MGA INSURANCE COMPANY, INC.

Statutory Financial Statements and Supplemental Schedules

December 31, 2012 and 2011

(With Independent Auditor's Report Thereon)

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Independent Auditor's Report

The Board of Directors and Shareholders
MGA Insurance Company, Inc.
Dallas, Texas

We have audited the accompanying statutory basis financial statements of MGA Insurance Company, Inc., which comprise the statements of admitted assets, liabilities and capital and surplus as of December 31, 2012 and 2011, and the related statements of operations, capital and surplus, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these statutory basis financial statements in accordance with the accounting practices prescribed or permitted by the Texas Department of Insurance. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these statutory basis financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the statutory basis financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 1, the statutory basis financial statements are prepared in accordance with accounting practices prescribed or permitted by the Texas Department of Insurance, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

The effects on the accompanying financial statements of the variances between such practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matters described in the "Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles" paragraph, the statutory basis financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of MGA Insurance Company, Inc. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended.

Opinion on Regulatory Basis of Accounting

In our opinion, the statutory basis financial statements referred to above present fairly, in all material respects, the financial position of MGA Insurance Company, Inc. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting practices prescribed or permitted by the Texas Department of Insurance as described in Note 1.

Restriction of Use

This report is intended solely for the information and use of the Board of Directors and management of MGA Insurance Company, Inc. and for filing with the Texas Department of Insurance, and is not intended to be and should not be used by anyone other than these specific parties.

BDO USA, LLP

Dallas, Texas
May 29, 2013

MGA INSURANCE COMPANY, INC.

Statutory Statements of Admitted Assets,
Liabilities and Capital and Surplus

December 31, 2012 and 2011

(Amounts in thousands, except share amounts)

		2012	2011
Admitted Assets			
Invested Assets:			
Bonds, at amortized cost (fair value: $146,666 – 2012, $137,728 – 2011)	$	145,503	137,739
Bonds, at lower of amortized cost or fair value		7,093	8,154
Preferred stocks, at amortized cost (fair value: $1,014 – 2012) $1,036 – 2011)		1,000	1,000
Preferred stocks, at lower of amortized cost or fair value		497	-
Certificates of deposit, at cost (which approximates fair value)		100	185
Investment in subsidiary		1	1
Other long-term investment, at equity method (which approximates fair value)		2,692	179
Short-term investments, at cost (fair value: $32,066 – 2012, $28,709 – 2011)		32,068	28,726
Cash overdraft		(9,016)	(6,099)
Total invested assets		179,938	169,885
Accrued investment income		1,664	1,584
Premiums receivable		33,086	49,332
Property and equipment (net of accumulated depreciation and amortization: $7,781 – 2012, $0 – 2011)		2,082	-
Receivable from affiliates		1,883	-
Current federal income taxes receivable		18	-
Net deferred tax asset		3,072	3,102
Other assets		119	448
Total admitted assets	$	221,862	224,351

(Continued)

MGA INSURANCE COMPANY, INC.

Statutory Statements of Admitted Assets,
Liabilities and Capital and Surplus

December 31, 2012 and 2011

(Amounts in thousands, except share amounts)

		2012	2011
Liabilities and Capital and Surplus			
Liabilities:			
Unpaid losses and loss adjustment expenses	$	78,744	75,590
Unearned premiums		44,923	43,042
Accounts payable		2,657	1,445
Taxes, licenses and fees		1,067	1,039
Payable to affiliates		1,459	663
Commissions payable		429	492
Current federal income taxes payable		-	44
Other liabilities		817	1,352
Total liabilities		130,096	123,667
Commitments and contingencies (notes 4 and 13)			
Capital and Surplus:			
Common capital stock ($1.00 par value, 12,000,000 shares authorized, 12,000,000 shares issued and 6,000,000 shares outstanding at December 31, 2012 and 2011)		12,000	12,000
Paid-in and contributed surplus		83,894	83,894
Special surplus from retroactive reinsurance		-	17
Unassigned surplus		1,872	10,773
Treasury stock, at cost (6,000,000 shares at December 31, 2012 and 2011)		(6,000)	(6,000)
Total capital and surplus		91,766	100,684
Total liabilities and capital and surplus	$	221,862	224,351

See accompanying notes to statutory-basis financial statements.

MGA INSURANCE COMPANY, INC.

Statutory Statements of Operations

Years ended December 31, 2012 and 2011

(Amounts in thousands)

		2012	2011
Underwriting gain (loss):			
Net premiums written	$	187,797	172,108
Change in unearned premiums		(1,881)	(3,321)
Premiums earned		185,916	168,787
Net losses and loss adjustment expenses incurred		145,876	121,563
Commissions and other underwriting expenses incurred		46,192	45,554
Expenses incurred		192,068	167,117
Underwriting (loss) gain		(6,152)	1,670
Investment income:			
Net investment income earned		4,775	4,607
Net realized capital gains on investments		1,902	312
Net investment income		6,677	4,919
Other (expense) income:			
Miscellaneous (expense) income		(27)	838
Total other (expense) income		(27)	838
Income from operations before federal income taxes		498	7,427
Federal income tax (benefit) expense		(18)	110
Net income	$	516	7,317

See accompanying notes to statutory-basis financial statements.

MGA INSURANCE COMPANY, INC.

Statutory Statements of Changes in Capital and Surplus

Years ended December 31, 2012 and 2011

(Amounts in thousands)

		2012	2011
Common capital stock:			
Balance at beginning and end of year	$	12,000	12,000
Paid-in and contributed surplus:			
Balance at beginning and end of year		83,894	83,894
Special surplus from retroactive reinsurance:			
Balance at beginning of year		17	17
Change in special surplus from retroactive reinsurance		(17)	-
Balance at end of year		-	17
Unassigned surplus:			
Balance at beginning of year		10,773	9,181
Net income		516	7,317
Change in non-admitted assets		15,937	3,662
Change in net deferred income tax		(16,042)	(3,024)
Dividends to stockholders		(10,068)	(6,000)
Change in net unrealized gains (losses)		739	(364)
Other		17	1
Balance at end of year		1,872	10,773
Treasury stock:			
Balance at beginning and end of year		(6,000)	(6,000)
Total capital and surplus at end of year	$	91,766	100,684

See accompanying notes to statutory-basis financial statements.

MGA INSURANCE COMPANY, INC.

Statutory Statements of Cash Flow

Years ended December 31, 2012 and 2011

(Amounts in thousands)

		2012	2011
Cash from operations:			
Premiums collected net of reinsurance	$	204,043	163,328
Net investment income		6,865	6,524
Miscellaneous income		96	626
Total		211,004	170,478
Benefit and loss related payments		(105,926)	(86,589)
Commissions, expenses paid and aggregate write-ins for deductions		(81,918)	(70,207)
Federal income taxes paid		(45)	(86)
Total		(187,889)	(156,882)
Net cash provided by operations		23,115	13,596
Cash from investments:			
Proceeds from investments sold, matured, or repaid:			
Bonds		90,631	72,183
Stocks		1,121	1,632
Other long-term investments		-	366
Net gains on short-term investments		12	12
Miscellaneous proceeds		222	-
Total investment proceeds		91,986	74,193
Cost of investments acquired:			
Bonds		(96,612)	(85,761)
Stocks		(1,500)	(1,000)
Other long-term investments		(2,533)	-
Miscellaneous applications		-	(184)
Total investments acquired		(100,645)	(86,945)
Net cash used in investments		(8,659)	(12,752)
Cash from financing and miscellaneous sources:			
Cash (applied) provided			
Dividends to stockholders		(10,068)	(6,000)
Other (applications) provisions		(4,048)	260
Net cash used in financing and miscellaneous sources		(14,116)	(5,740)
Net increase (decrease) in cash, certificates of deposit and short-term investments		340	(4,896)
Cash, certificates of deposit and short-term investments, beginning of year		22,812	27,708
Cash, certificates of deposit and short-term investments, end of year	$	23,152	22,812

See accompanying notes to statutory-basis financial statements.

(1) Background and Summary of Significant Accounting Policies

(a) Basis of Presentation

MGA Insurance Company, Inc. (the "Company"), an insurance company domiciled in the State of Texas, owns 100% of MGA Agency, Inc. ("MGAA"). The Company is wholly-owned by GAINSCO, INC. ("Parent Company" or "GAINSCO"). GAINSCO is a Texas incorporated public holding company.

The accompanying statutory financial statements have been prepared in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance ("SAP"). The State of Texas requires that insurance companies domiciled in Texas prepare their statutory basis financial statements in accordance with the codified National Association of Insurance Commissioners' ("NAIC") Accounting Practices and Procedures Manual ("NAIC SAP") subject to any deviations prescribed or permitted by the Texas Insurance Commissioner. There are no material differences between the accounting practices prescribed or permitted by SAP and NAIC SAP as of and for the years ended December 31, 2012 and 2011, except as disclosed in Note 5.

