	—	28,657
Balances December 31, 2014	\$ 501	\$ 277,192	\$ 145,543	\$ (683 )	\$ 35,080	\$ 457,633

The accompanying notes are an integral part of the Consolidated Financial Statements.



TABLE OF CONTENTS**MEADOWBROOK INSURANCE GROUP, INC.**  
CONSOLIDATED STATEMENT OF CASH FLOWS

	<b>For the Years Ended December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>(In thousands)</b>		
<b>Cash Flows From Operating Activities</b>			
Net income (loss)	\$ 28,657	\$ (112,310 )	\$ 11,749
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Amortization of other intangible assets	3,988	4,137	7,296
Amortization of deferred debenture issuance costs	—	73	125
Impairment of goodwill	—	115,397	—
Depreciation of furniture, equipment, and building	4,243	4,698	5,098
Net amortization of discount and premiums on bonds	12,424	11,556	6,526
Accretion of issued debt/original issue discount	1,559	1,165	—
Amortization of capitalized convertible note fees	443	331	—
Gain on investments	(10,876 )	(7,741 )	(55,313 )
Gain on sale of fixed assets	(231 )	(88 )	(88 )
Long term incentive plan expense	709	453	212
Stock award	129	358	362
Equity earnings of affiliates, net of taxes	(3,609 )	(3,441 )	(2,652 )
Equity (earnings) losses of unconsolidated subsidiaries, net of taxes	(21 )	965	(2 )
Deferred income tax expense (benefit)	3,648	(13,427 )	(8,890 )
Write-off of book of business	52	100	123
Changes in operating assets and liabilities:			
(Increase) decrease in:			
Premiums and agent balances receivable	38,437	(5,401 )	(25,583 )
Reinsurance recoverable on paid and unpaid losses	(15,541 )	(124,367 )	(69,763 )
Prepaid reinsurance premiums	35,983	79,272	(109,426 )
Deferred policy acquisition costs	1,911	(17,356 )	29,050
Other assets	5,398	(36,566 )	745
Increase (decrease) in:			
Losses and loss adjustment expenses	(26,162 )	160,541	261,003
Unearned premiums	(78,017 )	(85,051 )	52,668
Payable to insurance companies	(4,722 )	39,084	1,320
Funds held and reinsurance balances payable	(5,892 )	(20,302 )	23,719
Other liabilities	(3,972 )	9,915	(6,236 )
Total adjustments	(40,119 )	114,305	110,294
Net cash (used in) provided by operating activities	(11,462 )	1,995	122,043

**Cash Flows From Investing Activities**

Purchase of equity securities available for sale	(39,561 )	(111,225 )	—
Purchase of debt securities available for sale	(79,308 )	(433,963 )	(594,264 )
Proceeds from sales and calls of equity securities available for sale	50,597	42,538	6,121
Proceeds from sales and maturities of debt securities available for sale	93,492	179,956	682,930
Capital expenditures	(1,563 )	(2,148 )	(2,663 )
Purchase of books of business	—	—	(3,700 )
Loan receivable	964	2,063	706
Other investing activities	(3,288 )	(3,233 )	(758 )
Net cash provided by (used in) investing activities	21,333	(326,012 )	88,372

**Cash Flows From Financing Activities**

Proceeds from term loan	—	—	30,000
Proceeds from lines of credit	—	—	30,000
Proceeds from FHLB advance	—	—	30,000
Payments on term loan	(6,000 )	(6,000 )	(25,375 )
Payments on lines of credit	(5,000 )	—	(14,500 )
Proceeds from convertible senior notes	—	96,324	—
Payments for convertible senior notes hedge	—	(12,942 )	—
Proceeds from issuance of warrants	—	3,023	—
Book overdrafts	(2,133 )	227	(144 )
Dividend paid on common stock	(4,008 )	(3,991 )	(8,542 )
Share repurchases of common stock	—	—	(11,517 )
Other financing activities	25	28	30
Net cash (used in) provided by financing activities	(17,116 )	76,669	29,952
Net increase (decrease) in cash and cash equivalents	(7,245 )	(247,348 )	240,367
Cash and cash equivalents, beginning of year	94,776	342,124	101,757
Cash and cash equivalents, end of year	\$ 87,531	\$ 94,776	\$ 342,124

**Supplemental Disclosure of Cash Flow Information:**

Interest paid	\$ 6,699	\$ 9,586	\$ 7,695
Net income taxes paid	\$ 5,307	\$ 1,058	\$ 176

**Supplemental Disclosure of Non Cash Investing and Financing Activities:**

Share-based employee compensation	\$ 129	\$ 358	\$ 362
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The accompanying notes are an integral part of the Consolidated Financial Statements.

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### **MEADOWBROOK INSURANCE GROUP, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

#### **1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

##### **Basis of Presentation and Principles of Consolidation**

The consolidated financial statements include accounts, after elimination of intercompany accounts and transactions, of Meadowbrook Insurance Group, Inc. (the Company or Meadowbrook), its wholly owned subsidiary Star Insurance Company (Star), and Star's wholly owned subsidiaries, Savers Property and Casualty Insurance Company (Savers), Williamsburg National Insurance Company (Williamsburg), and Ameritrust Insurance Corporation (Ameritrust). The consolidated financial statements also include Meadowbrook, Inc., Crest Financial Corporation, and their respective subsidiaries. In addition, the consolidated financial statements also include ProCentury Corporation (ProCentury) and its wholly owned subsidiaries. ProCentury's wholly owned subsidiaries consist of Century Surety Company (Century) and its wholly owned subsidiary ProCentury Insurance Company (PIC). In addition, ProCentury Risk Partners Insurance Company, Ltd. (PROPIC) is a wholly owned subsidiary of ProCentury. Star, Savers, Williamsburg, Ameritrust, Century, and PIC are collectively referred to as the Insurance Company Subsidiaries.

