

AMERICAN PHYSICIANS SERVICE GROUP INC  
Form 10-K  
March 03, 2010

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

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**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2009**

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**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**Commission File Number: 001-31434**

**AMERICAN PHYSICIANS SERVICE GROUP, INC.**

*(Exact name of registrant as specified in its charter)*

**Texas**  
*(State or other jurisdiction of incorporation or organization)*

**75-1458323**  
*(I.R.S. employer Identification No.)*

**1301 Capital of Texas Highway, Suite C-300, Austin**  
**Texas**  
*(Address of principal executive offices)*

**78746**  
*(Zip Code)*

**Registrant's telephone number, including area code: (512) 328-0888**

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

Title of each class	Name of each exchange on which registered
Common Stock, \$0.10 par value	The NASDAQ Stock Market LLC

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

Series A Preferred Stock, \$1.00 par value  
(Title of Class)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter.

Aggregate Market Value at June 30, 2010: \$156,776,124

Indicate the number of shares outstanding of each of the registrant's class of common stock, as of the latest practicable date.

	<b>Number of Shares Outstanding At</b>
<b><u>Title of Each Class</u></b>	<b><u>February 26, 2010</u></b>
Common Stock, \$.10 par value	<b>6,852,607</b>

**Documents Incorporated By Reference**

None



**AMERICAN PHYSICIANS SERVICE GROUP, INC.**

**2009 Annual Report on Form 10-K**

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**AMERICAN PHYSICIANS SERVICE GROUP, INC.**

**ANNUAL REPORT ON FORM 10-K**

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2009**

**Cautionary Statement Regarding Forward-Looking Statements**

This Annual Report on Form 10-K, including Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements involve risks and uncertainties, as well as assumptions that, if they do not materialize or prove correct, could cause our results to differ materially from those expressed or implied by such forward-looking statements. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including statements: of our plans, strategies and objectives for future operations; concerning new products, services, or developments; regarding future economic conditions, performance, or outlook; as to the outcome of contingencies; of beliefs or expectations; and of assumptions underlying any of the foregoing.

Forward-looking statements may be identified by their use of forward-looking terminology, such as believes, expects, may, should, would, intends, plans, estimates, anticipates, projects and similar words or expressions. Do not place undue reliance on these forward-looking statements, which reflect our management's beliefs and assumptions only as of the date of the filing of this Annual Report on Form 10-K. We undertake no obligation, other than that imposed by law, to update forward-looking statements to reflect further developments or information obtained after the date of filing of this Annual Report on Form 10-K or, in the case of any document incorporated by reference, the date of that document.

The following important factors, in addition to those referenced under Risk Factors in Item 1A, could affect the future results of our operations and could cause those results to differ materially from those expressed in or implied by such forward-looking statements:

general economic conditions, either nationally or in our market area, that are worse than expected;

changes in the healthcare industry;

regulatory and legislative actions or decisions that adversely affect our business plans or operations;

inflation and changes in the interest rate environment, and/or changes in the securities markets including the performance of financial markets affecting the fair value of our investments or making it difficult to determine the value of our investments;

uncertainties inherent in the estimate of loss and loss adjustment expense reserves and reinsurance;

significantly increased competition among insurance providers;

changes in the availability or cost of reinsurance including our ability to renew our existing reinsurance treaty or obtain new reinsurance;

failure or inability of our reinsurers to pay claims or amounts due us in a timely manner;

loss of key executives, personnel, accounts or customers; and

potential losses and litigation risk associated with our Financial Services businesses.

The foregoing factors should not be construed as exhaustive and we caution you not to place undue reliance on forward-looking statements, which speak only as of the date of this report. In addition to any risks and uncertainties specifically identified in the text surrounding forward-looking statements, you should consult our other filings under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, for factors that could cause our actual results to differ materially from those presented.





## PART 1

### *ITEM 1. Business.*

#### **General**

We were organized in October 1974 under the laws of the State of Texas. Our principal executive office is at 1301 S. Capital of Texas Highway, Suite C-300, Austin, Texas 78746, and our telephone number is (512) 328-0888. Our website is [www.amph.com](http://www.amph.com). We make available free of charge on our website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission, or the SEC. We also show details about stock trading by corporate insiders by providing access to SEC Forms 3, 4, and 5. Our stock trades on the NASDAQ Stock Market under the symbol AMPH. References in this annual report on Form 10-K to we, our, or the Company refer to American Physicians Service Group, Inc. and its subsidiaries.

We provide (1) insurance services, specifically medical professional liability insurance, and (2) financial services, including brokerage and other investment services to individuals and institutions.

#### **Insurance Services Operations**

##### *Corporate Overview*

Through our insurance subsidiary, American Physicians Insurance Company ( API ), we specialize in writing medical professional liability insurance for physicians and other healthcare providers. API is authorized to do business in the States of Texas, where we have written business for over 33 years. We also are authorized and write business in Arkansas and Oklahoma. We became authorized to do business in Oklahoma in August 2007. We currently insure approximately 6,360 physicians and other healthcare providers, the vast majority of which are in Texas. Approximately 92% of our premiums are written through purchasing groups, which in Texas currently subjects us to less stringent state regulation of premium rates and policy forms. In 2009, approximately 5% and 3% of our premiums were written in Oklahoma and Arkansas, respectively.

