

CONSOLIDATED FINANCIAL STATEMENTS

Midwest Medical Insurance Holding Company and Subsidiaries
Years Ended December 31, 2005 and 2004

Midwest Medical Insurance Holding Company and Subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2005 and 2004

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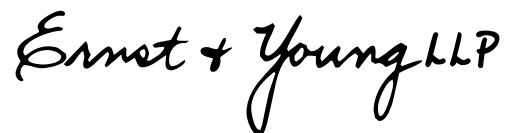
Report of Independent Auditors

The Board of Directors
Midwest Medical Insurance Holding Company
and Subsidiaries

We have audited the accompanying consolidated balance sheets of Midwest Medical Insurance Holding Company and Subsidiaries (the Company) as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Midwest Medical Insurance Holding Company and Subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.



February 10, 2006

Midwest Medical Insurance Holding Company and Subsidiaries

Consolidated Balance Sheets

(In Thousands, Except for Share Amounts)

	December 31	
	2005	2004
Assets		
Investments:		
Available for sale:		
Fixed maturities at fair value (amortized cost: 2005 – \$231,763; 2004 – \$200,495)	\$233,006	\$205,068
Equity securities at fair value (cost: 2005 – \$33,230; 2004 – \$30,429)	41,548	38,701
Other at fair value (cost: 2005 – \$38,491; 2004 – \$37,043)	52,899	48,455
Trading securities at fair value (cost: 2005 – \$12,849; 2004 – \$11,765)	12,584	12,454
Short-term	37,570	23,779
	377,607	328,457
Cash	2,830	2,850
Accrued investment income	2,341	1,962
Premiums receivable	15,478	11,396
Reinsurance recoverables on paid and unpaid losses	11,835	15,035
Amounts due from reinsurers	3,430	3,957
Deferred income taxes	2,303	832
Other assets	12,568	11,924
Total assets	\$428,392	\$376,413
Liabilities and shareholders' equity		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$219,912	\$188,946
Unearned premiums	31,200	26,573
Advance premiums	15,850	13,606
Amounts due to reinsurers	37	1,717
Other liabilities	20,744	12,509
Total liabilities	287,743	243,351
Shareholders' equity:		
Class B Common Stock – authorized, issued and outstanding, 1 share	1	1
Class C Common Stock – authorized, 300,000 shares; issued and outstanding, 11,964 shares in 2005 and 11,627 shares in 2004; no par value	–	–
Paid-in capital	12,789	12,789
Retained earnings	112,594	104,893
Accumulated other comprehensive income, net of tax:		
Net unrealized appreciation of investments	15,820	16,010
Minimum pension liability	(555)	(631)
Total shareholders' equity	140,649	133,062
Total liabilities and shareholders' equity	\$428,392	\$376,413

See accompanying notes.

Midwest Medical Insurance Holding Company and Subsidiaries

Consolidated Statements of Income

(In Thousands)

	Year Ended December 31	
	2005	2004
Revenues:		
Net premiums earned	\$113,141	\$ 96,026
Net investment income	13,436	11,883
Realized capital gains	1,822	4,532
Other	4,325	3,246
	132,724	115,687
Losses and expenses:		
Losses and loss adjustment expenses	101,529	90,173
Underwriting, acquisition and insurance expenses	14,652	13,548
Other operating expenses	6,180	5,978
	122,361	109,699
Income before income taxes	10,363	5,988
Income tax expense	2,662	1,752
Net income	\$ 7,701	\$ 4,236

See accompanying notes.

Midwest Medical Insurance Holding Company and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity

(In Thousands)

	Total	Class B Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income
Balance at December 31, 2003	\$124,740	\$1	\$12,789	\$100,657	\$11,293
Comprehensive income:					
Net income	4,236	-	-	4,236	-
Other comprehensive income:					
Unrealized gains on securities, net of \$3,779 in taxes	7,336	-	-	-	7,336
Reclassification adjustment for gains included in net income, net of \$1,541 in taxes	(2,991)	-	-	-	(2,991)
Minimum pension liability, net of \$134 in tax benefits	(259)	-	-	-	(259)
Total comprehensive income	<u>8,322</u>				
Balance at December 31, 2004	133,062	1	12,789	104,893	15,379
Comprehensive income:					
Net income	7,701	-	-	7,701	-
Other comprehensive income:					
Unrealized gains on securities, net of \$521 in taxes	1,013	-	-	-	1,013
Reclassification adjustment for gains included in net income, net of \$619 in taxes	(1,203)	-	-	-	(1,203)
Minimum pension liability, net of \$39 in taxes	76	-	-	-	76
Total comprehensive income	<u>7,587</u>				
Balance at December 31, 2005	<u>\$140,649</u>	\$1	\$12,789	\$112,594	\$15,265

See accompanying notes.