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (GAAP), which differ from statutory accounting practices prescribed or permitted for insurance companies by regulatory authorities. Prescribed statutory accounting practices include a variety of publications of the National Association of Insurance Commissioners (NAIC), as well as state laws, regulations and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed.

##### **Business**

The Company, through its affiliated Insurance Company Subsidiaries, is a specialty niche focused commercial insurance underwriter and insurance administration services company. The Company markets and underwrites specialty property and casualty insurance programs and products on both an admitted and non-admitted basis through a broad and diverse network of independent retail agents, wholesalers, program administrators and general agents. Program business refers to an aggregation of individually underwritten risks that have some unique characteristic and are distributed through a select group of agents. The Company seeks to combine profitable underwriting, income from net commissions and fees, investment returns and efficient capital management to deliver consistent long-term growth in shareholder value.

Through its retail property and casualty agencies, the Company also generates commission revenue, which represents 2.5% of total consolidated revenues. The Company's agencies are located in Michigan, California, Massachusetts, and Florida and produce commercial, personal lines, life and accident and health insurance primarily with unaffiliated insurance carriers. These agencies produce a minimal amount of business for the Company's affiliated Insurance Company Subsidiaries.

##### **Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. While management believes the amounts included in the consolidated financial statements reflect management's best estimates and assumptions, actual results may differ from those estimates.

### **Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand and highly liquid short-term investments. The Company considers all short-term investments purchased with an original maturity of three months or less to be cash equivalents.

### **Investments**

The Company's investment securities are classified as available for sale. Investments classified as available for sale are available to be sold in the future in response to the Company's liquidity needs, changes in market interest rates, tax strategies and asset-liability management strategies, among other reasons. Available for sale

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### **MEADOWBROOK INSURANCE GROUP, INC.**

#### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

securities that are not determined to be other-than-temporarily impaired ( OTTI ) are reported at fair value, with unrealized gains and losses reported in the accumulated other comprehensive income component of shareholders' equity, net of deferred taxes and, accordingly, have no effect on net income.

Realized gains or losses on sale of investments are determined on the basis of specific costs of the investments. Dividend income is recognized when declared and interest income is recognized when earned. Discount or premium on debt securities purchased at other than par value is amortized using the effective yield method.

Refer to Note 2 ~ *Investments* of the Notes to Consolidated Financial Statements for further detail in regard to the Company's investments.

#### **Losses and Loss Adjustment Expenses and Reinsurance Recoverables**

The liability for losses and loss adjustment expenses ( LAE ) represents case base estimates of reported unpaid losses and LAE and actuarial estimates of incurred but not reported ( IBNR ) losses and LAE. In addition, the liability for losses and loss adjustment expenses represents estimates received from ceding reinsurers on assumed business. Such liabilities, by necessity, are based upon estimates and, while management believes the amount of its reserves is adequate, the ultimate liability may be greater or less than the estimate.

Reserves related to the Company's direct business and assumed business it manages directly are established through transactions processed through the Company's internal systems and related controls. Accordingly, case reserves are established on a current basis, therefore, there is no delay or lag in reporting of losses from a ceding company, and IBNR is determined utilizing various actuarial methods based upon historical data. Ultimate reserve estimates related to assumed business from residual markets are provided by the mandatory pools on a two quarter lag and include an estimated reserve determined based upon internal actuarial methods for this lag. Lastly, in relation to assumed business from other sources, the Company receives case and paid loss data within a forty-five day reporting period and develops estimates for IBNR based on both current and historical data.

In addition to case reserves and in accordance with industry practice, the Company maintains estimates of reserves for losses and LAE IBNR. The Company projects an estimate of ultimate losses and LAE expenses at each reporting date. The difference between the projected ultimate loss and LAE reserves and the case loss and LAE reserves is carried as IBNR reserves. By using both estimates of reported claims and IBNR determined using generally accepted actuarial reserving techniques, the Company estimates the ultimate liability for losses and LAE, net of reinsurance recoverables.

Reinsurance recoverables represent (1) amounts currently due from reinsurers on paid losses and LAE, (2) amounts recoverable from reinsurers on case basis estimates of reported losses and LAE, and (3) amounts recoverable from reinsurers on actuarial estimates of incurred but not reported losses and LAE. Such recoverables, by necessity, are based upon estimates and, while management believes that the amount accrued is collectible, the ultimate recoverable may be greater or less than the amount accrued.

The methods for making such estimates and for establishing the loss reserves and reinsurance recoverables are continually reviewed and updated. We reviewed the key assumptions that underlie the actuarial methods and made the appropriate adjustments to reflect the emergence of claim activity.

