

CONSOLIDATED FINANCIAL STATEMENTS

Midwest Medical Insurance Holding Company and Subsidiaries  
Years Ended December 31, 2007 and 2006  
With Report of Independent Auditors

Midwest Medical Insurance Holding Company and Subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2007 and 2006

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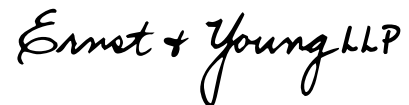
## Report of Independent Auditors

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, 2007 and 2006, 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, 2007 and 2006, 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 20, 2008

# Midwest Medical Insurance Holding Company and Subsidiaries

## Consolidated Balance Sheets (In Thousands, Except for Share Amounts)

	December 31	
	2007	2006
<b>Assets</b>		
Investments:		
Available for sale:		
Fixed maturities at fair value (amortized cost: 2007 – \$306,474; 2006 – \$253,291)	\$ 309,441	\$ 255,011
Equity securities at fair value (cost: 2007 – \$36,328; 2006 – \$33,112)	52,857	47,436
Trading securities at fair value (cost: 2007 – \$-0-; 2006 – \$12,512)	–	13,490
Other at fair value (cost: 2007 – \$59,871; 2006 – \$23,375)	73,018	37,579
Short-term	23,227	61,620
	458,543	415,136
Cash	3,987	4,503
Accrued investment income	3,443	2,787
Premiums receivable	14,755	15,644
Reinsurance recoverables on paid and unpaid losses	6,596	14,636
Amounts due from reinsurers	4,176	3,973
Deferred income taxes	4,716	1,780
Other assets	12,012	12,216
Total assets	\$ 508,228	\$ 470,675
<b>Liabilities and shareholders' equity</b>		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$ 255,972	\$ 238,393
Unearned premiums	36,929	35,812
Policyholder dividends	6,500	3,000
Advance premiums	10,479	11,662
Amounts due to reinsurers	–	88
Other liabilities	20,308	19,503
Total liabilities	330,188	308,458
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, 12,706 shares in 2007 and 12,257 shares in 2006; no par value	–	–
Paid-in capital	12,789	12,789
Retained earnings	145,293	130,330
Accumulated other comprehensive income, net of tax:		
Net unrealized appreciation of investments	21,218	19,661
Postretirement plans liability	(1,261)	(564)
Total shareholders' equity	178,040	162,217
Total liabilities and shareholders' equity	\$ 508,228	\$ 470,675

See accompanying notes.

# Midwest Medical Insurance Holding Company and Subsidiaries

## Consolidated Statements of Income

*(In Thousands)*

	<b>Year Ended December 31</b>	
	<b>2007</b>	<b>2006</b>
Revenues:		
Net premiums earned	\$ 121,608	\$ 122,140
Net investment income	17,312	16,616
Realized capital (losses) gains	(5,133)	10,294
Other	4,529	5,081
	<b>138,316</b>	154,131
Losses and expenses:		
Losses and loss adjustment expenses	90,058	102,416
Policyholder dividends	6,500	5,500
Underwriting, acquisition, and insurance expenses	17,060	15,894
Other operating expenses	5,433	5,720
	<b>119,051</b>	129,530
Income before income taxes	<b>19,265</b>	24,601
Income tax expense	4,302	6,865
Net income	<b>\$ 14,963</b>	\$ 17,736

*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, 2005	\$ 140,649	\$ 1	\$ 12,789	\$ 112,594	\$ 15,265
Comprehensive income:					
Net income	17,736	-	-	17,736	-
Other comprehensive income:					
Unrealized gains on securities, net of \$6,040 in taxes	10,532	-	-	-	10,532
Reclassification adjustment for gains included in net income, net of \$3,603 in taxes	(6,691)	-	-	-	(6,691)
Minimum pension liability, net of \$(5) in taxes	(9)	-	-	-	(9)
Total comprehensive income	<u>21,568</u>				
Balance at December 31, 2006	162,217	1	12,789	130,330	19,097
Comprehensive income:					
Net income	14,963	-	-	14,963	-
Other comprehensive income:					
Unrealized losses on securities, net of \$(958) in taxes	(1,780)	-	-	-	(1,780)
Reclassification adjustment for losses included in net income, net of \$(1,797) in taxes	3,337	-	-	-	3,337
Minimum pension liability, net of \$(51) in taxes	(95)	-	-	-	(95)
Total comprehensive income	<u>16,425</u>				
Adjustment to initially apply SFAS No. 158	(602)	-	-	-	(602)
Balance at December 31, 2007	<u>\$ 178,040</u>	<u>\$ 1</u>	<u>\$ 12,789</u>	<u>\$ 145,293</u>	<u>\$ 19,957</u>

See accompanying notes.