Midwest Medical Insurance Holding Company and Subsidiaries

Consolidated Statements of Cash Flows

(In Thousands)

	Year Ended December 31	
	2005	2004
Operating activities		
Net income	\$ 7,701	\$ 4,236
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accrued investment income	(379)	(429)
(Increase) decrease in premiums receivable	(4,082)	60
Decrease (increase) in reinsurance recoverables	3,200	(1,880)
Decrease in amounts due from reinsurers	527	61
Increase in other assets	(735)	(2,713)
Deferred tax provision	(1,412)	(390)
Increase in unpaid losses and loss adjustment expenses	30,966	22,535
Increase in unearned premiums	4,627	2,626
Increase in advance premiums	2,244	1,584
Decrease in amounts due to reinsurers	(1,680)	(185)
Increase in other liabilities	8,440	2,280
Premium amortization, net of accretion of bond discount	1,336	1,216
Realized capital gains	(1,822)	(4,532)
Net cash provided by operating activities	48,931	24,469
Investing activities		
Purchases of fixed maturity investments and equity securities	(109,150)	(200,952)
Sales of fixed maturity investments and equity securities	68,323	131,335
Calls and maturities of fixed maturity investments	7,206	16,317
Purchases of other investments	(732)	(722)
Sales of other investments	-	6,000
Purchases of trading securities	(4,568)	(13,357)
Sales of trading securities	3,760	1,618
Net (purchases) sales of short-term investments	(13,790)	35,623
Net cash used in investing activities	(48,951)	(24,138)
(Decrease) increase in cash	(20)	331
Cash at beginning of year	2,850	2,519
Cash at end of year	\$ 2,830	\$ 2,850

See accompanying notes.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2005

1. Accounting Policies

Organization and Operations

The consolidated financial statements include the accounts of Midwest Medical Insurance Holding Company (Midwest Holding) and its wholly owned subsidiaries, Midwest Medical Insurance Company (Midwest Medical), MMIC Agency, Inc. (Agency) and MMIC Technology Solutions, Inc. (Solutions). All transactions between Midwest Holding and its subsidiaries have been eliminated in consolidation.

Hereafter, Midwest Holding, Midwest Medical, Agency and Solutions shall be collectively referred to as the Company unless the reference pertains to a specific entity.

The Company, through its subsidiary Midwest Medical and its predecessors, has been providing professional liability insurance to physicians in the Upper Midwest since October 1980. The current structure of the Company is the result of a reorganization in 1988 followed by two business combinations with other insurers. In 1993, the Company merged with Iowa Physicians Mutual Insurance Trust. In 1996, the Company merged with Medical Liability Mutual Insurance Company of Nebraska.

Agency was incorporated in 1995 and began active operations in January 1999 with the acquisition of a book of business from Johnson-McCann Benefits, Inc. Agency subsequently sold its group insurance book of business back to Johnson-McCann Benefits, Inc. and one other producer, effective December 31, 2003. Prior to the sale, Agency specialized in providing clients with group insurance products such as health, dental, life, disability and workers' compensation. Agency continues as an intermediary that provides clients with workers' compensation, business owners' protection and non-standard professional liability insurance products.

During 1997, the Company formed Solutions to develop businesses that would strengthen and promote the independence and interdependencies of physicians, clinics and hospitals that the Company serves. Solutions currently provides practice enhancement software, technology services and support and physician office outsourcing services.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Midwest Holding provides management and administrative services to Midwest Medical and Solutions for a fee generally equal to the cost of services provided. Agency operates independently and does not have a management agreement with Midwest Holding.

Midwest Medical provides professional liability insurance to physicians, clinics, hospitals and healthcare systems in Minnesota, Iowa, Nebraska, North Dakota, South Dakota, Wisconsin and Illinois. Insurance policies issued by Midwest Medical are on a “claims made” basis and provide coverage for the policyholder for claims first made against the policyholder and reported to Midwest Medical during the policy period for claims which occurred on or after the retroactive date stated in the policy.

Midwest Medical provides, upon payment of an additional premium, a reporting endorsement which extends the period in which claims otherwise covered by the “claims made” policy may be reported to Midwest Medical. In the event of death or permanent disability of a policyholder, the reporting endorsement is issued without additional premium. Upon retirement, as defined in the policy, a policyholder with at least five years of consecutive coverage with Midwest Medical is eligible for a credit toward the additional premium for the reporting endorsement.

Prior acts coverage may be purchased by policyholders who were previously insured under a “claims made” policy with another professional liability insurer for an additional premium at the option of the insured in lieu of purchasing reporting endorsement coverage from the previous insurer.

Basis of Presentation

The consolidated financial statements have been presented in conformity with accounting principles generally accepted in the United States (U.S. GAAP), which differ in certain respects from statutory accounting practices followed by Midwest Medical in reporting to the Minnesota Department of Commerce (see Note 11).

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses as well as disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Investments

The principal investment objectives of the Company's portfolio, which support the long-term underwriting operations and enhance the financial strength and stability of the Company, are, in order of emphasis, to provide optimal levels of after-tax income, to conserve principal, to maintain the necessary level of liquidity to meet business needs and to maximize potential long-term rates of return.

Although management believes the Company has the ability to hold its fixed maturity investment portfolio to maturity, most investments, including fixed maturities, equity securities and other, are classified as "available for sale," as management may take advantage of opportunities to increase total return through sales of selected securities in response to changing market conditions. As a result, the Company carries these investments at fair value, with unrealized holding gains and losses reflected as a separate component of accumulated other comprehensive income, net of applicable deferred taxes.

Trading securities consist of fixed maturities and preferred stocks that are convertible into common stock at the option of the Company. Trading securities are carried at fair value with unrealized holding gains and losses reflected as realized gains and losses in the consolidated statements of income.