#### **Revenue Recognition**

Premiums written, which include direct, assumed and ceded amounts are recognized as earned on a pro rata basis over the life of the policy term. Unearned premiums represent the portion of premiums written that are applicable to the unexpired terms of policies in force. Provisions for unearned premiums on reinsurance assumed from others are made on the basis of ceding reports when received and actuarial estimates.

Assumed premium estimates include business where the Company accepts a portion of the risk from a ceding carrier as well as the mandatory assumed pool business from the National Council on Compensation Insurance ( NCCI ), or residual market business.

Effective July 1, 2013 the Insurance Company Subsidiaries of the Company entered into an agreement with State National Insurance Company, National Specialty Insurance Company and United Specialty Insurance



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**MEADOWBROOK INSURANCE GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

Company (collectively, SNIC ), wherein certain portions of our business from our Insurance Company Subsidiaries were written direct with SNIC and 100% assumed collectively by our Insurance Company Subsidiaries based on agreed upon percentages. The SNIC business has a 5.5% fee, which is reflected as assumed commission on the applicable Insurance Company Subsidiaries' financial statements. Our Insurance Company Subsidiaries collectively have assumed \$268.5 million and \$170.2 million in gross written premium from SNIC for the years ended December 31, 2014 and 2013, respectively. The impact of the SNIC fee on the Company's expense ratio was 2.4% for the year ending December 31, 2014 and 0.5% for the year ended December 31, 2013.

Fee income, which includes risk management consulting, loss control, and claims services, is recognized during the period the services are provided. Depending on the terms of the contract, claims processing fees are recognized as revenue over the estimated life of the claims, or the estimated life of the contract. For those contracts that provide services beyond the expiration or termination of the contract, fees are deferred in an amount equal to management's estimate of the Company's obligation to continue to provide services in the future.

Commission income, which includes reinsurance placement, is recorded on the later of the effective date or the billing date of the policies on which they were earned. Commission income is reported net of any sub-producer commission expense. Commission adjustments that occur subsequent to the issuance of the policy, typically because of cancellation, are recognized when the policy is effectively cancelled. Profit sharing commissions from Insurance Company Subsidiaries are recognized when determinable, which is when such commissions are received.

The Company reviews, on an ongoing basis, the collectability of its receivables and establishes an allowance for estimated uncollectible accounts. As of December 31, 2014 and 2013, the allowance for uncollectibles on receivables was \$5.5 million and \$5.1 million, respectively.

The agent balances receivable from Midwest Financial Holdings, LLC ( MFH ) for the years ended December 31, 2014 and 2013 were \$32.7 million and \$37.7 million, respectively. No other receivable exceeds 10% of the aggregate amount of receivables.

**Equity Earnings of Affiliates**

Equity earnings represent investments in affiliates in which the Company does not exercise control and has a 20% or more voting interest. Such investments in affiliates are accounted for using the equity method of accounting. The Company has a 28.5% equity interest in one affiliate, MFH. The equity earnings of this interest were recorded in net income. Equity earnings, net of tax, from MFH in 2014, 2013, and 2012, were \$2.5 million, \$2.8 million, and \$3.0 million, respectively. The Company received dividends from MFH in 2014, 2013, and 2012, for \$3.2 million, \$2.0 million, and \$4.0 million, respectively. The Company is recording the equity earnings in MFH based on a month lag due to timing differences with respect to the availability of information.

The Company has a 1.3% equity interest in another affiliate, Aquiline Financial Services Fund II L.P. The equity earnings incurred with respect to this interest were recorded in net income. The equity earnings, net of tax, from Aquiline Financial Services Fund II L.P. in 2014 were \$1.1 million and \$0.6 million in 2013. The Company had no equity earnings related to the Aquiline Financial Services Fund II L.P. for 2012.

**Deferred Policy Acquisition Costs**

Commissions and other costs of acquiring insurance business that vary with and are primarily related to the production of new and renewal business are deferred and amortized over the terms of the policies or reinsurance treaties to which they relate. Investment earnings are anticipated in determining the recoverability of such deferred amounts. The Company reduces these costs for premium deficiencies. There were no premium deficiencies for the years ended December 31, 2014, 2013, and 2012.

### **Participating Policyholder Dividends**

The Company's method for determining policyholder dividends is a combination of subjective and objective decisions, which may include, among other things, a loss ratio analysis for the specific program and the

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### **MEADOWBROOK INSURANCE GROUP, INC.**

#### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

Company's overall business strategy and regulatory constraints related to the Insurance Company Subsidiaries. The Company determines the total dividends to be paid and then obtains the approval of the Board of Directors to pay up to a certain amount. At December 31, 2014 and 2013, the Company had \$1.2 million and \$1.3 million accrued for policyholder dividends, respectively.

#### **Furniture and Equipment**

Furniture and equipment are stated at cost, net of accumulated depreciation, and are primarily depreciated using the straight-line method over the estimated useful lives of the assets, generally three to ten years. Upon sale or retirement, the cost of the asset and related accumulated depreciation are eliminated from their respective accounts, and the resulting gain or loss is included in income. Repairs and maintenance are charged to operations when incurred.

#### **Goodwill**

The Company evaluates existing goodwill for impairment on an annual basis as of October 1, or more frequently, if events or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Goodwill impairment is performed at the reporting unit level.

Refer to Note 14 ~ *Goodwill and Other Intangible Assets* of the Notes to Consolidated Financial Statements for further detail in regard to the Company's Goodwill.