The preparation of these financial statements 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. Actual results could differ from those estimates.

SAP varies in some respects from accounting principles generally accepted in the United States ("GAAP"). The significant differences between SAP and GAAP are as follows:

<u>Investment Securities</u>

- Investments are not classified into held-to-maturity, trading or available-for-sale categories.
- Investments in debt securities are carried at amortized cost; for GAAP, held-to-maturity investments would be reported at amortized cost, and the remaining fixed maturity investments would be reported at fair value with unrealized holding gains and losses reported in operations for those designated as trading and as a separate component of shareholder's equity for those designated as available-for-sale.
- Investment grade bonds not backed by other assets are stated at amortized cost. Non-investment grade bonds and asset backed securities with an NAIC designation of 3 through 6 are stated at the lower of amortized costs or fair value. Investment grade asset backed securities, excluding residential mortgage backed securities, are stated at amortized cost. Residential mortgage-backed securities are valued using a matrix of values provided by the NAIC, which are compared to amortized cost to determine the carrying value and NAIC designation.

- Investment grade perpetual preferred stocks are stated at fair value. Non-investment grade preferred stocks are stated at the lower of amortized cost or fair value. Common stocks are stated at fair value.

Negative Cash Balances

- Negative cash balances are recorded as a reduction to assets and not as a liability.

Allowance for Doubtful Accounts

- No allowance for agents' or premium balances determined to be unrecoverable is required for statutory accounting practices, rather these amounts are charged off and expensed through the statements of operations upon determination of unrecoverability.

Deferred Policy Acquisition Costs

- The costs related to acquiring business such as commissions, premium taxes, and other items are charged to expense in the year incurred and are not amortized over the periods benefited, whereas the related premiums are taken into operations on a pro rata basis over the periods covered by the policies.
- Ceding commission is deferred and taken into income on a pro rata basis over the period covered by the policies only to the extent that the ceding commission exceeds the acquisition costs related to those policies.

Reinsurance Ceded Reserves

- Reinsurance ceded reserves are recorded as a reduction of reserves rather than as an asset.

Retroactive Reinsurance Gains

- Retroactive reinsurance gains are recognized into income immediately and segregated in surplus as Special surplus from retroactive reinsurance and not deferred, and amortized over the period that the reinsurance is recovered.

Deferred Income Taxes

- Deferred tax assets are admitted in an amount equal to the sum of (1) the amount of federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, plus (2) the lesser of the remaining gross deferred tax assets expected to be realized within three years of the balance sheet date or 15% of capital and surplus excluding any net deferred tax assets, plus (3) the amount or remaining gross deferred tax assets that can be offset against existing gross deferred tax liabilities. Any non-admitted deferred tax assets are recorded directly to surplus.

<u>Tax Contingency Reserves</u>

- In determining the need for tax contingency reserves, consideration is given to whether it is probable that specific uncertain tax benefits will be realized. GAAP requires that a more-likely-than-not standard be used, and then subjects the tax benefits to an additional quantitative measurement step and qualitative analysis.

<u>Admitted and Non-admitted Assets</u>

- Admitted assets are those recognized and accepted by state insurance departments in measuring the solvency of an insurer for statutory accounting purposes. Non-admitted do not contribute to the insurer's solvency. The statutory financial statements only present admitted assets on the balance sheet. Non-admitted assets are recorded by a charge to surplus.

<u>Policy Fees</u>

- Policy fees can be recognized into income immediately as they are written and not deferred, and earned on a pro rata basis over the period the Company is at risk under the related policy.

<u>Statement of Comprehensive Income (Loss)</u>

- The statement of comprehensive income (loss) is not required for statutory accounting practices.

<u>Statement of Cash Flow</u>

- The statement of cash flow is presented as prescribed by statutory accounting practices.

For further information on the differences between statutory reporting and GAAP reporting refer to Note 11 in tabular format for the reconciliation between statutory capital and surplus and GAAP shareholders' equity and statutory net income and GAAP net (loss) income.

(b) Nature of Operations

The Company's nonstandard personal auto products are primarily aligned with customers seeking to purchase basic coverage and limits of liability required by statutory requirements, or slightly higher. Our products include coverage for third party liability, for bodily injury and physical damage, as well as collision and comprehensive coverage for theft, physical damage and other perils for an insured's vehicle. Within this context, we offer our products to a wide range of customers who present varying degrees of potential risk to the Company, and we strive to price our product to reflect this range of risk accordingly, in order to earn an underwriting profit. Simultaneously, when actuarially prudent, we attempt to position our product price to be competitive with other companies offering similar products to optimize our likelihood of securing our targeted customers. We offer flexible premium down payment, installment payment, late payment, and policy reinstatement plans that we believe help us secure new customers and retain existing customers, while generating an additional source of income from fees that we charge for those services. We primarily write six-month policies in Arizona, Florida, Nevada, New Mexico and Texas, with one year policies in California and both six month and one year policies in Georgia and South Carolina. The terms of policies we are permitted to offer varies in the states in which we operate.

(c) Investments

Investments are valued in accordance with the laws of the State of Texas and the valuations prescribed by the Securities Valuation Office ("SVO") of the NAIC. Investment grade bonds not backed by other assets are stated at amortized cost using the interest method. Non-investment grade bonds, asset-backed and loan-backed securities with NAIC designations of 3 through 6 are stated at the lower of amortized costs or fair value. Investment grade loan backed securities, excluding residential mortgage backed securities, are stated at amortized cost. The prospective adjustment method is used to value all such securities. In order to value residential mortgage-backed securities, the Company followed the procedures established by the NAIC Modeling Process, which involves utilizing a matrix of values provided by the NAIC, which are compared to amortized cost to determine the carrying value and NAIC designation. The Company does not own any mortgage loans or reverse mortgages. The Company owns no derivatives. Investment grade redeemable preferred stocks are stated at amortized cost. Non-investment grade preferred stocks are stated at the lower of amortized cost or fair value. Common stocks, other than investments in stocks of subsidiaries, are stated at fair value. Other long-term investments in partnerships or limited liability companies are recorded under the equity method, which approximates fair value. The Company has no investments in joint ventures. Short-term investments, including money market funds, are stated at cost. Other investments with remaining maturities of one year or less at the time of acquisition are stated at amortized cost. Premiums and discounts on loan-backed and asset-backed securities are amortized over a period based on estimated future principal payments, including prepayments. Prepayment assumptions are reviewed periodically and adjusted to reflect actual prepayments and changes in expectations. The most significant determinants of prepayments are the difference between interest rates on the underlying mortgages, or underlying securities, and the current mortgage loan rates and the structure of the security. Other factors affecting prepayments include the size, type and age of underlying mortgages, the geographic location of the mortgaged properties, the credit worthiness of the borrowers and current loan to value ratios. Variations from anticipated prepayments affect the life and yield of these securities.

Investment securities are exposed to a number of factors, including general economic and business environment, changes in the credit quality of the issuer of the fixed income securities, changes in market conditions or disruptions in particular markets, changes in interest rates, or regulatory changes. Fair values of securities fluctuate based on the magnitude of changing market conditions. Our securities are issued by domestic entities and are backed either by collateral or the credit of the underlying issuer. Factors such as an economic downturn, disruptions in the credit markets, a regulatory change pertaining to the issuer’s industry, deterioration in the cash flows or the quality of assets of the issuer, or a change in the issuer’s marketplace may adversely affect our ability to collect principal and interest from the issuer. Both equity and fixed income securities have been affected over the past several years, and may be affected in the future, by significant external events. Credit rating downgrades, defaults, and impairments may result in write-downs in the value of the investment securities held by the Company. The Company regularly monitors its portfolio for pricing changes, which might indicate potential impairments, and performs reviews of securities with unrealized losses. In such cases, changes in fair value are evaluated to determine the extent to which such changes are attributable to (i) fundamental factors specific to the issuer, such as financial conditions, business prospects or other factors, or (ii) market-related factors, such as interest rates.

For fixed maturity securities that are other-than-temporarily impaired, the Company assesses its intent to sell and the likelihood that we will be required to sell the security before recovery of its amortized cost. If a fixed maturity security is considered other-than-temporarily impaired, but the Company does not intend to and is not more than likely to be required to sell the security prior to its recovery to amortized cost, the amount of the impairment is separated into a credit loss component and the amount due to all other factors. The credit loss component of an impairment charge on a fixed maturity security is determined by the excess of the amortized cost over the present value of the expected cash flows. The present value is determined using the best estimate of cash flows discounted at (1) the effective interest rate implicit at the date of acquisition for non-structured securities or (2) the book yield for structured securities. The techniques and assumptions for determining the best estimate of cash flows varies depending on the type of security. The credit loss component of an impairment charge is recognized in net earnings.