# Midwest Medical Insurance Holding Company and Subsidiaries

## Consolidated Statements of Cash Flows (In Thousands)

	<b>Year Ended December 31</b>	
	<b>2007</b>	<b>2006</b>
<b>Operating activities</b>		
Net income	\$ 14,963	\$ 17,736
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accrued investment income	(656)	(446)
Decrease (increase) in premiums receivable	889	(3,130)
Decrease (increase) in reinsurance recoverables	8,040	(2,801)
Increase in amounts due from reinsurers	(203)	(543)
Decrease in other assets	13	260
Deferred tax provision	(3,577)	(1,896)
Increase in unpaid losses and loss adjustment expenses	17,579	18,481
Increase in unearned premiums	1,117	4,612
Decrease in advance premiums	(1,183)	(1,224)
(Decrease) increase in amounts due to reinsurers	(88)	51
Increase in dividends payable to policyholders	3,500	3,000
Increase (decrease) in other liabilities	144	(1,177)
Premium amortization, net of accretion of bond discount	443	551
Realized capital losses (gains)	5,133	(10,294)
Net cash provided by operating activities	<b>46,114</b>	<b>23,180</b>
<b>Investing activities</b>		
Purchases of fixed maturity investments and equity securities	(189,409)	(133,169)
Sales of fixed maturity investments and equity securities	113,592	103,180
Calls and maturities of fixed maturity investments	7,848	7,444
Purchases of trading securities	(4,737)	(5,238)
Sales of trading securities	18,618	5,752
Purchases of other investments	(31,310)	(3,757)
Sales of other investments	-	28,331
Payments received on loans	375	-
Net sales (purchases) of short-term investments	<b>38,393</b>	<b>(24,050)</b>
Net cash used in investing activities	<b>(46,630)</b>	<b>(21,507)</b>
(Decrease) increase in cash	(516)	1,673
Cash at beginning of year	4,503	2,830
Cash at end of year	<b>\$ 3,987</b>	<b>\$ 4,503</b>

*See accompanying notes.*

# Midwest Medical Insurance Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements

December 31, 2007

### **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. Since then, the Agency has served 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 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 Insurance Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### **1. Accounting Policies (continued)**

Midwest Medical provides professional liability insurance primarily to physicians, clinics, hospitals, and healthcare systems in Minnesota, Iowa, Nebraska, North Dakota, South Dakota, and Wisconsin. 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).

### **Use of Estimates**

The preparation of financial statements in conformity with U.S. GAAP 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.

# Midwest Medical Insurance Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### 1. Accounting Policies (continued)

#### Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an Interpretation of FAS 109, Accounting for Income Taxes*, to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 became effective for fiscal years beginning after December 15, 2006 and the Company adopted FIN 48 as of January 1, 2007, as required. The adoption of FIN 48 had no effect on the Company's consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106, and 132(R)* (Statement 158). Statement 158 requires plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, "postretirement benefit plans") to recognize the funded status of their postretirement benefit plans in the statement of financial position, measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end statement of financial position, and provide additional disclosures. On December 31, 2007, the Company adopted the recognition and disclosure provisions of Statement 158. The effect of adopting Statement 158 on the Company's financial condition at December 31, 2007 has been included in the accompanying consolidated financial statements. Statement 158 did not have an effect on the Company's consolidated financial condition at December 31, 2006. The Statement 158 requirement regarding the change in the measurement date for postretirement plan assets and benefit obligations is not applicable as the Company already uses a measurement date of December 31 for the Supplemental Executive Retirement Plan (SERP). See Note 8 for further discussion of the effect of adopting Statement 158 on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS Statement No. 157, *Fair Value Measurements* (Statement 157). Statement 157 defines fair value, establishes a fair value hierarchy to be used in generally accepted accounting principles and expands disclosures about fair value measurements. Although this statement does not require any new fair value measurements, the application could change current practice. Statement 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of Statement 157 to the consolidated financial statements.

# Midwest Medical Insurance Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### 1. Accounting Policies (continued)

In February 2007, the FASB issued SFAS Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an Amendment of FASB Statement No. 115* (Statement 159). Statement 159 permits entities to choose to measure many financial instruments and certain other items at fair value at specified election dates. A business entity would report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option: 1. May be applied instrument by instrument, with few exceptions, such as investments otherwise accounted for by the equity method, 2. Is irrevocable (unless a new election date occurs), 3. Is applied only to entire instruments and not to portions of instruments. Statement 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact of electing Statement 159.