#### **Income Taxes**

The Company provides for federal income taxes based on amounts the Company believes it ultimately will owe. Inherent in the provision for federal income taxes are estimates regarding the deductibility of certain items and the realization of certain tax credits. In the event the ultimate deductibility of certain items or the realization of certain tax credits differs from estimates, the Company may be required to significantly change the provision for federal income taxes recorded in the consolidated financial statements. Any such change could significantly affect the amounts reported in the consolidated statements of income.

The Company and its subsidiaries file a consolidated federal income tax return in accordance with a tax sharing agreement, whereby allocation is made primarily on a separate return basis with current credit for any net operating losses or other items utilized in the consolidated tax return.

The Company utilizes the asset and liability method of accounting for income tax. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under this method, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce the deferred tax assets to the amounts that are more likely than not to be realized.

#### **Restricted Stock Awards, Long Term Incentive Plan, and Deferred Compensation Plan**

Refer to Note 11 ~ *Variable Compensation* of the Notes to Consolidated Financial Statements for further details in regards to the Company's Restricted Stock Awards, Long Term Incentive Plan, and Deferred Compensation Plan.

### **Earnings Per Share**

Basic earnings per share are based on the weighted average number of common shares outstanding during the year, while diluted earnings per share includes the weighted average number of common shares and potential dilution from shares issuable pursuant to stock awards using the treasury stock method.

Shares related to the LTIP included in diluted earnings per share were all zero for the years ended December 31, 2014, 2013, and 2012, respectively.

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**MEADOWBROOK INSURANCE GROUP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

Restricted stock awards granted under the Plan on February 23, 2011, and 2010, were 28,500 and 202,500, respectively. Shares retired under both plans for tax withholding were 35,183 resulting in a net issuance of 195,817, which are included in the weighted average number of common shares for the year ended December 31, 2014.

**Comprehensive Income**

Comprehensive income encompasses all changes in shareholders' equity (except those arising from transactions with shareholders) and includes net income, net unrealized capital gains or losses on available for sale securities, net unrealized gains or losses in affiliates and unconsolidated subsidiaries, net increase or decrease on non-credit other-than-temporary impairments on available for sale securities, and net deferred derivative gains or losses on hedging activity.

**Derivative Instruments**

The Company has entered into interest rate swap transactions to mitigate its interest rate risk on its existing debt obligations. These interest rate swap transactions have been designated as cash flow hedges and are deemed highly effective hedges. These interest rate swap transactions are recorded at fair value on the balance sheet and the effective portion of the changes in fair value are accounted for within other comprehensive income. The interest differential to be paid or received is accrued and recognized as an adjustment to interest expense. The Company does not use interest rate swaps for trading or other speculative purposes.

**Fair Value Disclosures**

Due to the short-term nature of cash and cash equivalents, premiums and agent balances receivable, reinsurance recoverables, accrued interest, and other assets, the estimated fair value of such items approximates their carrying value. Since debt and equity securities are recorded in the financial statements at their estimated fair value as securities available for sale, their carrying value is their estimated fair value. The Company's long term debt, including its debentures, line of credit, accrued expenses and other liabilities, and reinsurance balances payable are either short term in nature or based on current market prices; therefore, their estimated fair value approximates their carrying value. In addition, the Company's derivative instruments, as disclosed in Note 7 ~ *Derivative Instruments*, are recorded in accordance with related accounting guidance and, therefore, are recorded at fair value.

**Recent Accounting Pronouncements**

*Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*

In February 2013, the FASB issued guidance to improve the reporting of reclassifications out of accumulated other comprehensive income. The guidance requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide addition detail about those amounts. The guidance is to be applied prospectively for reporting periods beginning after December 15, 2012. The Company adopted this new guidance on January 1, 2013 and included the required disclosures in Note 19 ~ *Accumulated Other Comprehensive Income*.

*Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Loss, or a Tax Credit Carryforward Exists*

In July 2013, the FASB issued a new standard that requires entities to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss carryforward, or similar tax loss or tax credit carryforward, rather than as a liability when the uncertain tax position would reduce the net operating loss or other carryforward under the tax law of the applicable jurisdiction and when the entity intends to use the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

deferred tax asset for that purpose. The new standard is effective for fiscal years and interim periods within those years that begin after December 15, 2013. The Company adopted this new guidance on January 1, 2014. The adoption of the new standard did not have a material impact on the Company's consolidated financial statements.

*Revenue Recognition*

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), (ASU 2014-09), which is intended to improve and converge the financial reporting requirements for revenue contracts with customers. Previous GAAP comprised broad revenue recognition concepts along with numerous industry-specific requirements. The new guidance establishes a five-step model which entities must follow to recognize revenue and removes inconsistencies and weaknesses in existing guidance. ASU 2014-09 is effective for annual and interim periods beginning after December 15, 2016, and must be retrospectively applied. Entities will have the option of presenting prior periods as impacted by the new guidance or presenting the cumulative effect of initial application along with supplementary disclosures. Early adoption is prohibited. The Company is currently evaluating the impact of adopting ASU 2014-09 on its financial condition and results of operations, but currently does not anticipate it having a material impact.