Fair values for fixed maturity and equity securities are based on quoted market prices, where available. For fixed maturity investments not actively traded, fair values are estimated using values obtained from independent pricing services.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Other investments consist of less than 20% equity interests in nontraded real estate investment trusts and an international equity limited partnership. The real estate investment trusts are recorded at appraised value or the initial public offering price prior to an appraised value being established. The international equity limited partnership is recorded at its net asset value.

Short-term investments are principally money market funds, repurchase agreements and fixed maturities purchased with maturities of less than one year. Short-term investments are recorded at cost, which approximates fair value.

Realized gains and losses on sales of investments are reported on a pretax basis as a component of income and are determined on the specific identification basis.

When evidence indicates a decline which is other than temporary in the underlying value or earning power of individual investments, such investments are written down to fair value by a charge to income.

Factors that management may consider in determining whether an other-than-temporary condition exists include:

- Whether a market decline is attributable to specific adverse conditions for a particular investment.
- Whether a market decline is attributable to general market conditions that reflect prospects of the economy as a whole or prospects of a particular industry.
- The length of time and the extent to which fair value has been less than amortized cost.
- The financial condition of the issuer.
- The intent and ability of management to retain the investment for a period of time sufficient to allow for prudent anticipation of a recovery in market value.
- Whether dividends have been reduced or eliminated or scheduled interest payments on debt securities have not been made.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Securities Lending

The Company engages in securities lending through its investment custodian, whereby certain securities are loaned to other institutions for short periods of time. Such securities are in investments on the consolidated balance sheets. The market value of the loaned securities is monitored on a daily basis, with additional collateral obtained or refunded as the market value of the loaned securities fluctuates. Initial collateral, primarily cash, is required at a rate of 102% of the market value of a loaned security. The collateral is deposited by the borrower with the custodian and retained and invested by the custodian according to the terms of the securities lending agreement to generate additional income. The agreement also provides that the custodian will indemnify the Company if the borrower defaults, becomes insolvent or fails to return the loaned securities. As of December 31, 2005 and 2004, the Company had securities on loan with a fair market value of \$15,694,000 and \$11,249,000, which were collateralized by \$16,089,000 and \$11,507,000 of cash, respectively. The fair market value of the collateral was 103% and 102% of the fair market value of the securities on loan at December 31, 2005 and 2004, respectively. The Company has not repledged the collateral.

Losses and Loss Adjustment Expenses

The liability for unpaid losses and loss adjustment expenses represents management's best estimate of the ultimate cost of all such amounts which are unpaid at the balance sheet dates. The liability is based on both case-by-case estimates and statistical analysis and projections using the historical loss experience of Midwest Medical and gives effect to estimates of trends in claim severity and frequency. These estimates are continually reviewed, and as adjustments become necessary, such adjustments are included in current operations. Midwest Medical believes that the estimate of the liability for losses and loss adjustment expenses is reasonable.

Premiums

Premiums received are recorded as earned ratably over the lives of the policies to which they apply. A portion of premiums received is deferred to recognize Midwest Medical's obligation to provide reporting endorsement coverage without additional premium upon the death, disability or retirement of policyholders. This amount is recorded as an unearned premium reserve and represents the actuarially determined present value of future benefits to be provided less the present value of future revenues to be received.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Policyholder Dividends

Midwest Medical implemented a policyholder dividend program in 1999. Policyholder dividends are accrued when approved by the Board of Directors and are recorded as a separate component of losses and expenses in the consolidated statements of income.

Dividends are generated from unanticipated profits on prior coverage years. Declared dividends are allocated to policyholders proportionately based on current year written premium. To receive a dividend, a policyholder is required to have been insured in the applicable coverage year and remain insured throughout the year the dividend is paid. Declared dividends are generally paid in quarterly installments in the year following declaration.

Participating policies represented approximately 98% of total premiums in force and premium income at December 31, 2005 and 2004. No dividends were declared for the years ended December 31, 2005 and 2004.

Reinsurance

Midwest Medical purchases reinsurance in order to reduce its liability on individual risks and to enable it to write business at limits it otherwise would be unable to accept. Reinsurance contracts are principally excess-of-loss contracts, which indemnify Midwest Medical for losses in excess of a stated retention up to the contractual limits. Midwest Medical remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations.

Acquisition Costs

The Company's deferred acquisition costs (DACs) represent the costs of acquiring new insurance, principally agent or broker commissions and state premium taxes. DACs are amortized ratably over the lives of the policies to which they apply. The unamortized portion of DACs is reflected on the consolidated balance sheets as a component of other assets.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Other Revenues

Other revenues consist primarily of Agency commission income from insurance carriers and Solutions' technology consulting and software sales and support to healthcare providers. Generally, such revenues are earned as the related services and products are performed or provided.

Income Taxes

The Company files a consolidated tax return with its subsidiaries. Income tax expense is allocated to the subsidiaries based upon separate company taxable income under a tax-sharing agreement. The Company uses the asset and liability method of accounting for income taxes. Deferred income tax assets or liabilities are recognized for the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts used for income tax purposes.