### 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, fixed maturities as well as equity securities 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, as long as the investments are not considered to be other than temporarily impaired.

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 include non-controlling equity interests in an international equity limited partnership, a convertible securities limited partnership, a municipal bond limited liability company and a nontraded real estate investment trust. Other investments also include a loan to a company shareholder and a loan to a company vendor. The international equity limited partnership, the convertible securities limited partnership and the municipal bond limited liability company are recorded at their respective net asset value. The real estate investment trust is recorded at its annual appraised value and the shareholder and vendor loans are recorded at their respective outstanding principal loan balance.

Short-term investments are principally money market funds, repurchase agreements, commercial paper 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 considers 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 principal and interest payments on debt securities have not been made.
- When the decision is made to sell a security that is in an unrealized loss position.

# Midwest Medical Insurance Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### **1. Accounting Policies (continued)**

#### **Securities Lending**

Midwest Medical 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 Midwest Medical if the borrower defaults, becomes insolvent, or fails to return the loaned securities. As of December 31, 2007 and 2006, Midwest Medical had securities on loan with a fair market value of \$11,929,000 and \$18,759,000, which were collateralized by \$12,198,000 and \$19,251,000 of cash, respectively. The fair market value of the collateral was 102% and 103% of the fair market value of the securities on loan at December 31, 2007 and 2006, respectively. Midwest Medical has not repledged the collateral and has restricted access to 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 frequently 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 the applicable coverage year written premium. To receive a dividend, a policyholder is generally 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, 2007 and 2006. Dividends of \$6,500,000 were declared during the year ended December 31, 2007. Dividends of \$2,500,000 and \$3,000,000 were declared during the year ended December 31, 2006. The dividend declared of \$2,500,000 was also paid in quarterly installments during the year ended December 31, 2006.

#### **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. Midwest Medical remains obligated for amounts ceded to reinsurers in the event that the reinsurers do not meet their obligations. 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. Reinsurance premiums, losses, and loss adjustment expenses are accounted for on a basis consistent with the terms of the reinsurance contracts.

#### **Acquisition Costs**

The Company's deferred acquisition costs represent the costs of acquiring new insurance, principally agent or broker commissions and state premium taxes. Deferred acquisition costs are amortized ratably over the lives of the policies to which they apply. The unamortized portion of deferred acquisition costs 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.

#### Reclassifications

Certain amounts in the prior year's financial statements have been reclassified to conform to the current-year presentation.

### 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. Upon termination of insurance coverage, the share of stock is redeemed by the Company. Since the Class C shares have no redemption value, no payment is made to the shareholder upon redemption. Each Class C 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:

	<b>2007</b>	<b>2006</b>
	<i>(In Thousands)</i>	
Fixed maturities	\$ 14,586	\$ 12,258
Equity securities	937	805
Trading securities	123	289
Other	1,913	3,250
Short-term	1,750	1,614
	<b>19,309</b>	18,216
Investment expenses	<b>(1,997)</b>	(1,600)
	<b>\$ 17,312</b>	<b>\$ 16,616</b>

## Midwest Medical Insurance Holding Company and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 3. Investments (continued)

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

	December 31, 2007			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	<i>(In Thousands)</i>			
Fixed maturities:				
United States government	\$ 7,028	\$ 150	\$ -	\$ 7,178
States, municipalities, and political subdivisions	184,027	826	(1)	184,852
Public utilities	461	-	-	461
Industrial and other	39,618	1,080	(1)	40,697
Mortgage-backed securities	75,340	920	(7)	76,253
Total	\$ 306,474	\$ 2,976	\$ (9)	\$ 309,441
Equity securities:				
Common stock:				
Public utilities	\$ 1,663	\$ 897	\$ (1)	\$ 2,559
Banks, trusts, and insurance companies	4,431	1,431	(48)	5,814
Industrial, miscellaneous, and other	30,234	14,368	(118)	44,484
Total	\$ 36,328	\$ 16,696	\$ (167)	\$ 52,857
Other long-term investments:				
International equity limited partnership	\$ 34,343	\$ 13,947	\$ -	\$ 48,290
Convertible securities limited partnership	18,910	-	(1,018)	17,892
Municipal bond fund limited liability company	3,128	-	(73)	3,055
Real estate investment trust	1,770	291	-	2,061
Shareholder loan	972	-	-	972
Vendor loan	748	-	-	748
Total	\$ 59,871	\$ 14,238	\$ (1,091)	\$ 73,018