**2. INVESTMENTS**

The cost or amortized cost, gross unrealized gains, losses, non-credit other than temporary impairments ( OTTI ) and estimated fair value of investments in securities classified as available for sale at December 31, 2014 and December 31, 2013 were as follows (in thousands):

	Cost or Amortized Cost	December 31, 2014			Estimated Fair Value
		Gross Unrealized		Non-Credit OTTI	
		Gains	Losses		
<b>Debt Securities:</b>					
U.S. Government and agencies	\$ 22,927	\$ 479	\$ (75 )	\$ —	\$ 23,331
Obligations of states and political subs	695,259	25,886	(2,224 )	—	718,921
Corporate securities	569,859	14,886	(3,728 )	—	581,017
Residential mortgage-backed securities	100,477	1,886	(1,043 )	—	101,320
Commercial mortgage-backed securities	19,805	262	(243 )	—	19,824
Other asset-backed securities	19,383	585	(5 )	—	19,963
Total debt securities available for sale	1,427,710	43,984	(7,318 )	—	1,464,376
<b>Equity Securities:</b>					
Common stock	94,371	17,217	(974 )	—	110,614
Total equity securities available for sale	94,371	17,217	(974 )	—	110,614
Total securities available for sale	\$ 1,522,081	\$ 61,201	\$ (8,292 )	\$ —	\$ 1,574,990

**December 31, 2013**

	<b>Cost or Amortized Cost</b>	<b>Gains</b>	<b>Gross Unrealized Losses</b>	<b>Non-Credit OTTI</b>	<b>Estimated Fair Value</b>
<b>Debt Securities:</b>					
U.S. Government and agencies	\$ 24,985	\$ 572	\$ (188 )	\$ —	25,369
Obligations of states and political subs	730,004	25,509	(20,121 )	—	735,392
Corporate securities	534,913	15,529	(11,935 )	—	538,507
Residential mortgage-backed securities	118,930	2,191	(4,737 )	—	116,384
Commercial mortgage-backed securities	26,719	617	(868 )	—	26,468
Other asset-backed securities	20,203	763	(40 )	—	20,926
Total debt securities available for sale	1,455,754	45,181	(37,889 )	—	1,463,046
<b>Equity Securities:</b>					
Perpetual preferred stock	71	147	—	—	218
Common stock	95,275	14,933	(444 )	—	109,764
Total equity securities available for sale	95,346	15,080	(444 )	—	109,982
Total securities available for sale	\$ 1,551,100	\$ 60,261	\$ (38,333 )	\$ —	\$ 1,573,028



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The Company's investment objective within the common stock portfolio focuses primarily on maximizing dividend yield while minimizing price risk.

Gross unrealized gains, losses, and non-credit OTTI on available for sale securities as of December 31, 2014 and December 31, 2013 were as follows (in thousands):

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
Unrealized gains	\$ 61,201	\$ 60,261
Unrealized losses	(8,292 )	(38,333 )
Non-credit OTTI	—	—
Net unrealized gains	52,909	21,928
Deferred federal income tax expense	(18,518 )	(7,675 )
Net unrealized gains on investments, net of deferred federal income taxes	\$ 34,391	\$ 14,253

Net realized gains (losses, including OTTI) on securities, for the three years ended December 31, 2014, 2013, and 2012 were as follows (in thousands):

	<b>December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
Realized gains (losses):			
Debt securities:			
Gross realized gains	\$ 1,198	\$ 2,002	\$ 54,196
Gross realized losses	(383 )	(531 )	(217 )
Total debt securities	815	1,471	53,979
Equity securities:			
Gross realized gains	10,689	6,671	1,351
Gross realized losses	(628 )	(401 )	(17 )
Total equity securities	10,061	6,270	1,334
Net realized gains	\$ 10,876	\$ 7,741	\$ 55,313

OTTI included in realized losses on securities above

\$ (116 )	\$ —	\$ —
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Proceeds from the sales of debt and equity securities available for sale were \$76.4 million, \$119.6 million, and \$572.1 million for the years ended December 31, 2014, 2013, and 2012, respectively.

At December 31, 2014, the amortized cost and estimated fair value of available for sale debt securities by contractual maturity, are shown below. Expected maturities may differ from contractual maturities, because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

**Available for Sale**

	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>
Due in one year or less	\$ 47,636	\$ 48,031
Due after one year through five years	548,555	569,760
Due after five years through ten years	591,038	602,327
Due after ten years	100,816	103,151
Mortgage-backed securities, collateralized obligations and asset-backed securities	139,665	141,107
	\$ 1,427,710	\$ 1,464,376

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

Net investment income for the three years ended December 31, 2014, 2013, and 2012 was as follows (in thousands):

	<b>December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
<b>Net Investment Income Earned From:</b>			
Debt securities	\$ 42,669	\$ 43,505	\$ 51,956
Equity securities	3,512	3,855	1,740
Cash and cash equivalents	628	728	825
Total gross investment income	46,809	48,088	54,521
Less investment expenses	1,667	1,615	1,378
Net investment income	\$ 45,142	\$ 46,473	\$ 53,143

United States Government obligations, municipal and corporate bonds aggregating \$959.7 million and \$756.5 million were on deposit at December 31, 2014 and 2013, respectively, with state regulatory authorities or otherwise pledged as required by law or contract.