2. Capital Structure

Midwest Holding has issued two classes of common stock. Each physician insured receives one share of Class C stock at no cost upon commencing coverage with Midwest Medical. The share of stock must be returned to the Company upon termination of insurance coverage. There is no payment to the shareholder upon return of Class C shares. Each share entitles the owner to one vote on matters that are subject to shareholder vote or approval. In the event of liquidation, sale or similar transaction involving Midwest Holding or Midwest Medical, Class C shareholders would participate in the proceeds according to a distribution formula developed by the Board of Directors. This formula takes into account the underwriting risk classification and years of coverage of each shareholder.

Midwest Holding has also issued one share of Class B voting stock that carries with it the right to elect the Board of Directors of Midwest Holding. The Minnesota Medical Association and the Iowa Medical Society currently exercise these voting rights. The Class C shareholders may at any time, by a two-thirds vote, elect to redeem the Class B share at cost.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Investments

Components of net investment income are summarized as follows:

	2005	2004
	<i>(In Thousands)</i>	
Fixed maturities	\$10,702	\$ 9,677
Equity securities	716	709
Other investments	2,600	2,594
Trading securities	78	(24)
Short-term investments	835	351
	14,931	13,307
Investment expenses	(1,495)	(1,424)
	\$13,436	\$11,883

The cost (amortized cost for fixed maturities) and fair value of available-for-sale investments are as follows:

	December 31, 2005			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	<i>(In Thousands)</i>			
Fixed maturities:				
United States government States, municipalities and political subdivisions	\$ 10,272	\$ 30	\$ (125)	\$ 10,177
Public utilities	127,061	754	(819)	126,996
Industrial and other	2,267	143	(5)	2,405
Total	92,163	2,118	(853)	93,428
Total	\$231,763	\$ 3,045	\$(1,802)	\$233,006
Equity securities:				
Common stock:				
Public utilities	\$ 2,468	\$ 480	\$ (9)	\$ 2,939
Banks, trusts and insurance companies	5,501	1,739	(6)	7,234
Industrial, miscellaneous and other	25,261	6,224	(110)	31,375
Total	\$ 33,230	\$ 8,443	\$ (125)	\$ 41,548
Other long-term investments:				
Real estate investment trusts	\$ 22,193	\$ 5,657	\$ -	\$ 27,850
International equity limited partnership	16,298	8,751	-	25,049
Total	\$ 38,491	\$14,408	\$ -	\$ 52,899

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Investments (continued)

	December 31, 2004			Market Value
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	
	<i>(In Thousands)</i>			
Fixed maturities:				
United States government States, municipalities and political subdivisions	\$ 42,497	\$ 514	\$(137)	\$ 42,874
Public utilities	54,213	812	(113)	54,912
Industrial and other	1,090	139	–	1,229
Total	102,695	3,631	(273)	106,053
Total	\$200,495	\$ 5,096	\$(523)	\$205,068
Equity securities:				
Common stock:				
Public utilities	\$ 621	\$ 78	\$ –	\$ 699
Banks, trusts and insurance companies	3,912	1,655	(1)	5,566
Industrial, miscellaneous and other	25,896	6,596	(56)	32,436
Total	\$ 30,429	\$ 8,329	\$ (57)	\$ 38,701
Other long-term investments:				
Real estate investment trusts	\$ 22,193	\$ 4,187	\$ –	\$ 26,380
International equity limited partnership	14,850	7,225	–	22,075
Total	\$ 37,043	\$11,412	\$ –	\$ 48,455

The components of the unrealized appreciation on available-for-sale securities as of December 31 are as follows:

	2005	2004
		<i>(In Thousands)</i>
Fixed maturities:		
Gross unrealized gains	\$ 3,045	\$ 5,096
Gross unrealized losses	(1,802)	(523)
Equity securities:		
Gross unrealized gains	8,443	8,329
Gross unrealized losses	(125)	(57)
Other long-term investments:		
Gross unrealized gains	14,408	11,412
Gross unrealized losses	–	–
	23,969	24,257
Deferred income taxes	(8,149)	(8,247)
	\$15,820	\$16,010

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Investments (continued)

The amortized cost and market value of fixed maturities at December 31, 2005, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Market Value
<i>(In Thousands)</i>		
Due in one year or less	\$ 2,362	\$ 2,380
Due after one year through five years	17,513	17,498
Due after five years through ten years	50,774	50,738
Due after ten years	161,114	162,390
	\$231,763	\$233,006

Proceeds from sales of available-for-sale investments and the related gross realized gains and losses are as follows:

	Proceeds From Sales	Gross Realized Gains	Gross Realized Losses
<i>(In Thousands)</i>			
Year ended December 31, 2005:			
Fixed maturities	\$42,656	\$ 387	\$ (642)
Equity securities	25,667	3,689	(1,255)
Year ended December 31, 2004:			
Fixed maturities	70,942	1,493	(467)
Equity securities	60,393	4,600	(2,238)
Other	6,000	445	(136)

The gross realized losses on sales of equity securities during 2004 were primarily the result of a change in the investment manager. The Company moved from an investment manager that used an actively managed, large-cap, growth investment style to an investment manager that uses a passively managed, Russell 3000 indexed, tax advantaged investment style.