# Midwest Medical Insurance Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### 3. Investments (continued)

	December 31, 2006			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	<i>(In Thousands)</i>			
Fixed maturities:				
United States government States, municipalities, and political subdivisions	\$ 13,767	\$ 67	\$ (67)	\$ 13,767
Public utilities	115,757	1,419	(171)	117,005
Industrial and other	1,183	-	(26)	1,157
Mortgage-backed securities	38,540	1,400	(337)	39,603
Total	\$ 253,291	\$ 3,402	\$ (1,682)	\$ 255,011
Equity securities:				
Common stock:				
Public utilities	\$ 1,814	\$ 886	\$ -	\$ 2,700
Banks, trusts, and insurance companies	4,649	2,520	-	7,169
Industrial, miscellaneous, and other	26,649	10,925	(7)	37,567
Total	\$ 33,112	\$ 14,331	\$ (7)	\$ 47,436
Other long-term investments:				
International equity limited partnership	\$ 18,863	\$ 14,044	\$ -	\$ 32,907
Real estate investment trust	1,770	128	-	1,898
Municipal bond fund limited liability company	1,772	32	-	1,804
Vendor loan	970	-	-	970
Total	\$ 23,375	\$ 14,204	\$ -	\$ 37,579

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

	2007	2006
	<i>(In Thousands)</i>	
Fixed maturities:		
Gross unrealized gains	\$ 2,976	\$ 3,402
Gross unrealized losses	(9)	(1,682)
Equity securities:		
Gross unrealized gains	16,696	14,331
Gross unrealized losses	(167)	(7)
Other long-term investments:		
Gross unrealized gains	14,238	14,204
Gross unrealized losses	(1,091)	-
	32,643	30,248
Deferred income taxes	(11,425)	(10,587)
	\$ 21,218	\$ 19,661

## 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, 2007, 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.

	<b>Amortized Cost</b>	<b>Market Value</b>
<i>(In Thousands)</i>		
Due in one year or less	\$ 200	\$ 200
Due after one year through five years	25,944	26,150
Due after five years through ten years	30,757	31,125
Due after ten years	174,233	175,713
Mortgage-backed securities	75,340	76,253
	\$ 306,474	\$ 309,441

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

	<b>Proceeds From Sales</b>	<b>Gross Realized Gains</b>	<b>Gross Realized Losses</b>
<i>(In Thousands)</i>			
Year ended December 31, 2007:			
Fixed maturities	\$ 98,931	\$ 1,087	\$ (2,255)
Equity securities	14,661	5,410	(1,451)
Other	-	-	-
Year ended December 31, 2006:			
Fixed maturities	\$ 91,608	\$ 592	\$ (808)
Equity securities	11,572	2,031	(847)
Other	28,331	7,908	-

At December 31, 2007, a fixed maturity investment carried at \$2,026,000 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)

The following table shows gross unrealized losses and fair values of investments at December 31, 2007, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

	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 States, municipalities, and political subdivisions	\$ 60,852	\$ 1	\$ —	\$ —	\$ 60,852	\$ 1
Public utilities	—	—	—	—	—	—
Industrial and other	—	—	5,145	1	5,145	1
Mortgage-backed securities	13,973	3	20,242	4	34,215	7
	74,825	4	25,387	5	100,212	9
Equity securities:						
Common stock:						
Public utilities	19	1	—	—	19	1
Banks, trust, and insurance companies	1,125	48	—	—	1,125	48
Industrial, miscellaneous, and other	3,179	118	—	—	3,179	118
	4,323	167	—	—	4,323	167
Other long-term investments:						
Convertible securities limited partnership	17,892	1,018	—	—	17,892	1,018
Municipal bond fund limited liability company	3,055	73	—	—	3,055	73
	20,947	1,091	—	—	20,947	1,091
Total investments with unrealized losses	\$ 100,095	\$ 1,262	\$ 25,387	\$ 5	\$ 125,482	\$ 1,267

## Midwest Medical Insurance Holding Company and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **3. Investments (continued)**

During 2007, the Company recorded realized investment losses totaling \$8,325,000 on 516 fixed maturity securities for declines in value that were deemed other than temporary. Most of these declines in value were in reaction to the recent downturn in the subprime mortgage credit market. Only 15 of these fixed maturity securities had direct subprime mortgage credit exposure. Although the Company believes it could hold these securities until they recover in value, it has elected to allow its investment managers to trade these securities as they see favorable market opportunities arise.