**Other-Than-Temporary Impairments of Securities and Unrealized Losses on Investments**

Available for sale securities are reviewed for declines in fair value that are determined to be other-than-temporary. For a debt security, if the Company intends to sell a security and it is more likely than not the Company will be required to sell a debt security before recovery of its amortized cost basis and the fair value of the debt security is below amortized cost, the Company concludes that an OTTI has occurred and the amortized cost is written down to current fair value, with a corresponding charge to realized loss in the Consolidated Statements of Income. If the Company does not intend to sell a debt security and it is not more likely than not the Company will be required to sell a debt security before recovery of its amortized cost basis but the present value of the cash flows expected to be collected is less than the amortized cost of the debt security (referred to as the credit loss), the Company concludes that an OTTI has occurred. In this instance, accounting guidance requires the bifurcation of the total OTTI into the amount related to the credit loss, which is recognized in earnings and the non-credit OTTI, which is recorded in Other Comprehensive Income as an unrealized non-credit OTTI in the Consolidated Statements of Comprehensive Income.

When assessing the Company's intent to sell a debt security, if it is more likely than not the Company will be required to sell a debt security before recovery of its cost basis, facts and circumstances such as, but not limited to, decisions to reposition the security portfolio, sale of securities to meet cash flow needs and sales of securities to capitalize on favorable pricing, are evaluated. In order to determine the amount of the credit loss for a debt security, the Company calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows expected to be recovered. The discount rate is the effective interest rate implicit in the underlying debt security upon issuance. The effective interest rate is the original yield or the coupon if the debt security was previously impaired. If an OTTI exists and there is not sufficient cash flows or other information to determine a recovery value of the security, the Company concludes that the entire OTTI is credit-related and the amortized cost for the security is written down to current fair value with a corresponding charge to realized loss in the Consolidated Statements of Income.

To determine the recovery period of a debt security, the Company considers the facts and circumstances surrounding the underlying issuer including, but not limited to the following:

- Historical and implied volatility of the security;
- Length of time and extent to which the fair value has been less than amortized cost;
- Conditions specifically related to the security such as default rates, loss severities, loan to value ratios, current levels of subordination, third party guarantees, and vintage;
- Specific conditions in an industry or geographic area;
- Any changes to the rating of the security by a rating agency;

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- Failure, if any, of the issuer of the security to make scheduled payments; and
- Recoveries or additional declines in fair value subsequent to the balance sheet date.

In periods subsequent to the recognition of an OTTI, the security is accounted for as if it had been purchased on the measurement date of the OTTI. Therefore, for a fixed maturity security, the discount or reduced premium is reflected in net investment income over the contractual term of the investment in a manner that produces a constant effective yield.

For an equity security, if the Company does not have the ability and intent to hold the security for a sufficient period of time to allow for a recovery in value, the Company concludes that an OTTI has occurred, and the cost of the equity security is written down to the current fair value, with a corresponding charge to realized loss within the Consolidated Statements of Income. When assessing the Company's ability and intent to hold the equity security to recovery, the Company considers, among other things, the severity and duration of the decline in fair value of the equity security, as well as the cause of decline, a fundamental analysis of the liquidity, business prospects and overall financial condition of the issuer.

Upon review of the Company's investment portfolio in the context of our OTTI policy, the Company recorded \$116,000 of OTTI losses on equity securities for the year ended December 31, 2014. The Company did not record a credit or a non-credit related OTTI loss on debt securities for the years ended December 31, 2014, 2013 and 2012.

The Company recorded an impairment which pertained to two lots of equities in our portfolio. The basis for the impairment was related to the length of time the lots had been in a loss position and not due to other factors such as severity of loss or credit worthiness of the issuances.

The fair value and amount of unrealized losses segregated by the time period the investment has been in an unrealized loss position were as follows (in thousands):

	December 31, 2014								
	Less than 12 months			Greater than 12 months			Total		
	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized and Non-Credit OTTI	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized and Non-Credit OTTI	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized and Non-Credit OTTI
<b>Debt Securities:</b>									
U.S. Government and agencies	—	\$ —	\$ —	3	\$ 3,440	\$ (75 )	3	\$ 3,440	\$ (75 )
Obligations of states and political subs	14	34,918	(79 )	48	150,683	(2,145 )	62	185,601	(2,224 )
Corporate securities	36	88,431	(748 )	64	120,883	(2,980 )	100	209,314	(3,728 )
	—	—	—	11	71,869	(1,042 )	11	71,869	(1,043 )

Residential mortgage-backed securities									
Commercial mortgage-backed securities	—	—	—	5	13,031	(244 )	5	13,031	(243 )
Other asset-backed securities	—	—	—	2	4,021	(5 )	2	4,021	(5 )
Total debt securities	<b>50</b>	<b>123,349</b>	<b>(827 )</b>	<b>133</b>	<b>363,927</b>	<b>(6,491 )</b>	<b>183</b>	<b>487,276</b>	<b>(7,318 )</b>
<b>Equity Securities:</b>									
Common stock	17	18,215	(974 )	—	—	—	17	18,215	(974 )
Total equity securities	<b>17</b>	<b>18,215</b>	<b>(974 )</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>17</b>	<b>18,215</b>	<b>(974 )</b>
Total securities	<b>67</b>	<b>\$ 141,564</b>	<b>\$ (1,801 )</b>	<b>133</b>	<b>\$ 363,927</b>	<b>\$ (6,491 )</b>	<b>200</b>	<b>\$ 505,491</b>	<b>\$ (8,292 )</b>