Accrued investment income is the interest earned on securities which has been recognized in the results of operations, but the cash has not been received from the various security issuers. This accrual is based on the terms of each of the various securities and uses the 'effective interest method' for amortizing the premium and accruing the discount. Realized gains (losses) on securities are computed based upon the "specific identification" method on trade date and include write downs on securities considered to have other than temporary declines in fair value. Dividends on preferred stock are recorded as investment income on the ex-dividend date with a corresponding receivable to be extinguished upon receipt of cash.

(d) Premium Revenues and Premium Receivables

Premiums are recognized as earned on a pro rata basis over the period the Company is at risk under the related policy. Unearned premiums represent the portion of premiums written which are applicable to the unexpired terms of policies in force. Premiums receivable consist of balances owed for coverages written with the Company.

(e) Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated using the straight-line method over the estimated useful lives of the respective assets (primarily three years for furniture and equipment). Computer software costs relating to programs for internal use are recorded in property and equipment and are amortized using the straight-line method over three years or the estimated useful life, whichever is longer.

Costs associated with software developed or purchased for internal use are capitalized based on Statements of Statutory Accounting and Principles ("SSAP") 16R and other related guidance. Capitalized costs include external direct costs of materials and services consumed in developing or obtaining internal-use software and payroll for employees directly associated with, and who devote time to, the development of the internal-use software. Costs incurred in development and enhancement of software that do not meet the capitalization criteria, such as costs of activities performed during the preliminary and post-implementation stages, are expensed as incurred. The critical estimate related to this process is the determination of the amount of time devoted by employees to specific stages of internal-use software development projects. The Company reviews any impairment of the capitalized costs on a periodic basis. The Company amortizes such costs over the estimated useful life of the software, which is three years once the software has been placed in service.

(f) Commissions

Commission expenses and other acquisition costs are charged to expense as incurred.

(g) Losses and Loss Adjustment Expenses

An insurance company generally makes claim payments as a result of accidents involving the risks insured under the insurance policies it issues. Months and sometimes years may elapse between the occurrence of an accident, reporting of the accident to the insurer and payment of the claim. Insurers record a liability for estimates of claims that will be paid for accidents reported to them, which are referred to as “case reserves.” In addition, since accidents are not always reported promptly upon occurrence and because the assessment of existing known claims may change over time with the development of new facts, circumstances and conditions, insurers estimate liabilities for such items, which are referred to as incurred but not reported (“IBNR”) reserves.

We maintain reserves for the payment of losses and loss adjustment expenses for both case and IBNR under policies written by the Company. These claims reserves are estimates, at a given point in time, of amounts that we expect to pay on incurred claims based on facts and circumstances then known. The amount of case claims reserves is primarily based upon a case-by-case evaluation of the type of claim involved, the circumstances surrounding the claim, and the policy provisions relating to the type of claim. The amount of IBNR claims reserves is estimated on the basis of historical information and anticipated future conditions by lines of insurance and actuarial review. Reserves for claim adjustment expenses are intended to cover the ultimate costs of settling claims, including investigation and defense of lawsuits resulting from such claims. Inflation is implicitly reflected in the reserving process through analysis of cost trends and review of historical reserve results.

The process of establishing claims reserves is imprecise and reflects significant judgmental factors. In many liability cases, significant periods of time, ranging up to several years or more, may elapse between the occurrence of an insured claim and the settlement of the claim. The actual emergence of losses and loss adjustment expenses may vary, perhaps materially, from the Company's estimates thereof, because (a) estimates of liabilities are subject to large potential revisions, as the ultimate disposition of claims incurred prior to the financial statement date, whether reported or not, is subject to the outcome of events that have not yet occurred (e.g., jury decisions, court interpretations, legislative changes (even after coverage is written and reserves are initially set) that broaden liability and policy definitions and increase the severity of claims obligations, changes in the medical condition of claimants, public attitudes and social/economic conditions such as inflation), (b) estimates of claims do not make provision for extraordinary future emergence of new classes of claims or types of claims not sufficiently represented in the Company's historical data base or which are not yet quantifiable, and (c) estimates of future costs are subject to the inherent limitation on the ability to predict the aggregate course of future events.

In determining our reserve estimates for nonstandard personal automobile insurance, for each financial reporting date we record our best estimate, which is a point estimate, of our overall unpaid losses and loss adjustment expenses for both current and prior accident years. Because the underlying processes require the use of estimates and professional actuarial judgment, establishing claims reserves is an inherently uncertain process. As our experience develops and we learn new information, our quarterly reserving process may produce revisions to our previously reported claims reserves, which we refer to as "development" and such changes may be material. We recognize favorable development when we decrease our previous estimate of ultimate losses, which results in an increase in net income in the period recognized. We recognize unfavorable development when we increase our previous estimate of ultimate losses, which results in a decrease in net income in the period recognized. Accordingly, while we record our best estimate, our claims reserves are subject to potential variability.

(h) Income Taxes

The Company's Federal income tax return is consolidated with GAINSCO, which includes the Company, GAINSCO, INC., MGAA, GAINSCO Service Corp. ("GSC"), National Specialty Lines, Inc. ("NSL") and DLT Insurance Adjusters, Inc. ("DLT"). The method of allocation among companies is subject to a written 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. GAINSCO has a policy whereby each subsidiary will pay to or recover from GAINSCO the amount of Federal income taxes it would have incurred (or been entitled to recover) as if that entity were filing its own Federal income tax return. Intercompany tax recoverable or payable balances are settled as soon as is practicable after GAINSCO, INC. recovers from or pays taxes to the Internal Revenue Service.

Deferred income tax items are accounted for under the "asset and liability" method which provides for temporary differences between the reporting of earnings for financial statement purposes and for tax purposes, primarily the discount on unpaid losses and loss adjustment expenses, net operating loss carryforwards and the nondeductible portion of the change in unearned premiums. The Company has elected to admit deferred tax assets in an amount equal to the sum of (1) the amount of federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, plus (2) the lesser of the remaining gross deferred tax assets expected to be realized within three years of the balance sheet date or 15% of capital and surplus excluding any net deferred tax assets, plus (3) the amount of remaining gross deferred tax assets that can be offset against existing gross deferred tax liabilities. The remaining deferred tax assets are non-admitted. Deferred taxes do not include amounts for state taxes. Deferred Federal income tax expense or benefit is recorded directly to surplus. The current period election does not differ from the prior reporting period.

The Company recognized a current income tax (benefit) expense of ($18,000) and $110,000 during 2012 and 2011 for alternative minimum tax, respectively. This tax can be recouped in future years.

(i) Special Surplus from Retroactive Reinsurance

Special surplus from retroactive reinsurance shall be limited to the lesser of (i) the actual amount recovered in excess of consideration paid or (ii) the initial surplus gain resulting from the respective retroactive reinsurance agreement. Any remaining balance in the special surplus from retroactive reinsurance account derived from any such agreement shall be returned to unassigned (deficit) surplus upon elimination of all policy obligations subject to the retroactive reinsurance agreement. At December 31, 2011, the Company reported offsetting Retroactive reinsurance reserves ceded and Special surplus from retroactive reinsurance in the amount of $17,000 for amounts recovered under the retroactive reinsurance treaty. This balance represented the remainder of the retroactive reinsurance gain. The gain was recognized as unassigned funds when the reinsurance treaty was commuted in 2012.

(2) Investments

The following schedule summarizes the components of net investment income:

		Years ended December 31,	
		2012	2011
		(Amounts in thousands)	
Investment income on:			
Bonds, preferred stocks and certificates of deposit	$	4,887	4,758
Cash, cash equivalents and short-term investments		125	99
Other long-term investments		(21)	(17)
		4,991	4,840
Investment expenses		(216)	(233)
Net investment income	$	4,775	4,607

The fair value of Bonds, Preferred stocks, Certificates of deposit and Short-term investments were obtained from published valuation guides. These fair values do not differ materially from the fair values prescribed by the NAIC. The fair value of total Bonds, Preferred stocks, Certificates of deposit, Other long-term investments and Short-term investments, as prescribed by the NAIC, approximately totaled $190,235,000 and $175,822,000 at December 31, 2012 and 2011, respectively. The difference between the fair values presented below and the fair values prescribed by the NAIC differ by the non-investment grade valuations. At December 31, 2012, twelve securities totaling $1,598,000 were non-investment grade bonds, mortgage backed-securities and preferred stocks with NAIC designations of 3 through 6 and were stated at fair value. At December 31, 2011, thirteen securities totaling $2,684,000 were non-investment grade bonds, mortgage backed-securities and preferred stocks with NAIC designations of 3 through 6 and were stated at fair value.