During 2006, 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, 2007, the Company has 301 investments with unrealized losses, of which 193 are fixed maturity investments, 106 are equity security investments and 2 are other investments. Only 30 of those positions have had unrealized losses for longer than 12 months and none of those 30 positions had an unrealized loss greater than \$1,000. Based on the Company's review of investments with unrealized losses, none of the declines in investment values were considered other than temporary.

Net unrealized appreciation of fixed maturities increased by \$1,247,000 and \$477,000 and net unrealized appreciation of equity securities increased by \$2,205,000 and \$6,006,000 for the years ended December 31, 2007 and 2006, respectively. Net unrealized appreciation of other long-term investments decreased by \$(1,057,000) and \$(204,000) for the years ended December 31, 2007 and 2006, respectively.

Net trading realized gains were \$401,000 and \$216,000 for trading securities for the years ended December 31, 2007 and 2006, respectively. Net mark-to-market realized gains were \$-0- and \$1,202,000 for trading securities for the years ended December 31, 2007 and 2006, respectively.

## Midwest Medical Insurance Holding Company and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 4. Unpaid Losses and Loss Adjustment Expenses

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

	<b>2007</b>	<b>2006</b>
	<i>(In Thousands)</i>	
Balance as of January 1, net of reinsurance recoverables	\$ <b>224,924</b>	\$ 208,367
Incurred related to:		
Current year	<b>103,471</b>	101,855
Prior years	<b>(13,413)</b>	561
Total incurred	<b>90,058</b>	102,416
Paid related to:		
Current year	<b>4,501</b>	4,791
Prior years	<b>61,105</b>	81,068
Total paid	<b>65,606</b>	85,859
Balance as of December 31, net of reinsurance recoverables	<b>249,376</b>	224,924
Reinsurance recoverables on unpaid losses at December 31	<b>6,596</b>	13,469
Balance as of December 31, gross	<b>\$ 255,972</b>	\$ 238,393

Midwest Medical frequently evaluates emerging trends in the development of loss liabilities. Based on this analysis, management periodically adjusts its estimates of ultimate losses. The favorable development on prior years is mainly due to a decrease in claim frequency and better than expected development on the 2006 report year.

# Midwest Medical Insurance Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### **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 2007 and 2006.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Segment Information (continued)

	2007					
	Management	Insurance	Technology	Agency	Eliminations <sup>(1)</sup>	Consolidated
	<i>(In Thousands)</i>					
Revenues:						
External customers	\$ –	\$ 121,608	\$ 3,417	\$ 472	\$ –	\$ 125,497
Intersegment	21,088	–	23	–	(21,111)	–
Net investment income	451	17,419	21	5	(584)	17,312
Other <sup>(2)</sup>	9	(5,169)	–	359	308	(4,493)
	<b>21,548</b>	<b>133,858</b>	<b>3,461</b>	<b>836</b>	<b>(21,387)</b>	<b>138,316</b>
Total expenses	<b>22,525</b>	<b>113,618</b>	<b>4,063</b>	<b>232</b>	<b>(21,387)</b>	<b>119,051</b>
(Loss) income before tax	(977)	20,240	(602)	604	–	19,265
Income tax (benefit) expense	(319)	4,614	(204)	211	–	4,302
Net (loss) income	<b>\$ (658)</b>	<b>\$ 15,626</b>	<b>\$ (398)</b>	<b>\$ 393</b>	<b>\$ –</b>	<b>\$ 14,963</b>
Total assets	<b>\$ 191,392</b>	<b>\$ 504,723</b>	<b>\$ 785</b>	<b>\$ 554</b>	<b>\$ (189,226)</b>	<b>\$ 508,228</b>

<sup>(1)</sup>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.

<sup>(2)</sup>Other revenues consist primarily of net realized capital gains (losses) 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)

	2006					
	Management	Insurance	Technology	Agency	Eliminations <sup>(1)</sup>	Consolidated
	<i>(In Thousands)</i>					
Revenues:						
External customers	\$ –	\$ 122,140	\$ 3,981	\$ 425	\$ –	\$ 126,546
Intersegment	19,740	–	130	–	(19,870)	–
Net investment income	418	16,810	16	3	(631)	16,616
Other <sup>(2)</sup>	24	10,253	–	333	359	10,969
	20,182	149,203	4,127	761	(20,142)	154,131
Total expenses	21,123	123,810	4,507	232	(20,142)	129,530
(Loss) income before tax	(941)	25,393	(380)	529	–	24,601
Income tax (benefit) expense	(364)	7,186	(145)	188	–	6,865
Net (loss) income	\$ (577)	\$ 18,207	\$ (235)	\$ 341	\$ –	\$ 17,736
Total assets	\$ 173,448	\$ 469,144	\$ 1,041	\$ 1,078	\$ (174,036)	\$ 470,675

<sup>(1)</sup>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.