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	December 31, 2013								
	Less than 12 months			Greater than 12 months			Total		
	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses and Non-Credit OTTI	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses and Non-Credit OTTI	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses and Non-Credit OTTI
<b>Debt Securities:</b>									
U.S. Government and agencies	5	\$ 6,181	\$ (91 )	1	\$ 903	\$ (97 )	6	\$ 7,084	\$ (188 )
Obligations of states and political subs	103	285,264	(16,218 )	16	43,811	(3,903 )	119	329,075	(20,121 )
Corporate securities	121	259,581	(10,663 )	8	16,734	(1,272 )	129	276,315	(11,935 )
Residential mortgage-backed securities	13	72,458	(3,879 )	1	8,095	(858 )	14	80,553	(4,737 )
Commercial mortgage-backed securities	5	12,451	(868 )	—	—	—	5	12,451	(868 )
Other asset-backed securities	4	8,522	(40 )	—	—	—	4	8,522	(40 )
Total debt securities	<b>251</b>	<b>644,457</b>	<b>(31,759 )</b>	<b>26</b>	<b>69,543</b>	<b>(6,130 )</b>	<b>277</b>	<b>714,000</b>	<b>(37,889 )</b>
<b>Equity Securities:</b>									
Perpetual preferred stock	—	—	—	—	—	—	—	—	—
Common stock	15	12,112	(444 )	—	—	—	15	12,112	(444 )
Total equity securities	<b>15</b>	<b>12,112</b>	<b>(444 )</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>15</b>	<b>12,112</b>	<b>(444 )</b>
Total securities	<b>266</b>	<b>\$ 656,569</b>	<b>\$ (32,203 )</b>	<b>26</b>	<b>\$ 69,543</b>	<b>\$ (6,130 )</b>	<b>292</b>	<b>\$ 726,112</b>	<b>\$ (38,333 )</b>

Changes in the amount of credit loss on fixed maturities for which a portion of an OTTI related to other factors was recognized in other comprehensive income were as follows (in thousands):

Balance as of January 1, 2013	\$ (156 )
Additional credit impairments on:	

Previously impaired securities	
Securities for which an impairment was not previously recognized	—
Reductions	156
Balance as of December 31, 2013	—
Additional credit impairments on:	
Previously impaired securities	—
Securities for which an impairment was not previously recognized	—
Reductions	—
Balance as of December 31, 2014	\$ —

### 3. FAIR VALUE MEASUREMENTS

According to accounting guidance for fair value measurements and disclosures, fair value is the price that would be received in the sale of an asset or would be paid in the transfer of a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date. The guidance establishes a three-level hierarchy for fair value measurements that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs) and the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs).

The estimated fair values of the Company's fixed investment portfolio are based on prices provided by a third party pricing service and a third party investment manager. The prices provided by these services are based



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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

on quoted market prices, when available, non-binding broker quotes, or matrix pricing. The third party pricing service and the third party investment manager provide a single price or quote per security and the Company has not historically adjusted security prices. The Company obtains an understanding of the methods, models and inputs used by the third party pricing service and the third party investment manager, and has controls in place to validate that amounts provided represent fair values. The Company's control process includes, but is not limited to, initial and ongoing evaluation of the methodologies used, a review of specific securities and an assessment for proper classification within the fair value hierarchy. The hierarchy level assigned to each security in the Company's available for sale portfolio is based upon its assessment of the transparency and reliability of the inputs used in the valuation as of the measurement date. The three hierarchy levels are defined as follows:

Level 1 – Valuations that are based on unadjusted quoted prices in active markets for identical securities. The fair value of exchange-traded preferred and common equities, and mutual funds included in the Level 1 category were based on quoted prices that are readily and regularly available in an active market. The fair value measurements that were based on Level 1 inputs comprise 7.0% of the fair value of the total investment portfolio.

Level 2 – Valuations that are based on observable inputs (other than Level 1 prices) such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly. The fair value of securities included in the Level 2 category were based on the market values obtained from a third party pricing service that were evaluated using pricing models that vary by asset class and incorporate available trade, bid and other observable market information. The third party pricing service monitors market indicators, as well as industry and economic events. The Level 2 category includes corporate bonds, government and agency bonds, asset-backed, residential mortgage-backed and commercial mortgage-backed securities and municipal bonds. The fair value measurements that were based on Level 2 inputs comprise 92.8% of the fair value of the total investment portfolio.

Level 3 – Valuations that are derived from techniques in which one or more of the significant inputs are unobservable and/or involve management judgment and/or are based on non-binding broker quotes. The fair value measurements that were based on Level 3 inputs comprise 0.2% of the fair value of the total investment portfolio.

For corporate, government and municipal bonds, the third party pricing service utilizes a pricing model with standard inputs that include benchmark yields, reported trades, issuer spreads, two-sided markets, benchmark securities, market bids/offers, and other reference data observable in the marketplace. The model uses the option adjusted spread methodology and is a multi-dimensional relational model. All bonds valued under these techniques are classified as Level 2.