SSAP No. 100 defines fair value as the exit price, which is the price that would be received to sell an asset or paid to transfer a liability in a transaction between market participants at the measurement date. The following schedule summarizes the amortized cost and fair values of investments in Bonds, Preferred stocks, Certificates of deposit securities, Other long-term investments and Short-term investments of which the carrying amounts differ from estimated fair value at December 31, 2012 and 2011:

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Amounts in thousands)			
U.S. Treasury	$ 6,350	284	-	6,634
U.S. Government agencies	4,466	64	-	4,530
Corporate bonds	124,259	1,400	(402)	125,257
Asset-backed	1,338	1	-	1,339
Mortgage-backed	8,990	57	(141)	8,906
Preferred stocks	1,000	14	-	1,014
Certificates of deposit	100	-	-	100
Other long-term investments	2,692	-	-	2,692
Short-term investments	32,068	6	(8)	32,066
Total Bonds, Preferred stocks, Certificates of deposit and Short-term investments	$ 181,263	1,826	(551)	182,538

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Amounts in thousands)			
U.S. Treasury	$ 8,226	266	-	8,492
U.S. Government agencies	2,714	73	-	2,787
Corporate bonds	116,473	1,233	(1,466)	116,240
Asset-backed	1,734	23	-	1,757
Mortgage-backed	8,592	90	(230)	8,452
Preferred stocks	1,000	36	-	1,036
Certificates of deposit	185	-	-	185
Other long-term investments	179	-	-	179
Short-term investments	28,726	3	(20)	28,709
Total Bonds, Preferred stocks, Certificates of deposit and Short-term investments	$ 167,829	1,724	(1,716)	167,837

The following schedule summarizes the gross unrealized losses showing the length of time that investments have been continuously in an unrealized loss position as of December 31, 2012 and 2011:

	December 31, 2012					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Amounts in thousands)					
Corporate bonds	$ 35,171	398	2,183	4	37,354	402
Asset-backed	744	-	-	-	744	-
Mortgage-backed	2,367	73	1,948	68	4,315	141
Short-term investments	11,185	8	-	-	11,185	8
Total investments	$ 49,467	479	4,131	72	53,598	551

	December 31, 2011					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Amounts in thousands)					
Corporate bonds	$ 39,464	1,330	11,202	136	50,666	1,466
Asset-backed	441	-	-	-	441	-
Mortgage-backed	4,016	36	470	194	4,486	230
Short-term investments	11,953	20	-	-	11,953	20
Total investments	$ 55,874	1,386	11,672	330	67,546	1,716

The gross unrealized losses, shown in the above tables, totaling $72,000 and $330,000 as of December 31, 2012 and 2011, respectively, relate to 6 and 14 individual securities, respectively, that had been in an unrealized loss position for 12 months or more as of such dates. At December 31, 2012 and 2011, approximately 77% and 85% of the unrealized gross losses were with issuers with a NAIC designation of 1 and 2, respectively. The decline in the market value is primarily related to the disruption and lack of liquidity in the markets in which these securities trade, along with credit risk aversion by investors. Other important factors include (i) the slowing of prepayments in mortgage and asset backed securities and (ii) the significant decline in the 3 month London Interbank Offered Rate for U.S. dollar deposits ("LIBOR") for securities with floating rate coupons since the purchase of these assets. At this time based upon information currently available, the Company has the ability and it is the Company's intent to hold the security until it fully recovers the principal, which could require the Company to hold these securities until their maturity; therefore, the Company considers the impairment to be temporary.

In order to determine whether it is appropriate in an accounting period to recognize other than temporary impairment ("OTTI") with respect to a portfolio security which has experienced a decline in fair value and as to which the Company has the ability and intent to hold the security until it fully recovers the principal, the Company considers all available evidence and applies judgment. With corporate debt issues, firm specific performance, industry trends, legislative and regulatory changes, government initiatives, and the macroeconomic environment all play a role in the evaluation process. With respect to asset backed securities (including mortgage backed securities), the Company uses individual cash flow modeling in addition to other available information. In the case of securities as to which the Company has the ability and intent to fully recover principal, if all scheduled principal and interest is expected to be received on a timely basis using the current best estimates of material inputs, such as default frequencies, severities, and prepayment speeds, generally no OTTI would be recognized unless other factors suggest that it would be appropriate to do so. The principal factors that the Company considers in this analysis are the extent to which the fair value of the security has declined, the ratings given to the security by recognized rating agencies, trends in those ratings, and information available to the Company from securities analysts and other commentators, public reports and other credible information.

The Company currently has one security backed directly by subprime loans and it has a NAIC designation of 5FM. The book adjusted carrying value of this security was $370,000 at December 31, 2012 and $377,000 at December 31, 2011.

Included in the Company's fixed income portfolio, are hybrid securities with a carrying value of $12,124,000 and fair value of $12,200,000 at December 31, 2012, and carrying value of $19,136,000 and fair value of $18,592,000 at December 31, 2011. A hybrid security as used here is one where the issuer of the debt instrument can choose to defer payment of the regularly scheduled interest due for a contractually set maximum period of time, usually five to ten years, without being in technical default on the issue.

One security, with carrying value and fair value of $847,000, at December 31, 2012, and a carrying and a fair value of $774,000 at December 31, 2011, is dependent on the continued claims paying ability of its financial guarantor (MBIA) in order for the Company not to sustain any loss of principal or interest. MBIA has a NAIC designation of 5FM. We believe that the probable outcome is that principal and interest will be paid in full and, accordingly, the impairment on that security is considered temporary.

Preferred stocks predominately consist of auction preferred instruments which are each issued by a trust that holds the preferred stock of a corporation, which are exchange traded. The Company has the option at stated intervals to redeem the auction preferred shares for a pro rata share of the underlying collateral. As of December 31, 2012, we have not chosen this option as the structure of the trust provides a higher coupon on the auction preferred shares than on the underlying collateral shares; and therefore, are of greater economic value. As of December 31, 2012, we do not believe that these underlying shares are other-than-temporarily impaired based on the credit review of the issuers.

Investments in partnerships or limited liability companies are stated at the underlying GAAP equity value. The Company has classified these investments as Other long-term investment. In 2009, the general partners of the limited partnership the Company invested in elected to commence dissolution and wind up the partnership's affairs allowing for liquidation of the partnership's assets.

When a security has an unrealized loss in fair value that is deemed to be other than temporary, the Company reduces the carrying value of the security to its current market value, recognizing the decline as a realized loss in the statement of operations. These determinations primarily reflect the market-related issues associated with the disruption in the mortgage and other credit markets, which created a significant deterioration in both the valuation of the securities as well as our view of future recoverability of the valuation decline.

Proceeds from the sale of securities for the years ended December 31, 2012 and 2011 are presented in the following table:

		Years ended December 31,	
		2012	2011
		(Amounts in thousands)	
Proceeds:			
Bonds, sales	$	46,558	27,244
Bonds, principal pay downs	$	15,568	22,309
Bonds, maturities	$	28,505	22,630
Preferred stocks	$	1,122	1,632

		Years ended December 31,	
		2012	2011
		(Amounts in thousands)	
Realized gains:			
Bonds	$	2,308	634
Preferred stocks		121	230
Short-term investments		12	12
Total realized gains		2,441	876
Realized losses:			
Bonds		(254)	(439)
Preferred stocks		-	(73)
Total realized losses		(254)	(512)
Other-than-temporary impairment losses		(285)	(52)
Total realized investment gains, net	$	1,902	312

During 2012 and 2011, the Company wrote down $285,000 and $52,000 in securities that were determined to have had an other-than-temporary credit related impairment charge.

The amortized cost and fair value of Bonds, Preferred stocks and Certificates of deposit at December 31, 2012 by maturity are shown below.

		2012	
		Amortized Cost	Fair Value
		(Amounts in thousands)	
Due in one year or less	$	27,337	27,477
Due after one year through five years		76,715	77,543
Due after five years through ten years		10,334	10,354
Due after ten year through twenty years		2,502	2,539
Beyond twenty years		18,288	18,608
Asset-back securities		1,338	1,339
Mortgage backed securities		8,990	8,905
Total Bonds, Preferred stocks and Certificates of deposit	$	145,504	146,765

Maturities subject to early or unscheduled prepayments have been included based upon their contractual maturity dates. Actual maturity dates may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Investments with a statement value of $4,960,000 and $4,828,000 as of December 31, 2012 and 2011, respectively, were on deposit with various regulatory bodies as required by law.

(3) Fair Value Measurements

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in SSAP No. 100. The framework is based on the inputs used in valuation, gives the highest priority to quoted prices in active markets and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the SSAP No. 100 hierarchy is based on whether the significant inputs into the valuation are observable. In determining the three-level hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions. The three levels of the hierarchy are as follows:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.

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

- Level 3 – Valuations based on models where significant inputs are not observable. The unobservable inputs reflect the Company's own estimates as to the assumptions that market participants would use.