<sup>(2)</sup>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:

	<b>2007</b>	<b>2006</b>
	<i>(In Thousands)</i>	
Current provision	\$ 7,879	\$ 8,761
Deferred tax provision	(3,577)	(1,896)
	<b>\$ 4,302</b>	<b>\$ 6,865</b>

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

	<b>2007</b>	<b>2006</b>
	<i>(In Thousands)</i>	
Income before tax at the federal statutory rate of 35%	\$ 6,743	\$ 8,610
Tax-exempt income (net of proration adjustment)	(2,208)	(1,388)
Dividends received deductions (net of proration adjustment)	(196)	(185)
Nondeductible expenses	70	65
State income taxes, net of federal tax benefit	-	13
Tax (benefit) expense for prior-year income taxes	(98)	52
Effect of change in tax rate	-	(302)
Other	(9)	-
	<b>\$ 4,302</b>	<b>\$ 6,865</b>

During 2007, the Company made income tax payments of \$3,815,000 for the 2007 tax year and \$5,520,000 for the 2006 tax year. During 2006, the Company made income tax payments of \$2,482,000 for the 2006 tax year and \$2,717,000 for the 2005 tax year. At December 31, 2007 and 2006, amounts due from subsidiaries for income taxes were \$4,605,000 and \$5,453,000, respectively.

## Midwest Medical Insurance Holding Company and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 6. Income Taxes (continued)

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

	<b>2007</b>	<b>2006</b>
	<i>(In Thousands)</i>	
Deferred tax assets:		
Unpaid losses and loss adjustment expenses	\$ <b>6,149</b>	\$ 5,947
Liabilities not currently deductible	<b>3,800</b>	3,441
Unearned and advanced premiums	<b>2,919</b>	3,050
Other-than-temporary impairment realized losses	<b>2,913</b>	–
Pension and postretirement benefits	<b>679</b>	304
Other	<b>2,035</b>	1,643
	<b>18,495</b>	14,385
Deferred tax liabilities:		
Unrealized gains	<b>(11,425)</b>	(10,587)
Other	<b>(2,354)</b>	(2,018)
	<b>(13,779)</b>	(12,605)
	<b>\$ 4,716</b>	\$ 1,780

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, 2007. 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, 2007 and 2006, reinsurance recoverables on paid and unpaid losses of \$1,461,000 and \$5,584,000, respectively, are associated with a single reinsurer, Hannover Rückversicherungs AG. In 2007 and 2006, Midwest Medical also holds collateral under related reinsurance agreements in the form of letters of credit totaling \$10,685,000 and \$9,505,000, respectively, that can be drawn upon in the event the applicable reinsuring company is unable to pay its obligation to Midwest Medical.

## Midwest Medical Insurance Holding Company and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **7. Reinsurance (continued)**

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 2007 policy year, Midwest Medical's treaty reinsurance program consists of three separate contracts: "excess cessions", "clash/eco/xpl", and "systemic/awards made." Under the excess cessions contract, for all policies with limits in excess of \$2,000,000 Midwest Medical cedes the full amount of the premiums and the risk excess of the company's retention of \$2,000,000 each insured, each claim or each occurrence, subject to a reinsurer limit of liability of \$13,000,000 each insured, each claim or occurrence. The reinsurance premium for the excess cessions contract is established as a percentage of the preceding coverage layer's premium gross of any ceding commission paid by the reinsurer to Midwest Medical.

There are two coverages under the clash/eco/xpl contract. The clash coverage provides coverage for losses in excess of \$3,000,000 per occurrence when it involves two or more insureds or policies and is subject to a limit of liability to the reinsurer of \$7,000,000. The extra contractual obligations and loss in excess of policy limits coverage provides coverage for losses in excess of policy limits and/or extra contractual obligations in excess of \$3,000,000 per occurrence and is subject to a limit of liability to the reinsurer of \$7,000,000 per occurrence. The reinsurer limit of liability on a combined basis for these coverages is \$7,000,000 per occurrence and \$14,000,000 per underwriting year. The reinsurance premium for the clash/eco/xpl contract is established as a percentage of the subject written premium under this contract.