For asset-backed, residential mortgage-backed and commercial mortgage-backed securities, the third party pricing service valuation methodology includes consideration of interest rate movements, new issue data, monthly remittance reports and other pertinent data that is observable in the marketplace. This information is used to determine the cash flows for each tranche and identifies the inputs to be used such as benchmark yields, prepayment assumptions and collateral performance. All asset-backed, residential mortgage-backed and commercial mortgage-backed securities valued under these methods are classified as Level 2.

Also included in Level 2 valuation are interest rate swap agreements the Company utilizes to hedge the floating interest rate on its debt, thereby changing the variable rate exposure to a fixed rate exposure for interest on these obligations. The estimated fair value of the interest rate swaps is obtained from the third party financial institution counterparties and measured using discounted cash flow analysis that incorporates significant observable inputs,

including the LIBOR forward curve, derivative counterparty spreads, and measurements of volatility.

The Level 3 securities consist of 15 securities totaling \$3.3 million or 0.2% of the total investment portfolio. These primarily represent asset-backed securities and corporate debt securities that have a principal protection feature supported by a U.S. Treasury strip. To fair value all 15 of these securities, the third party investment manager used benchmarking techniques based upon industry sector, rating and other factors.

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Also included in Level 3 valuation, are the conversion feature within the Notes (as defined in Note 6) and the convertible senior notes hedge. The estimated fair values of the both the conversion feature and the convertible senior notes hedge are obtained from the third party financial institution counterparties valued using non-binding broker quotations and significant unobservable inputs.

The following table presents the Company's assets and liabilities measured at fair value on a recurring basis, classified by the valuation hierarchy as of December 31, 2014 (in thousands):

	December 31, 2014 Total	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Debt Securities:</b>				
U.S. Government and agencies	\$ 23,331	\$ —	\$ 23,331	\$ —
Obligations of states and political subs	718,921	—	718,921	—
Corporate securities	581,017	—	579,847	1,170
Residential mortgage-backed securities	101,320	—	101,320	—
Commercial mortgage-backed securities	19,824	—	19,824	—
Other asset-backed securities	19,963	—	17,845	2,118
Total debt securities available for sale	1,464,376	—	1,461,088	3,288
<b>Equity Securities:</b>				
Common stock	110,614	110,614	—	—
Total equity securities available for sale	110,614	110,614	—	—
Total securities available for sale	\$ 1,574,990	\$ 110,614	\$ 1,461,088	\$ 3,288
<b>Derivatives:</b>				
Derivatives - interest rate swaps	\$ (1,158 )	\$ —	\$ (1,158 )	\$ —
Cash conversion feature of cash convertible notes	(16,571 )	—	—	(16,571 )
Purchased cash convertible note hedge	16,571	—	—	16,571
Total derivatives	\$ (1,158 )	\$ —	\$ (1,158 )	\$ —
Total securities available for sale and derivatives	\$ 1,573,832	\$ 110,614	\$ 1,459,930	\$ 3,288

The following table presents changes in Level 3 available for sale investments measured at fair value on a recurring basis as of December 31, 2014 (in thousands):

**Fair Value Measurement Using Significant  
Unobservable Inputs - Level 3  
Total**

	<b>Commercial mortgage-backed and Other asset- backed securities</b>	<b>Corporate securities</b>	
Balance as of January 1, 2013	\$ 4,303	\$ 1,141	\$ 5,444
Total gains or losses (realized/unrealized):			
Included in earnings	711	55	766
Included in other comprehensive income	(290 )	(229 )	(519 )
Purchases	—		
Issuances	—		
Settlements	(2,116 )	(78 )	(2,194 )
Transfers in and out of Level 3	—	—	—
Balance as of December 31, 2013	\$ 2,608	\$ 889	\$ 3,497

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	<b>Fair Value Measurement Using Significant Unobservable Inputs - Level 3</b>		
	<b>Commercial mortgage-backed and Other asset- backed securities</b>	<b>Corporate securities</b>	<b>Total</b>
Total gains or losses (realized/unrealized):			
Included in earnings	373	32	405
Included in other comprehensive income	(197 )	250	53
Purchases	—		
Issuances	—		
Settlements	(667 )	—	(667 )
Transfers in and out of Level 3	—	—	—
Balance as of December 31, 2014	\$ 2,117	\$ 1,171	\$ 3,288

There were no credit related losses for the period included in earnings attributable to the change in unrealized losses on Level 3 assets still held at the reporting date.

The Company's policy on recognizing transfers between hierarchy levels is applied at the end of a reporting period. During the year ended December 31, 2014, there were no transfers between Levels 1, 2 and 3.

**4. LIABILITY FOR LOSSES AND LOSS ADJUSTMENT EXPENSES**

The Company regularly updates its reserve estimates as new information becomes available and further events occur that may impact the resolution of unsettled claims. Changes in prior reserve estimates are reflected in results of operations in the year such changes are determined to be needed and recorded. Activity in the reserves for ultimate losses and loss adjustment expenses is summarized as follows (in thousands):

	<b>For the Years Ended December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
Balance, beginning of year	\$ 1,616,521	\$ 1,455,980	\$ 1,194,977
Less reinsurance recoverables	505,431	381,905	315,884
Total Beginning Reserves	1,111,090	1,074,075	879,093
Incurred related to:			
Current year	422,549	480,637	592,169
Prior years	(1,741 )	68,400	85,515
Total Incurred	420,808	549,037	677,684
Paid related to:			
Current year	94,907	115,542	