<u>Valuation of Investments</u>

The Company receives pricing from independent pricing services, and these are compared to prices available from sources accessed through the Bloomberg Professional System. The number of available quotes varies depending on the security, generally we obtain one quote for Level 1 investments, one to three quotes for Level 2 investments and one to two quotes, if available, for Level 3 investments. If there is a material difference in the prices obtained, further evaluation is made. Market prices and valuations from sources such as the Bloomberg system, TRACE and dealer offerings are used as a check on the prices obtained from the independent pricing services. Should a material difference exist, then an internal valuation is made. For purposes of valuing these securities management produces expected cash flows for the security utilizing the standard mortgage security modeling capabilities available on the Bloomberg Professional System. The key inputs are the default rate, severity of default, and voluntary prepayment rate for the underlying mortgage collateral. These are generally based at the start on the actual historical values of these parameters for the prior three months. These cash flows are then discounted by a required yield derived from market based observations of broker inventory offerings, or in some cases Bloomberg Indices of like securities. Management uses this valuation model primarily with mortgage backed securities where the matrix pricing methodology used by the independent pricing service is too broad in its categorizations. This often involves differences in reasonable prepayment assumptions or significant differences in performance among issuers. In some cases, other external observable inputs such as credit default swap levels are used as input in the fair value analysis.

Fixed Maturities

For U. S. Treasury, U. S. government and corporate bonds, the independent pricing services obtain information on actual transactions from a large network of broker-dealers and determine a representative market price based on trading volume levels. For asset backed and mortgage backed instruments, the independent pricing services obtain information on actual transactions from a large network of broker-dealers and sorts the information into various components, such as asset type, rating, maturity, and spread to a benchmark such as the U.S. Treasury yield curve. These components are used to create a pricing matrix for similar instruments.

All broker-dealer quotations obtained are non-binding. For short-term investments classified as Level 1 and Level 2, the Company uses prices provided by independent pricing services.

The Company uses the following hierarchy for each instrument in total invested assets:

1. The Company obtains a price from an independent pricing service.

2. If no price is available from an independent pricing service for the instrument, the Company obtains a market price from a broker-dealer or other reliable source, such as Bloomberg.

3. The Company then validates the price obtained by evaluating its reasonableness. The Company's review process includes quantitative analysis (i.e., credit spreads and interest rate and prepayment fluctuations) and initial and ongoing evaluations of methodologies used by outside parties to calculate fair value and comparing the fair value estimates to its knowledge of the current market. If a price provided by a pricing service is considered to be materially different from the other indications that are obtained, the Company will make a determination of the proper fair value of the instrument based on data inputs available.

In order to determine the proper SSAP No. 100 classification for each instrument, the Company obtains from its independent pricing service the pricing procedures and inputs used to price the instrument. The Company analyzes this information, taking into account asset type, rating and liquidity, to determine what inputs are observable and unobservable in order to determine the proper SSAP No. 100 level. For those valued internally, a determination is made as to whether all relevant inputs are observable or unobservable in order to classify correctly.

All of the Company's Level 1 and Level 2 invested assets held at December 31, 2012 and 2011 were priced using either independent pricing services or available market prices to determine fair value. The Company classifies such instruments in active markets as Level 1 and those not in active markets as Level 2. The residential mortgage backed securities which are valued in the manner described above are all classified as Level 3. Those for which the individual pricing service value is used are classified as Level 2.

The quantitative disclosures about the fair value measurements for each major category of assets at December 31, 2012 and 2011 were as follows:

		December 31, 2012	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(Amounts in thousands)		
Assets:					
Corporate bonds	$	5,524	1,152	4,372	-
Mortgage backed		3,260	-	3,260	-
Total available-for-sale securities		8,784	1,152	7,632	-
Preferred stocks		497	497	-	-
Total preferred stock securities		497	497	-	-
Total assets classified by SSAP No. 100	$	9,281	1,649	7,632	-
Percentage of total		100%	18%	82%	0%

		December 31, 2011	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(Amounts in thousands)		
Assets:					
Corporate bonds	$	2,573	1,313	1,260	-
Mortgage backed		5,581	-	-	5,581
Total available-for-sale securities		8,154	1,313	1,260	5,581
Total assets classified by SSAP No. 100	$	8,154	1,313	1,260	5,581
Percentage of total		100%	16%	15%	69%

Level 1 includes exchange-traded securities. Level 2 securities are comprised of securities whose fair value was determined using observable market inputs. Investments classified as Level 3 are comprised of certain mortgage backed securities that values provided by an independent pricing service or quoted market prices were not used, many of which are not publicly traded or are not actively traded.

The following table provides a summary of changes in fair value associated with the Level 3 assets for the years ended December 31, 2012 and 2011:

		Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
		December 31,	
		2012	2011
		(Amounts in thousands)	
Beginning balance	$	5,581	8,136
Total gains or losses (realized/unrealized):			
Included in earnings (or changes in net assets)		-	(10)
Included in unassigned surplus		-	(2,045)
Purchases, issuances, and settlements		-	(500)
Transfers in and/or out of Level 3		(5,581)	-
Ending balance	$	-	5,581

The above table of Level 3 assets begins with the prior period balance and adjusts the balance for the gains or losses (realized and unrealized) that occurred during the current period. Any new purchases that are identified as Level 3 securities are then added and any sales of securities which were previously identified as Level 3 are subtracted. Next, any securities which were previously identified as Level 1 or Level 2 securities and which are currently identified as Level 3 are added. Finally, securities which were previously identified as Level 3 and which are now designated as Level 1 or as Level 2 are subtracted. The ending balance of the Level 3 securities presented above represent our best estimates and may not be substantiated by comparisons to independent markets and, in many cases, could not be realized in immediate settlement of the instruments.

The Company wrote down Alt-A securities (Level 2) for the year ended December 31, 2012 that were determined to have had an other-than-temporary credit related impairment charge. The Company wrote down Alt-A securities (Level 3) for the year ended December 31, 2011 that were determined to have had an other-than-temporary credit related impairment charge.

Securities transferred out of Level 3 in 2012 represent mortgage-backed securities with the Company previously valued internally. At present, fair values derived from an independent pricing service are utilized. Therefore, these securities were all transferred to Level 2. There were no transfers between Levels 1 and 2 during the periods presented.

(4) Reinsurance

(a) Unsecured Reinsurance Recoverables

The Company does not have an unsecured aggregate reinsurance recoverable for claims paid and unpaid, including incurred but not reported, loss adjustment expenses and unearned premium reserves that exceeds 3% of the Company's surplus as regards policyholders, as of December 31, 2012 or 2011.

(b) Assumed

The Company has, in the past, utilized reinsurance arrangements with various non-affiliated admitted insurance companies, whereby the Company underwrote the coverage and assumed the policies 100% from the companies. These arrangements required that the Company maintain escrow accounts to assure payment of the unearned premiums and unpaid losses and loss adjustment expenses relating to risks insured through such arrangements and assumed by the Company. As of December 31, 2012 and 2011, the balance held in trust in conjunction with reinsurance agreements totaled $2,516,000 and $3,653,000, respectively.

For 2012 and 2011, the premiums earned by assumption were $781,000 and $1,376,000, respectively, and the assumed unpaid losses and loss adjustment expenses were $1,548,000 and $2,449,000, respectively.

At December 31, 2012 and 2011, if all reinsurance were cancelled, there are no return commissions that would be due reinsurers with the return of the unearned premium reserve.

(c) Ceded

Runoff Lines

On February 7, 2002, the Company announced its decision to cease writing commercial, specialty and umbrella lines of insurance due to continued adverse claims development and unprofitable underwriting results, these lines became known as runoff lines. The Company has ceded unpaid losses and loss adjustment expenses of $900,000 at December 31, 2012.

Nonstandard Personal Auto Lines

In 2011, the Company maintained catastrophe reinsurance on its physical damage coverage for property claims of $14,000,000 in excess of $1,000,000 for a single catastrophe, as well as for aggregate catastrophes. For 2012, the Company maintains catastrophe reinsurance on its physical damage coverage for property claims of $14,000,000 in excess of $1,000,000 for a single catastrophe, as well as for aggregate catastrophes.

The amounts deducted in the financial statements for reinsurance ceded as of and for the years ended December 31, 2012 and 2011 were as follows:

		2012	2011
		(Amounts in thousands)	
Unpaid losses and loss adjustment expenses	$	19	27
Premiums written and earned	$	1,031	1,019
Losses and loss adjustment expenses incurred	$	3	-

The Company remains directly liable to their policyholders for all policy obligations and the reinsuring companies are obligated to the Company to the extent of the reinsured portion of the risks.

At December 31, 2012 and 2011, there are no return commissions due reinsurers if all reinsurance were canceled with the return of the unearned premium reserve.

There were no write-offs of any uncollectible reinsurance balances during the years ended December 31, 2012 and 2011.

The Company does not have any reinsurance recoverables in dispute for losses and loss adjustment expenses that exceed 5% of the Company's surplus as regards policyholders from an individual reinsurer or that exceed 10% of the Company's surplus as regards policyholders in the aggregate, as of December 31, 2012 or 2011.