There are two coverages under the systemic, awards made contract. The systemic coverage covers losses from a common loss occurrence when it involves at least two claims or at least two policies or insureds. The systemic coverage provides reinsurance coverage for losses in excess of \$3,000,000 per common loss occurrence and is subject to a limit of liability to the reinsurer of \$10,000,000 per common loss occurrence. The Awards Made coverage covers losses arising from Awards in Excess of Policy Limits and Extra Contractual Obligation Awards and provides reinsurance coverage for losses in excess of \$10,000,000 per occurrence and is subject to a limit of liability to the reinsurer of \$10,000,000 per occurrence. The reinsurer limit of liability on a combined basis for these two coverages is \$20,000,000 during the term of the reinsurance contract. The reinsurance premium for the systemic, awards made contract is established as a percentage of the subject written premium under this contract.

## Midwest Medical Insurance Holding Company and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **7. Reinsurance (continued)**

For the 2006 policy year, Midwest Medical's reinsurance program consists of two separate contracts: "aggregate stop loss" and "excess cessions." 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 90% 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 15% of Midwest Medical's net written premium or \$20,000,000, whichever is less. Under the excess cessions contract, for all policies with limits in excess of \$2,000,000 Midwest Medical cedes the full amount of the premiums and the risk excess of the company's retention of \$2,000,000 each insured, each claim or each occurrence, subject to a reinsurer limit of liability of \$13,000,000 each insured, each claim or occurrence. The reinsurance premium for the excess cessions contract is established as a percentage of the preceding coverage layer's premium gross of any ceding commission paid by the reinsurer to Midwest Medical.

The reinsurance program for the 2005 policy year was the same as the 2006 policy year with the exception that Midwest Medical was liable for the sum of all losses up to 92% of its net written premium under the ASL contract. The reinsurers were then liable for the sum of all losses in excess of Midwest Medical's retention, but the liability of the reinsurers under the 2005 ASL contract was not to exceed 13% of Midwest Medical's net written premium or \$20,000,000, whichever was less.

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 premiums and 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 cessions contract is established as a percentage of the preceding coverage layer's premium gross of any ceding commission paid by the reinsurer to Midwest Medical.

## Midwest Medical Insurance Holding Company and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 7. Reinsurance (continued)

The effect of reinsurance on premiums written and earned for 2007 and 2006 is as follows:

	<b>2007</b>		<b>2006</b>	
	<b>Written</b>	<b>Earned</b>	<b>Written</b>	<b>Earned</b>
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Current year:				
Direct	\$ 140,332	\$ 139,215	\$ 144,105	\$ 139,494
Ceded – ASL	(49)	(679)	(4,103)	(3,987)
Ceded – excess cessions	(13,532)	(13,826)	(13,661)	(13,234)
Ceded – clash/eco/xpl	(3,381)	(2,871)	–	–
Ceded – systemic/awards made	(426)	(426)	–	–
	<b>122,944</b>	<b>121,413</b>	126,341	122,273
Prior years:				
Ceded	<b>195</b>	<b>195</b>	(133)	(133)
Net	<b>\$ 123,139</b>	<b>\$ 121,608</b>	\$ 126,208	\$ 122,140

Losses and loss adjustment expenses incurred are net of applicable reinsurance of \$2,364,000 and \$18,184,000 for the years ended December 31, 2007 and 2006, respectively.

#### 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, 2007 and 2006, were \$1,114,000 and \$1,032,000, 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, 2007 and 2006, related to this plan was \$1,800,000 and \$1,603,000, respectively.

# Midwest Medical Insurance Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### 8. Benefit Plans (continued)

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.

On December 31, 2007, the Company adopted the recognition and disclosure provisions of Statement 158. Statement 158 required the Company to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its SERP and postretirement medical plan in the December 31, 2007 statement of financial position, with a corresponding adjustment to accumulated other comprehensive income, net of tax. The adjustment to accumulated other comprehensive income at adoption represents the net unrecognized actuarial losses, unrecognized prior service costs and unrecognized transition obligation remaining, all of which were previously netted against the plan's funded status in the Company's statement of financial position pursuant to existing accounting guidance. These amounts will be subsequently recognized as net periodic pension cost pursuant to the Company's historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic pension cost in the same periods will be recognized as a component of other comprehensive income. These amounts will be subsequently recognized as a component of net periodic pension cost on the same basis as the amounts recognized in accumulated other comprehensive income at adoption of Statement 158.