At December 31, 2005 and 2004, a fixed maturity investment carried at \$1,976,000 and \$2,120,000, respectively, was on deposit with the Minnesota Department of Commerce as required by law.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Investments (continued)

Investments with unrealized losses at December 31, 2005, are summarized as follows:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	<i>(In Thousands)</i>					
Fixed maturities:						
United States						
government	\$ 4,497	\$ 57	\$ 2,388	\$ 68	\$ 6,885	\$ 125
States, municipalities and political subdivisions	66,308	746	2,200	73	68,508	819
Public utilities	1,172	5	–	–	1,172	5
Industrial and other	45,002	574	9,737	279	54,739	853
	116,979	1,382	14,325	420	131,304	1,802
Equity securities:						
Common stock:						
Public utilities	535	9	–	–	535	9
Banks, trust and insurance companies	163	6	–	–	163	6
Industrial, miscellaneous and other	3,111	110	–	–	3,111	110
	3,809	125	–	–	3,809	125
Total securities with unrealized loss	\$120,788	\$1,507	\$14,325	\$420	\$135,113	\$1,927

During 2005 and 2004, the Company did not experience any declines in investment values that were deemed other than temporary requiring the recognition of realized investment losses.

At December 31, 2005, the Company has 330 securities with unrealized losses, of which 204 are fixed maturity investments and 126 are equity security investments. Only 34 of those positions have had unrealized losses for longer than 12 months. The largest single unrealized loss that is longer than 12 months is \$72,000 on an asset-backed fixed income security, which is less than 3% of the holding's cost. The Company believes this is primarily an interest rate-driven temporary impairment. The issuer is current on monthly interest payments, and the Company expects to receive full value at maturity. Based on the Company's review of these securities, none of their declines in investment values were considered other than temporary.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Investments (continued)

Net unrealized appreciation of fixed maturities (decreased) increased by \$(3,330,000) and \$769,000 and net unrealized appreciation of equity securities increased by \$46,000 and \$368,000 for the years ended December 31, 2005 and 2004, respectively. Net unrealized appreciation of other long-term investments increased by \$2,996,000 and \$5,446,000 for the years ended December 31, 2005 and 2004, respectively.

Net trading realized gains were \$269,000 and \$146,000 for trading securities for the years ended December 31, 2005 and 2004, respectively. Net mark-to-market realized (losses) gains were \$(626,000) and \$689,000 for trading securities for the years ended December 31, 2005 and 2004, respectively.

4. Unpaid Losses and Loss Adjustment Expenses

The reconciliation of the liability for unpaid losses and loss adjustment expenses is as follows:

	2005	2004
	<i>(In Thousands)</i>	
Balance as of January 1, net of reinsurance recoverables	\$173,896	\$155,067
Incurred related to:		
Current year	92,309	83,377
Prior years	9,220	6,796
Total incurred	101,529	90,173
Paid related to:		
Current year	5,154	3,511
Prior years	61,904	67,833
Total paid	67,058	71,344
Balance as of December 31, net of reinsurance recoverables	208,367	173,896
Reinsurance recoverables on unpaid losses at December 31	11,545	15,050
Balance as of December 31, gross	\$219,912	\$188,946

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Unpaid Losses and Loss Adjustment Expenses (continued)

Midwest Medical continually evaluates emerging trends in the development of loss liabilities. Based on this analysis, management periodically adjusts its estimates of ultimate losses. The increase in unfavorable development on prior years is primarily due to late development on 2002 report year claims in Minnesota. This later development resulted from a change in the Minnesota statute of limitations from two to four years that was enacted during 1999 and was ultimately applied retroactively. This has caused a longer period of time to elapse between a preliminary report of a potential compensable event and an actual claim or suit being filed.

5. Segment Information

The Company is organized along four main product and service groups. Management and administrative services provided by Midwest Holding are the Management business segment. Professional liability insurance provided by Midwest Medical is the Insurance business segment. Technology-based products and services provided by Solutions are the Technology business segment. Property and casualty insurance intermediary services provided by Agency are the Agency business segment. The business and accounting policies of the reportable segments are described in Note 1 to the consolidated financial statements. Management evaluates the performance of each business segment based primarily on profit or loss from operations. With the exception of the international equity limited partnership and any foreign stocks and bonds held as investments by Midwest Medical, all business transactions are conducted in the United States. The following financial information summarizes the results of operations and total assets reported by the business segments for the years ended 2005 and 2004.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Segment Information (continued)

	2005					Consolidated
	Management	Insurance	Technology	Agency	Eliminations ⁽¹⁾	
	<i>(In Thousands)</i>					
Revenues:						
External customers	\$ –	\$113,141	\$ 3,075	\$ 491	\$ –	\$116,707
Intersegment	18,824	–	153	–	(18,977)	–
Net investment income	621	13,707	11	2	(905)	13,436
Other ⁽²⁾	17	1,787	–	184	593	2,581
	19,462	128,635	3,239	677	(19,289)	132,724
Total expenses	20,173	116,180	5,019	278	(19,289)	122,361
(Loss) income before tax	(711)	12,455	(1,780)	399	–	10,363
Income tax (benefit) expense	(37)	3,166	(603)	136	–	2,662
Net (loss) income	\$ (674)	\$ 9,289	\$ (1,177)	\$ 263	\$ –	\$ 7,701
Total assets	\$151,193	\$425,091	\$ 1,391	\$1,560	\$(150,843)	\$428,392

⁽¹⁾ Intersegment eliminations for revenues and expenses are primarily for management and administrative services provided by Midwest Holding. Eliminations for assets consist primarily of investments in wholly owned subsidiaries, intersegment receivables for management fees and reclassifications between assets and liabilities primarily for taxes.