(5) Property and Equipment

The following schedule summarizes the components of property and equipment as of December 31, 2012 (amounts in thousands):

		2012
Furniture	$	1,049
Equipment		2,707
Software		6,107
Accumulated depreciation and amortization		(7,781)
Property and equipment, net	$	2,082

Accounting practices prescribed or permitted by the Texas Department of Insurance allows furniture and equipment to be admitted whereas as NAIC SAP does not. The Company adopted this practice in 2012. The Company had followed the guidance as prescribed by NAIC SAP for 2011.

(6) Unpaid Losses and Loss Adjustment Expenses

The following table sets forth the changes in unpaid losses and loss adjustment expenses, net of reinsurance cessions, as shown in the Company's statutory financial statements for the periods indicated:

		As of and for the Years ended December 31, 2012	2011
		(Amounts in thousands)	
Net unpaid losses and loss adjustments expenses, beginning of period (net of reinsurance recoverables of $34 at January 1, 2012 and 2011, respectively)	$	75,590	65,480
Net losses and loss adjustment expenses incurred related to:			
Current period		136,342	122,243
Prior periods		9,534	(680)
Total net losses and loss adjustment expenses incurred		145,876	121,563
Net losses and loss adjustment expenses paid related to:			
Current period		85,848	70,028
Prior periods		56,874	41,425
Total net losses and loss adjustment expenses paid		142,722	111,453
Net unpaid loss and loss adjustment expenses, end of period (net of reinsurance recoverables of $9 and $34 as of December 31, 2012 and 2011, respectively)	$	78,744	75,590

The unfavorable development for prior periods net losses and loss adjustment expenses incurred in 2012 was primarily attributable to Florida personal injury protection litigation of $13.5 million. The favorable development for prior periods net losses and loss adjustment expense incurred in 2011 was primarily attributable to nonstandard personal auto lines in the Southwest region as a result of the difference in actual and expected claims frequency and severity associated with most of our coverages. As of December 31, 2012 and 2011, we believe that the unpaid losses and loss adjustment expenses and the reinsurance agreements in force are sufficient to support the future emergence of prior year losses and loss adjustment expenses in both our runoff lines and our nonstandard automobile line.

The following table presents the (unfavorable) favorable development in nonstandard personal auto for claims occurring in prior accident years for each region for the years ended December 31, 2012 and 2011:

		2012		2011
		(Amounts in thousands)		
Region:				
Southeast (Florida, Georgia and South Carolina)	$	(12,486)	$	(1,754)
Southwest (Arizona, California, New Mexico, Nevada and Texas)		3,038		2,195
Net (unfavorable) favorable development	$	(9,448)	$	441

Salvage and subrogation anticipated deducted from unpaid losses and loss adjustment expenses at December 31, 2012 and 2011 was $1,009,000 and $925,000, respectively.

(7) Federal Income Taxes

The following table presents the components of the net deferred tax assets and deferred tax liabilities at December 31, 2012 and 2011 and the changes in these balances:

		December 31,						
		2012				2011		
		(Amounts in thousands)						
		Ordinary	Capital	Total		Ordinary	Capital	Total
Gross deferred tax assets	$	19,911	884	20,795	$	18,711	1,133	19,844
Statutory valuation allowance		(16,540)	(831)	(17,371)		-	-	-
Total gross deferred tax assets		3,371	53	3,424		18,711	1,133	19,844
Total gross deferred tax liabilities		(299)	(53)	(352)		(347)	-	(347)
Net deferred tax asset				3,072				19,497
Deferred tax assets non-admitted				-				16,395
Net admitted deferred tax asset				3,072				3,102
Decrease in non-admitted deferred tax asset	$			(16,395)	$			(3,661)

The Company has not recognized a deferred tax liability for the undistributed earnings of its wholly-owned subsidiary that arose in 2012 and prior years because the Company does not expect those undistributed earnings to reverse and become taxable to the Company in the foreseeable future. A deferred tax liability will be recognized when the Company expects that it will recover those undistributed earnings in a taxable manner, such as through receipt of dividends or sale of the investment.

The components of current income taxes are presented in the following table:

		Years ended December 31,	
		2012	2011
		(Amounts in thousands)	
Federal income taxes incurred	$	18	110

Under SAP, deferred Federal income taxes are provided (through surplus) for temporary differences between the statutory accounting practices basis and tax basis of existing assets and liabilities with certain statutory limits on the amount of deferred tax assets that may be admitted. As a consequence, the portion of the tax expense, which is a result of the change in the deferred tax asset or liability, may not always be consistent with the income reported on the statutory statements of operations. The Company has evaluated its tax contingencies, and at December 31, 2012 and 2011, the Company does not have any uncertain tax positions.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

		December 31	
		2012	2011
		(Amounts in thousands)	
Deferred Tax Assets:			
Ordinary			
Net operating loss carryforward	$	14,330	13,598
Discounting of unearned premiums		3,055	2,927
Discounting of unpaid losses and loss adjustment expenses		1,303	1,372
Investments		884	1,132
Property and equipment		566	391
Non-admitted assets		546	-
AMT carryforward		111	424
Total deferred tax assets		20,795	19,844
Statutory valuation allowance		(17,371)	-
Non-admitted deferred tax assets		-	(16,395)
Admitted deferred tax assets		3,424	3,449
Deferred Tax Liabilities:			
Accretion of bond discount		345	339
Discounting of anticipated salvage and subrogation		7	8
Total deferred tax liabilities		352	347
Net admitted deferred tax asset	$	3,072	3,102

The change in net deferred income taxes reported in surplus before consideration of non-admitted assets is comprised of the following components:

		December 31,		
		2012	2011	Change
		(Amounts in thousands)		
Total gross deferred tax assets	$	3,424	19,844	(16,420)
Total gross deferred tax liabilities		(352)	(347)	(5)
Net deferred tax asset		3,072	19,497	(16,425)
Deferred tax change in net unrealized losses				383
Change in net deferred income tax				$ (16,042)

The provision for federal income taxes is different from that which would be obtained by applying the statutory Federal income tax rate to income before income taxes. The significant items giving rise to this difference are as follows:

		Years ended December 31,	
		2012	2011
		(Amounts in thousands)	
Provision computed at statutory rate of 34%	$	169	2,525
Utilization of NOL carryforwards		(172)	(2,090)
Change in net deferred tax asset		186	2,837
Other, net		(15)	(138)
Total statutory income tax expense	$	168	3,134
Federal income taxes incurred	$	(18)	110
Change in net deferred income tax		186	3,024
Total statutory income tax expense	$	168	3,134

As a result of losses in prior years, as of December 31, 2012, the Company has net operating loss carryforwards for tax purposes aggregating $42,148,000. These net operating loss carryforwards of $22,167,000, $9,369,000, $130,000 and $10,482,000, if not utilized, will expire in 2021, 2022, 2023 and 2027, respectively. As of December 31, 2011, the tax benefit of the net operating loss carryforwards was $14,330,000, which is calculated by applying the Federal statutory income tax rate of 34% against the net operating loss carryforwards of $42,148,000. The Company incurred no Federal income taxes that are available for recoupment in the event of future net losses but did incur Federal Alternative Minimum Tax (“AMT”) which will be recoverable in future taxable years of $111,000.

(8) Capital and Surplus

Authorized capital stock consisted of 12,000,000 shares of $1.00 par value common stock authorized and issued, of which 6,000,000 shares were outstanding and 6,000,000 shares were in treasury as of December 31, 2012 and 2011.

The Company had special surplus funds in the amount of $17,000 at December 31, 2011 due to a retroactive reinsurance gain recorded under a reserve reinsurance cover agreement with a nonaffiliated reinsurer. This treaty was commuted in 2012.

Statutes in Texas restrict the payment of dividends by MGA to earned surplus (surplus derived from net income less dividends paid and other statutory based adjustments), among other provisions. At December 31, 2012, earned surplus was $3,153,000. Dividends cannot be paid without regulatory notification of no objection from the Texas Department of Insurance.