The following table illustrates the incremental effect of adopting Statement 158 on individual line items in the consolidated balance sheet at December 31, 2007:

	<b>Increase (Decrease)</b>
	<i>(In Thousands)</i>
Assets:	
Other assets	\$ 117
Deferred tax asset	324
Liabilities:	
Other liabilities	1,044
Shareholders' Equity:	
Accumulated other comprehensive income, net of tax	(602)

# 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:

	<b>2007</b>	<b>2006</b>
	<i>(In Thousands)</i>	
Change in projected benefit obligation:		
Benefit obligation at beginning of year	\$ 9,075	\$ 8,562
Service cost	119	176
Interest cost	535	505
Plan amendments	(63)	-
Actuarial (loss) gain	(36)	129
Benefits paid	(280)	(297)
Benefit obligation at measurement date	\$ 9,350	\$ 9,075
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ -	\$ -
Actual return on plan assets	-	-
Employer contributions	280	297
Benefits paid	(280)	(297)
Fair value of plan assets at measurement date	\$ -	\$ -
Funded status:		
Funded status at measurement date	\$ (9,350)	\$ (9,075)
Unrecognized prior service cost	-	411
Unrecognized net actuarial loss	-	785
Net amount recognized	\$ (9,350)	\$ (7,879)
Amounts recognized in the consolidated financial statements:		
Accrued benefit liability	\$ (9,350)	\$ (6,600)
Minimum pension liability	-	(1,279)
Net amount recognized	\$ (9,350)	\$ (7,879)
Accumulated benefit obligation	\$ 8,458	\$ 7,879

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

	<b>2007</b>	<b>2006</b>
	<i>(In Thousands)</i>	
Service cost	\$ 119	\$ 176
Interest cost	535	505
Amortization of prior service cost	91	91
Amortization of net loss	123	115
Net periodic benefit cost	\$ 868	\$ 887

# Midwest Medical Insurance Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### 8. Benefit Plans (continued)

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

	2007	2006
Discount rate in determining benefit obligations	<b>6.00%</b>	6.00%
Rate of increase in future compensation	<b>5.00%</b>	5.00%
Expected long-term rate of return on plan assets	<b>N/A</b>	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 \$484,000 to the SERP to fund anticipated withdrawals in 2008.

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

2008	\$	484
2009		484
2010		480
2011		498
2012		493
2013–2017		3,209
Total	\$	5,648

### 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 \$1,188,000 and \$1,178,000 for 2007 and 2006, respectively. At December 31, 2007, future minimum payments under noncancelable leases are as follows (in thousands):

2008	\$	799
2009		695
2010		513
2011		10
2012		1
Thereafter		–
	\$	2,018

# Midwest Medical Insurance Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### 10. Commitment and Contingencies

The Company is named as a defendant in various legal actions arising principally from claims made under insurance policies and contracts. Those actions are considered by Midwest Medical in estimating the loss and loss adjustment expense reserves. Management believes the resolution of those actions will not have a material effect on the Company's financial statements.

### 11. Reconciliation With Statutory Accounting Principles

U.S. GAAP 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 shareholder equity under U.S. GAAP with that reported for Midwest Medical on a statutory basis:

	<b>Net Income</b>	
	<b>Year Ended December 31</b>	
	<b>2007</b>	<b>2006</b>
	<i>(In Thousands)</i>	
On the basis of U.S. GAAP, Midwest Medical only	\$ 15,626	\$ 18,207
Additions (deductions):		
Deferred acquisition costs	97	(218)
Deferred income taxes	(3,237)	(1,483)
Other-than-temporary impairment realized losses	8,325	-
Mark-to-market realized loss (gain) on trading securities, net of tax	633	(625)
Prescribed investment value differences	765	(123)
On the basis of statutory accounting principles	<u>\$ 22,209</u>	<u>\$ 15,758</u>

	<b>Shareholder Equity</b>	
	<b>December 31</b>	
	<b>2007</b>	<b>2006</b>
	<i>(In Thousands)</i>	
On the basis of U.S. GAAP, Midwest Medical only	\$ 175,348	\$ 160,416
(Deductions) additions:		
Deferred acquisition costs	(1,454)	(1,551)
Deferred income taxes	(1,366)	1,141
Mark-to-market realized gain on trading securities, net of tax	-	(992)
Net unrealized loss (gain) on fixed maturities	5,357	(1,720)
Prescribed investment value differences	(579)	(4)
Other	(1)	(105)
On the basis of statutory accounting principles	<u>\$ 177,305</u>	<u>\$ 157,185</u>

## Midwest Medical Insurance Holding Company and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **11. Reconciliation With Statutory Accounting Principles (continued)**

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 2007.

Dividends to Midwest Holding 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, 2007, the maximum dividend that may be paid by Midwest Medical in 2008 without regulatory approval is approximately \$17,731,000. Midwest Medical paid cash dividends to Midwest Holding of \$2,250,000 in 2007 and \$1,500,000 in 2006.