⁽²⁾ Other revenues consist primarily of net realized capital gains and a gain adjustment on an asset sale by Agency.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Segment Information (continued)

	2004					
	Management	Insurance	Technology	Agency	Eliminations ⁽¹⁾	Consolidated
	<i>(In Thousands)</i>					
Revenues:						
External customers	\$ –	\$ 96,026	\$ 2,547	\$ 350	\$ –	\$ 98,923
Intersegment	18,805	–	139	–	(18,944)	–
Net investment income	165	12,184	5	2	(473)	11,883
Other ⁽²⁾	39	4,453	–	235	154	4,881
	<u>19,009</u>	<u>112,663</u>	<u>2,691</u>	<u>587</u>	<u>(19,263)</u>	<u>115,687</u>
Total expenses	<u>20,113</u>	<u>103,721</u>	<u>4,886</u>	<u>242</u>	<u>(19,263)</u>	<u>109,699</u>
(Loss) income before tax	(1,104)	8,942	(2,195)	345	–	5,988
Income tax (benefit) expense	(262)	2,634	(740)	120	–	1,752
Net (loss) income	<u>\$ (842)</u>	<u>\$ 6,308</u>	<u>\$(1,455)</u>	<u>\$ 225</u>	<u>\$ –</u>	<u>\$ 4,236</u>
Total assets	<u>\$142,070</u>	<u>\$372,873</u>	<u>\$ 2,397</u>	<u>\$2,339</u>	<u>\$(143,266)</u>	<u>\$376,413</u>

⁽¹⁾ Intersegment eliminations for revenues and expenses are primarily for management and administrative services provided by Midwest Holding. Eliminations for assets consist primarily of investments in wholly owned subsidiaries, intersegment receivables for management fees and reclassifications between assets and liabilities primarily for taxes.

⁽²⁾ Other revenues consist primarily of net realized capital gains and a gain adjustment on an asset sale by Agency.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Income Taxes

Components of income tax expense are as follows:

	2005	2004
	<i>(In Thousands)</i>	
Current provision	\$4,074	\$2,142
Deferred tax provision	(1,412)	(390)
	\$2,662	\$1,752

The Company's income taxes differ from the federal statutory rate applied to income before tax as follows:

	2005	2004
	<i>(In Thousands)</i>	
Income before tax at the federal statutory rate of 34%	\$3,523	\$2,036
Tax-exempt income (net of proration adjustment)	(846)	(213)
Dividends received deductions (net of proration adjustment)	(163)	(137)
Nondeductible expenses	49	50
State income taxes, net of federal tax benefit	5	5
Expense (benefit) for prior year income taxes	76	(10)
Other	18	21
	\$2,662	\$1,752

The Company made income tax payments of \$1,482,000 and \$2,010,000 in 2005 and 2004, respectively.

The components of the net deferred income tax asset as of December 31 are as follows:

	2005	2004
	<i>(In Thousands)</i>	
Deferred tax assets:		
Unpaid losses and loss adjustment expenses	\$ 5,497	\$ 5,003
Liabilities not currently deductible	3,104	2,808
Unearned and advanced premiums	2,692	2,262
Minimum pension liability	286	325
Other	1,580	1,716
	13,159	12,114
Deferred tax liabilities:		
Unrealized gains	(8,149)	(8,247)
Other	(2,707)	(3,035)
	(10,856)	(11,282)
	\$ 2,303	\$ 832

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Income Taxes (continued)

The Company is required to establish a valuation allowance for any portion of the deferred income tax assets that management believes will not be realized. In the opinion of management, it is more likely than not that the Company will realize the benefit of the deferred income tax assets, and therefore, no valuation allowance has been established.

7. Reinsurance

To reduce overall risk, including exposure to large losses, Midwest Medical participates in various reinsurance programs. Midwest Medical would only become liable for losses in excess of its retention limits in the event that any reinsuring company were unable to meet its obligations under the existing agreement. Management is not aware of any such default at December 31, 2005. Midwest Medical evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from similar geographic regions, activities or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. At December 31, 2005 and 2004, reinsurance recoverables on paid and unpaid losses of \$3,418,000 and \$4,157,000, respectively, are associated with a single reinsurer, Hannover Rückversicherungs AG. In 2005 and 2004, Midwest Medical also holds collateral under related reinsurance agreements in the form of letters of credit totaling \$11,224,000 and \$8,709,000, respectively, that can be drawn upon in the event the applicable reinsuring company is unable to pay its obligation to Midwest Medical.