(9) Non-admitted Assets

The following table presents the components of non-admitted assets:

		December 31,	
		2012	2011
		(Amounts in thousands)	
Deferred tax assets	$	-	16,395
Prepaid expenses		1,396	-
Electronic data processing equipment and software		-	820
Furniture and equipment		209	328
Total non-admitted assets	$	1,605	17,543

(10) Reconciliation with Statutory Annual Statements

The following schedules reconcile these financial statements with the Annual Statement filed with the State of Texas:

		December 31,	
		2012	2011
		(Amounts in thousands)	
Statutory admitted assets as reported in the Annual Statement	$	221,864	224,351
Add:			
Decrease in current federal taxes receivable		(2)	-
Statutory admitted assets as reported in audited statutory financial statements	$	221,862	224,351

		December 31,	
		2012	2011
		(Amounts in thousands)	
Statutory liabilities as reported in the Annual Statement	$	129,617	123,667
Add:			
Increase in taxes, licenses and fees		500	-
Decrease in payable to affiliates		(21)	-
Statutory liabilities as reported in audited statutory financial statements	$	130,096	123,667

		December 31,	
		2012	2011
		(Amounts in thousands)	
Statutory capital and surplus as reported in the Annual Statement	$	92,247	100,684
Add:			
Increase in other underwriting expenses incurred		(479)	-
Increase in federal taxes expense		(2)	-
Statutory capital and surplus as reported in audited statutory financial statements	$	91,766	100,684

		Year ended December 31,	
		2012	2011
		(Amounts in thousands)	
Statutory net income as reported in the Annual Statement	$	997	7,317
Add:			
Increase in other underwriting expenses incurred		(479)	
Increase in federal taxes expense		(2)	-
Statutory net income as reported in audited statutory financial statements	$	516	7,317

		Year ended December 31,	
		2012	2011
		(Amounts in thousands)	
Net cash provided by operations as reported in the Annual Statement	$	23,094	13,596
Add (deduct):			
Decrease in payable to affiliates		21	-
Net cash provided by operations as reported in audited statutory financial statements	$	23,115	13,596

		Year ended December 31,	
		2012	2011
		(Amounts in thousands)	
Net cash used in financing and miscellaneous sources as reported in the Annual Statement	$	(14,095)	(5,740)
Add (deduct):			
Decrease in payable to affiliates		(21)	-
Net cash used in financing and miscellaneous sources as reported in audited statutory financial statements	$	(14,116)	(5,740)

Subsequent to the filing of the 2012 Annual Statement, but before finalizing the 2012 audited financial statements, the Company made a change to the amount recorded for premium tax expense. While an amount had been previously recorded in the Annual Statement, this amount did not appropriately reflect the 2012 expense or the full amount of the accrual for premium tax expense. Neither of which were considered material to capital and surplus. The amounts indicated in these audited financial statements properly reflect the accrual for premium tax expense in its respective period by virtue of an adjustment to beginning unassigned surplus in the Statutory Statement of Admitted Assets, Liabilities and Capital and Surplus, as well as an adjustment to the expense noted in the current year Statutory Statement of Operations.

(11) Reconciliation with GAAP Financial Statements

The following schedules reconcile statutory capital and surplus and statutory net income with shareholders' equity and net income on the basis of GAAP as of and for the years ended December 31, 2012 and 2011:

		2012	2011
		(Amounts in thousands)	
Statutory capital and surplus	$	91,766	100,684
(Deduct) add :			
Deferred Federal income tax		(711)	(16,137)
Non-admitted assets		1,605	17,543
Deferred policy acquisition costs		6,761	6,895
Unearned policy fees		(2,510)	(2,306)
Net unrealized gains on investments, gross of tax		1,419	74
Allowance for doubtful accounts		(320)	(128)
Deferred retroactive reinsurance gain		-	(2)
GAAP shareholders' equity	$	98,010	106,623
Statutory net income	$	516	7,317
Add (deduct):			
Deferred Federal income tax benefit		(394)	855
Increase (decrease) in deferred policy acquisition costs		(134)	460
Decrease in allowance for doubtful accounts		(193)	245
Decrease in prepaid commission expense		-	(100)
(Increase) decrease in unearned policy fees		(204)	(55)
Other		2	(1)
GAAP net (loss) income	$	(407)	8,721

(12) Related Party Transactions

The following table reflects intercompany balances which were generated under various service contracts and cost sharing arrangements as of December 31, 2012 and 2011:

		2012	2011
		(Amounts in thousands)	
Receivable from affiliates:			
NSL	$	1,635	-
MGAA		248	-
Total receivable from affiliates	$	1,883	-
Payable to affiliates:			
GSC	$	1,459	475
NSL		-	161
MGAA		-	27
Total payable to affiliates	$	1,459	663

At December 31, 2012, the amount receivable from affiliates relates to allocated corporate general and administrative expenses based on cost sharing arrangements. For the year ended December 31, 2012, the Company had paid and expensed $514,000 and $762,000, respectively, to MGAA resulting in a receivable over funding of the settlement of the allocated expenses with MGAA. For the year ended December 31, 2012, the Company had paid and expensed $1,379,000 and $3,013,000, respectively, to NSL resulting in a receivable over funding of the settlement of the allocated expenses with NSL. At December 31, 2012 and 2011, the amount payable to affiliates relates to underwriting expenses incurred based on service contracts and cost sharing arrangements. For the year ended December 31, 2012, the Company paid and expensed $1,379,000 and $3,013,000 to GSC. For the year ended December 31, 2011, the Company paid and expensed $3,884,000 and $3,409,000 to GSC, $598,000 and $437,000 to NSL, and $372,000 and $345,000 to MGAA, respectively. The terms of the arrangements require that the balances be settled within thirty days to forty-five days.

The only other material related party transactions are described in notes 4 and 13.

(13) Commitments and Contingencies

Assessments

The Company is not aware of any assessments that could have a material effect on the Company's financial position or results of operations. The Company has not accrued any liability for assessments.

Claims Related to Alleged Extra Contractual Obligations and Alleged Bad Faith Losses Stemming from Lawsuits

The Company paid $4,945,000 in 2012 to settle claims related to alleged extra contractual obligations or to alleged bad faith claims stemming from lawsuits. The number of claims where amounts were paid to settle claims related to alleged extra contractual obligations or to alleged bad faith claims stemming from lawsuits was in the 0 to 25 range during the reporting period. The claim count information is provided on a per claimant basis.

Legal Proceedings

In the normal course of its operations, the Company is named as defendant in various legal actions seeking monetary damages, including cases involving business disputes and those involving allegations that the Company wrongfully denied insurance claims and is liable for damages. Some cases involving insurance claims seek amounts significantly in excess of our policy limits. In the opinion of the Company's management, based on the information currently available, the ultimate liability, if any, resulting from the disposition of such litigation will not have a material adverse effect on the Company's consolidated financial position or results of operations. However, in view of the uncertainties inherent in such litigation, it is possible that the ultimate cost to the Company might exceed the reserves we have established by amounts that could have a material adverse effect on the Company's future results of operations, financial condition and cash flows in a particular reporting period.

In November 2010, a claim for recovery of damages of less than $500 in a Personal Injury Protection (“PIP”) in Dade County, Florida (Feijoo v. MGA Insurance Company, Inc.) was amended, with the plaintiff seeking to convert the case to a putative class action representing all persons similarly situated with respect to PIP claims in Florida against MGA Insurance Company, Inc. The Amended Complaint seeks damages of an unspecified amount and equitable and other relief. In August, 2012, the Court dismissed the class action claims with prejudice, and the individual PIP case was subsequently transferred to County Court. Dismissal of the class action claims is subject to possible appeal by the named Plaintiff at the conclusion of the individual case. While such litigation is inherently unpredictable, the Company believes that the complaint is without merit and intends to defend itself vigorously. As a result, the Company is unable to reasonably estimate a possible range of losses, if any, arising from the litigation.

In April 2011, a putative class action was filed in Dade County, Florida, against MGA Insurance Company, Inc. (Advanced Chiropractic Center Company, D/B/A Accident & Wellness Centers, as Assignee v. MGA Insurance Company, Inc.). This lawsuit, purportedly brought on behalf of all persons similarly situated with respect to PIP claims in Florida, asserts that the defendant has failed to comply with requirements of the Florida Personal Injury Protection (“PIP”) law by improperly calculating the amounts charged against PIP deductibles and seeks damages of an unspecified amount and equitable and other relief. While such litigation is inherently unpredictable, the Company believes that the complaint is without merit and intends to defend itself vigorously. As a result, the Company is unable to reasonably estimate a possible range of losses, if any, arising from the litigation.

In November 2011, a Complaint was filed against MGA in the Circuit Court of the Seventeenth Judicial Circuit in and for Broward County, Florida (Pericles v. MGA Insurance Company, Inc.). The Complaint arises out of an automobile accident that occurred in 2007. MGA denied coverage under a policy that had expired on the date of the accident. The plaintiff obtained a judgment against the named insured and the driver and is now seeking to enforce the judgment against MGA based on allegations of bad faith. While such litigation is inherently unpredictable, MGA intends to defend the case vigorously and believes that it has valid defenses. As a result, the Company is unable to reasonably estimate a possible range of losses, if any, arising from the litigation.