Midwest Medical is authorized to issue policies with limits not to exceed \$15,000,000 for each claim and \$17,000,000 in the aggregate under each policy. Limits in excess of \$15,000,000 for each claim and \$17,000,000 annual aggregate are available to physicians, clinics and hospitals through reinsurance placed on a facultative basis by Midwest Medical. For the 2005 policy year, Midwest Medical's reinsurance program consists of two separate contracts: "aggregate stop loss" and "excess of loss." Under the aggregate stop loss contract (ASL), Midwest Medical retains the first \$2,000,000 of each claim and the premiums are based on a flat rate and could be subject to a favorable adjustment through a "no paid ceded loss bonus" provision at the time of the commutation of this contract. Midwest Medical is liable for the sum of all losses up to 92% of its net written premium under this contract. The reinsurers are then liable for the sum of all losses in excess of Midwest Medical's retention, but the liability of the reinsurers under this contract shall not exceed 13% of Midwest Medical's net written premium or \$20,000,000, whichever is less. Under the excess of loss contract, Midwest

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Reinsurance (continued)

Medical acts as an intermediary and cedes the full amount of the risk for policies with limits in excess of \$2,000,000 for each claim and \$4,000,000 in the aggregate up to \$15,000,000 for each claim and \$17,000,000 in the aggregate. The reinsurance premium for the excess of loss contract is a percentage of the preceding layer of coverage gross of any ceding commission paid by the reinsurers to Midwest Medical.

For the 2004 and prior policy years, Midwest Medical's reinsurance program is structured in two components: "basic" and "excess." Under the basic component, Midwest Medical generally retains the first \$1,000,000 of each claim and reinsures the next \$1,000,000 through a treaty under which premiums are based on a flat rate and could be subject to adjustment through a profit sharing provision. Under the excess component, Midwest Medical acts as an intermediary and cedes the full amount of the risk for policies with limits in excess of \$2,000,000 for each claim and \$4,000,000 in the aggregate up to \$12,000,000 for each claim and \$14,000,000 in the aggregate. The reinsurance premium for the excess of loss contract is a percentage of the preceding layer of coverage gross of any ceding commission paid by the reinsurers to Midwest Medical.

The effect of reinsurance on premiums written and earned for 2005 and 2004 is as follows:

	2005		2004	
	Written	Earned	Written	Earned
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Current year:				
Direct	\$133,795	\$129,167	\$120,380	\$117,754
Ceded – ASL	(3,486)	(2,972)	–	–
Ceded – basic	(293)	(1,865)	(11,549)	(11,312)
Ceded – excess	(11,593)	(11,063)	(10,489)	(10,786)
	118,423	113,267	98,342	95,656
Prior years:				
Ceded	(126)	(126)	370	370
Net	\$118,297	\$113,141	\$ 98,712	\$ 96,026

Losses and loss adjustment expenses incurred are net of applicable reinsurance of \$8,569,000 and \$15,018,000 for the years ended December 31, 2005 and 2004, respectively.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Reinsurance (continued)

In March 2004, Midwest Medical commuted all reinsurance agreements with Gerling Global Reinsurance Company of America (Gerling). This resulted in a payment by Gerling of \$2,400,000 to Midwest Medical in return for the release from its exposure to future losses. This resulted in ceded paid losses and ceded loss adjustment expenses of \$2,200,000 and \$200,000, respectively, being recorded by Midwest Medical. These ceded paid losses and ceded loss adjustment expenses were directly offset by an increase in direct loss and loss adjustment expense reserves resulting in no net loss or gain under the commutation.

8. Benefit Plans

The Company sponsors a number of postretirement and deferred compensation benefit plans. The principal plans are discussed below; other such plans are not significant individually or in the aggregate.

Employees of Midwest Holding are covered by a noncontributory defined contribution pension plan. Contributions to the plan are based upon each covered employee's salary. Employees at Midwest Holding are also covered by a 401(k) plan that provides a 50% match on employee contributions subject to certain limitations. Total contributions charged to expense for the years ended December 31, 2005 and 2004, were \$980,000 and \$939,000, respectively.

Midwest Holding provides an unfunded Deferred Compensation Plan (DCP), which is a nonqualified, voluntary plan that provides eligible key management employees of Midwest Holding the opportunity to defer pretax dollars. Benefits provided by the DCP are supplemental to Midwest Holding's other benefit plans. The liability recognized in the consolidated balance sheets at December 31, 2005 and 2004, related to this plan was \$1,377,000 and \$1,152,000, respectively.

Midwest Holding provides an unfunded Supplemental Executive Retirement Plan (SERP) which is a non-qualified, defined benefit pension plan covering certain Midwest Holding officers. At least annually, an outside actuary is engaged to assist management in evaluating plan assumptions and to calculate the plan's pension cost and benefit obligation.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Benefit Plans (continued)

Midwest Holding uses a December 31 measurement date for the SERP. The following table summarizes the benefit obligation and plan asset activity for the SERP:

	2005	2004
	<i>(In Thousands)</i>	
Change in projected benefit obligation:		
Benefit obligation at beginning of year	\$ 8,109	\$ 7,615
Service cost	126	197
Interest cost	478	470
Actuarial loss (gain)	180	4
Benefits paid	(331)	(177)
Benefit obligation at measurement date	\$ 8,562	\$ 8,109
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ –	\$ –
Actual return on plan assets	–	–
Employer contributions	331	177
Benefits paid	(331)	(177)
Fair value of plan assets at measurement date	\$ –	\$ –
Funded status:		
Funded status at measurement date	\$(8,562)	\$(8,109)
Unrecognized prior service cost	502	593
Unrecognized net actuarial loss (gain)	706	516
Net amount recognized	\$(7,354)	\$(7,000)
Amounts recognized in the consolidated financial statements:		
Accrued benefit liability	\$(6,011)	\$(5,451)
Minimum pension liability	(1,343)	(1,549)
Net amount recognized	\$(7,354)	\$(7,000)
Accumulated benefit obligation	\$ 7,354	\$ 7,000

The following discloses the minimum pension liability adjustment included in “accumulated other comprehensive income, net of tax” under shareholders’ equity in the consolidated balance sheets at December 31, 2005 and 2004:

	2005	2004
	<i>(In Thousands)</i>	
Minimum pension liability	\$(1,343)	\$(1,549)
Intangible asset – unrecognized prior service cost	502	593
Deferred tax benefit	286	325
Accumulated other comprehensive loss, net of tax – minimum pension liability	\$ (555)	\$ (631)

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Benefit Plans (continued)

The following discloses the net periodic benefit costs of the SERP:

	2005	2004
	<i>(In Thousands)</i>	
Service cost	\$126	\$197
Interest cost	478	470
Amortization of prior service cost	91	92
Amortization of net loss (gain)	128	138
Net periodic benefit cost	\$823	\$897

The following discloses the assumptions used in the measurement of the SERP pension costs and benefit obligations:

	2005	2004
Discount rate in determining benefit obligations	6.00%	6.25%
Rate of increase in future compensation	5.00%	5.00%
Expected long-term rate of return on plan assets	N/A	N/A

Although the SERP is technically unfunded and therefore does not have plan assets, Midwest Holding invests in specified assets that are designed to coordinate with the projected obligation under the SERP. Midwest Holding expects to contribute cash of \$297,000 to the SERP to fund anticipated withdrawals in 2006.

The following benefit payments are expected to be paid from the SERP (in thousands):

2006	\$ 297
2007	315
2008	310
2009	454
2010	450
2011–2015	2,879
Total	\$4,705

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Leases

The Company leases office space and equipment under lease agreements that expire at various intervals over the next five years and are subject to renewal options at market rates prevailing at the time of renewal. Rental expense for all leases was \$1,177,000 and \$1,088,000 for 2005 and 2004, respectively. At December 31, 2005, future minimum payments under noncancelable leases are as follows (in thousands):

2006	\$ 797
2007	517
2008	502
2009	420
2010	386
Thereafter	—
	\$2,622

10. Commitment and Contingencies

The Company is named as a defendant in various legal actions in the course of conducting its business. Management believes the resolution of those actions will not have a material effect on the Company's financial position or results of operations.

11. Reconciliation With Statutory Accounting Principles

Accounting principles generally accepted in the United States differ in certain respects from the accounting practices prescribed or permitted by insurance regulatory authorities (statutory basis).

The following is a reconciliation of net income and shareholders' equity under U.S. GAAP with that reported for Midwest Medical on a statutory basis:

	Net Income Year Ended December 31	
	2005	2004
	<i>(In Thousands)</i>	
On the basis of U.S. GAAP, Midwest Medical only	\$9,289	\$6,308
(Deductions) additions:		
Deferred acquisition costs	(282)	(251)
Deferred income taxes	(1,235)	289
Mark-to-market realized loss (gain) on trading securities, net of tax	205	(455)
Prescribed investment value differences	—	270
On the basis of statutory accounting principles	\$7,977	\$6,161

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Reconciliation With Statutory Accounting Principles (continued)

	Shareholders' Equity	
	December 31	
	2005	2004
	<i>(In Thousands)</i>	
On the basis of U.S. GAAP, Midwest Medical only	\$139,872	\$132,273
(Deductions) additions:		
Deferred acquisition costs	(1,332)	(1,051)
Deferred income taxes	876	1,912
Mark-to-market realized gain on trading securities, net of tax	(250)	(455)
Net unrealized gain on fixed maturities	(1,243)	(4,573)
Prescribed investment value differences	(72)	(22)
Other	(40)	(18)
On the basis of statutory accounting principles	\$137,811	\$128,066

Under Minnesota insurance statutes, Midwest Medical is required to maintain statutory surplus in excess of ten times its per risk reinsurance retention limit. Since Midwest Medical limited its retention to \$2,000,000 on any single risk, the minimum statutory surplus level was \$20,000,000 for 2005.

Dividends that exceed the greater of 10% of Midwest Medical's prior year-end policyholder surplus or Midwest Medical's prior year net income excluding realized capital gains are considered extraordinary under Minnesota insurance statutes. Payment of extraordinary dividends is subject to the approval of the Commissioner of the Minnesota Department of Commerce. At December 31, 2005, the maximum dividend that may be paid by Midwest Medical in 2006 without regulatory approval is approximately \$13,781,000. Cash dividends paid to Midwest Holding by Midwest Medical in 2005 and 2004 were \$1,500,000 and \$-0-, respectively.

12. Subsequent Event

Subsequent to the end of 2005, a \$2,500,000 policyholder dividend was approved for Minnesota policyholders that were insured with Midwest Medical in 1999 and remain insured throughout 2006. The dividend will be paid in quarterly installments during 2006.