In March 2013, a Complaint was filed naming "Gainsco, Auto Insurance, Inc." and other defendants in the Second Judicial District Court in Bernalillo County, New Mexico (Kalgaree Fish, Individually and on behalf of all others similarly situated, v. Gainsco, Auto Insurance, Inc., et al.). The Complaint asserts that the defendants acted improperly in denying coverage to the plaintiff, the named insured on a policy issued by MGA Insurance Company, Inc., for property damage to the plaintiff's vehicle, which was being driven at the time of an accident by a family member of the plaintiff excluded from coverage by the terms of the policy. The Complaint seeks recovery on behalf of the plaintiff and an alleged class of claimants. While such litigation is inherently unpredictable, the Company believes that the complaint is without merit and intends to defend itself vigorously. As a result, the Company is unable to reasonably estimate a possible range of losses, if any, arising from the litigation.

Off-balance-sheet-risk

The Company does not have any financial instruments where there is off-balance-sheet-risk of accounting loss due to credit or market risk. There is credit risk in the premiums receivable and reinsurance balances receivable of the Company. At December 31, 2012 and 2011, the Company did not have any claims receivables by individual reinsurers that were material with regard to capital and surplus.

The following table sets forth significant receivable balances at December 31, 2012 and 2011:

	2012		2011	
	Balance	% of Policyholder Surplus	Balance	% of Policyholder Surplus
	(Dollar amounts in thousands)			
Premiums receivable from:				
NSL	$ 18,284	19.9%	30,662	30.4%
MGAA	14,059	15.3%	17,780	17.7%
Old American County Mutual	637	0.7%	732	0.7%

(14) Leases

The Company entered into an eleven-year lease agreement for the Florida office in May of 2010 that includes rentable office space of 22,480 square feet. Under the terms of this lease, the Company has the option of renewing for two additional five year periods through the year 2031. The Company also has the option of terminating the lease agreement during the sixth year of the term subject to payment of a penalty. The lease contains an annual rent escalation of 2.25%. The Company entered this agreement during 2011 and recorded lease expense on a straight line basis of $465,000. During 2012, the Company recorded lease expense on a straight line basis of $507,000.

The future minimum rental payments are as follows:

Year		Amount
2013	$	1,775
2014		1,506
2015		548
2016		560
2017		573
Thereafter		2,003
Total	$	6,965

The Company has not entered into any sale and leaseback arrangements.

(15) Geographical Distribution

The following table sets forth the direct premium written by Managing General Agents/Third Party Administrators that exceeds 5% of policyholder surplus for the year ended December 31, 2011:

Name	Type of business written	Direct Written Premium (Amounts in thousands)	
NSL	Property and Casualty	$	107,802
MGAA	Property and Casualty	$	80,015

Both MGAA and NSL are affiliates of the Company. NSL is wholly-owned by GAINSCO.

The Company makes available nonstandard personal auto lines of business to U.S. residents in several states. The following table sets forth the Company's total yearly direct premiums written by geographic area for the years indicated.

Area	2012	2011
Florida	48.7%	54.0%
Texas	28.0	23.0
Arizona	8.9	8.7
South Carolina	4.9	5.7
New Mexico	4.6	4.5
Georgia	3.6	3.4
California	1.1	0.3
Oklahoma	0.2	0.3
Nevada	0.0	0.1

(16) Risk-Based Capital

The Company's statutory capital exceeds the benchmark capital level under the Risk Based Capital ("RBC") formula for its insurance companies. RBC is a method for establishing the minimum amount of capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. As of December 31, 2012, the Company's RBC authorized control level was $12,316,000 and the total adjusted capital was $91,766,000.

MGA INSURANCE COMPANY, INC.

Summary Investment Schedule

December 31, 2012

(Dollar amounts in thousands)

	Gross investment holdings		Admitted assets as reported in the Annual Statement	
	Amount	Percentage	Amount	Percentage
Bonds:				
U.S. Treasury	$ 6,350	3.53%	$ 6,350	3.53%
U.S. Government agencies	4,466	2.48	4,466	2.48
Asset-backed	1,338	0.75	1,338	0.75
Mortgage-backed	12,250	6.81	12,250	6.81
Other debt and other fixed income securities – unaffiliated domestic securities	128,192	71.24	128,192	71.24
Total bonds	152,596	84.81	152,596	84.81
Preferred stocks	1,497	0.83	1,497	0.83
Cash overdraft and certificates of deposit	(8,916)	(4.96)	(8,916)	(4.96)
Common stock of subsidiary	1	-	1	-
Other long-term investments	2,692	1.50	2,692	1.50
Short-term investments	32,068	17.82	32,068	17.82
Total invested assets	$ 179,938	100.00%	$ 179,938	100.00%

See accompanying independent auditor's report.

MGA INSURANCE COMPANY, INC.

Investment Risk Interrogatories

December 31, 2012

(Dollar amounts in thousands)

1. Total admitted assets as reported on the statement of admitted assets, liabilities, and capital and surplus $ 221,862

2. The ten largest exposures to a single insurer/borrower/investment, excluding U.S. Government, U.S. Government agency securities and those U.S. Government money market funds listed in the Appendix to the SVO Purposes and Procedures Manual as exempt, property occupied by the Company, and policy loans.

Investment Category		Amortized Cost	Percentage of total admitted assets
Bonds:			
FPL Group Capital, Inc.	$	2,009	0.905%
JP Morgan Chase & Co.	$	1,687	0.761%
Lincoln National Corp.	$	1,433	0.646%
Ingersoll-Rand Co.	$	1,308	0.590%
Farm Credit Bank of Texas	$	1,280	0.577%
Kohl's Corporation	$	1,209	0.545%
Valero Energy Corp.	$	1,205	0.543%
Converium Holdings, Inc.	$	1,194	0.538%
AMGEN, Inc.	$	1,174	0.529%
Allstate Corp.	$	1,173	0.528%

3. Total admitted assets held in bonds and preferred stocks by NAIC rating.

Bonds with an NAIC rating of 1	$	73,051	32,926%
Bonds with an NAIC rating of 2	$	100,773	45.872%
Preferred Stocks with an NAIC rating of 2	$	1,000	0.451%
Bonds with an NAIC rating of 3	$	6,584	2.968%
Preferred Stocks with an NAIC rating of 3	$	497	0.224%
Bonds with an NAIC rating of 4	$	1,679	0.757%
Bonds with an NAIC rating of 5	$	1,576	0.710%

The answers to each of the remaining interrogatories of the reporting entity's aggregate holdings are not applicable.

See accompanying independent auditor's report.

MGA INSURANCE COMPANY, INC.

Schedule of Supplemental Reinsurance Risk Interrogatories

December 31, 2012

The following represent Annual Statement interrogatories, which are required to be included with the annual audit report beginning with audit reports on financial statements as of and for the year ended December 31, 2012 for reinsurance contracts entered into, renewed or amended on or after January 1, 1994 and any other reinsurance contracts that are in force on January 1, 1995 and cover insurable events on the underlying insurance policies that occur on or after that date.

7.1	Has the reporting entity reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)?	YES [ ] NO [X]
7.2	If yes, indicate the number of reinsurance contracts containing such provisions.	____________
7.3	If yes, does the amount of reinsurance credit taken reflect the reduction in quota share coverage caused by any applicable limiting provision(s)?	YES [ ] NO [X]
8.1	Has this reporting entity reinsured any risk with any other entity and agreed to release such entity from liability, in whole or in part, from any loss that may occur on this risk, or portion thereof, reinsured?	YES [ ] NO [X]
8.2	If yes, give full information.	Not Applicable
9.1	Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:	
	(a) A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;	YES [ ] NO [X]
	(b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;	
	(c) Aggregate stop loss reinsurance coverage;	
	(d) An unconditional or unilateral right by either party to commute the reinsurance contract except for such provisions which are only triggered by a decline in the credit status of the other party;	
	(e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or	
	(f) Payment schedule, accumulating retentions form multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.	

MGA INSURANCE COMPANY, INC.

Schedule of Supplemental Reinsurance Risk Interrogatories

December 31, 2012

9.2	Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member where:	
	(a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or	YES [ ] NO [X]
	(b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates.	
9.3	If yes to 9.1 or 9.2, please provide the following information in the Reinsurance Summary Supplemental Schedule for Interrogatory 9:	
	(a) The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income;	Not Applicable
	(b) A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting the criteria in 9.1 or 9.2; and	
	(c) A brief discussion of management’s principal objectives in entering into the reinsurance contract including the economic purpose to be achieved.	
9.4	Except for transactions meeting the requirements of paragraph 30 of SSAP No. 62, Property and Casualty Reinsurance, has the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:	
	(a) Accounted for that contract as reinsurance (either positive or retroactive) under statutory accounting principles (“SAP”) and a deposit under generally accepted accounting principles (“GAAP”); or	YES [ ] NO [X]
	(b) Accounted for that contract as reinsurance under GAAP and as a deposit under SAP?	
9.5	If yes to 9.4, explain in the Reinsurance Summary Supplemental Schedule for Interrogatory 9 (Section D) why the contract(s) is treated differently for GAAP and SAP.	Not Applicable

See accompanying independent auditor’s report.