Prior to April 1, 2007, we had operated as the attorney-in-fact manager for API since 1975. On April 1, 2007, we acquired API in a stock transaction, thus combining our insurance management experience with an insurance underwriting entity to allow for the increased capacity for continued growth in existing markets and for expansion into new markets. The business combination was valued at \$45,167,000, consisting of consideration of common and preferred stock of the Company, and was accounted for using the purchase method of accounting. The purchase price was allocated to assets acquired and liabilities assumed based on fair values at the date of acquisition. We are required to redeem at least \$1 million of the preferred stock each calendar year until December 31, 2016, at which time all of the preferred stock must have been redeemed.

Prior to our acquisition, API had been organized as a reciprocal insurance exchange under the laws of the State of Texas since 1975. A reciprocal insurance exchange is an entity, similar to a mutual insurance company, which sells insurance to its subscribers and other eligible healthcare providers, who may pay, at the election of the company, in addition to their annual insurance premiums, a contribution to the exchange's surplus. These exchanges generally enter into a contract with an attorney-in-fact that provides for all management and administrative services for the reciprocal exchange. The Company, through a wholly owned subsidiary, was the attorney-in fact for API from its inception until the acquisition.

In consideration for performing services as the attorney-in-fact, API paid management fees to us equal to 13.5% of API's earned premiums before payment of reinsurance premiums. In addition, any pre-tax profits of API would be shared equally with us (profit sharing) so long as the total amount of profit sharing did not exceed 3% of API's earned premiums. As a result of our acquisition of API, the attorney-in-fact relationship ended and, after the first quarter of 2007, these management fees no longer affect our consolidated results of operations.

Since the acquisition of API, our results of operations are now directly affected by premiums we earn from the sale of medical professional liability insurance, investment income earned on assets we hold, insurance losses and loss adjustment expenses relating to the insurance policies we write as well as commissions and other insurance underwriting and policy acquisition expenses we incur. For both years ended December 31, 2009 and 2008, revenues and pre-tax earnings from our Insurance Services segment, represented approximately 88% of our total revenues and substantially all of pre-tax earnings. On a pro forma basis, as if the acquisition had occurred on January 1, 2007, revenues and pre-tax earnings from our Insurance Services segment would have contributed approximately 79% and 96% of our total revenues and pre-tax earnings, respectively, for the year ended December 31, 2007.

### *Products and Services*

We offer medical professional liability insurance coverage, which is designed to protect our policyholders from losses and legal costs associated with medical professional liability claims. Our policies are written for one-year terms. Generally, medical professional liability insurance is offered on either a claims made basis or an occurrence basis. Claims made policies insure physicians only against claims that are reported during the period covered by the policy. Occurrence policies insure physicians against claims based on occurrences during the policy period regardless of when they are reported. We primarily offer claims made policies. We also provide for an extended reporting option, or tail policy, which is written on an occurrence basis to policyholders who meet certain requirements upon the non-renewal or cancellation of their policy, or upon their death, disability or retirement from practice.

### *Revenues and Industry Overview*

The information required by Regulation S-K Items 101(b) and 101(d) related to financial information about segments and geographic areas is contained in Note 21 of our accompanying consolidated financial statements included in Item 15 of this Annual Report on Form 10-K.

We derive the majority of our revenues from earned premiums that result from issuing policies written on a claims-made basis to physicians, physician groups and other healthcare providers as well as income generated from our investment portfolio. Policies are written for a one-year term and premiums are earned on a pro-rata basis over the term of the policy. Upon termination of coverage, policyholders may purchase an extended reporting period (tail) policy for additional periods of time. These extended period coverage policy premiums are immediately earned when the policy is issued. The following table summarizes the written premiums by state for the years ended December 31, 2009 and 2008 (in thousands):

<b>State</b>	<b>2009</b>	<b>2008</b>
Texas	\$ 59,914	\$ 60,903
Oklahoma	3,569	1,970
Arkansas	1,947	1,244
Total	\$ 65,430	\$ 64,117

Our results from operations are primarily driven by underwriting results, which is measured by subtracting incurred loss and loss adjustment expenses and other underwriting expenses from net earned premiums. Net earned premiums exclude premiums ceded to reinsurers. Premiums ceded to reinsurers (ceded premiums) represent amounts paid to the reinsurance companies in return for the reinsurance company assuming a portion of the risk. Substantial underwriting losses could result in a curtailment or cessation of our operations. We utilize reinsurance to provide us with increased capacity to write additional risk and the ability to write specific risks within our capital resources and underwriting guidelines

Investment income is a result of the performance of our assets invested in fixed maturities securities and dividends received on equity securities. Investment income is impacted by the size of the portfolio and the rate of return, or yield, on the fixed maturities portfolio and is in addition to realized gains or losses on the sale of equity or fixed maturities securities.

The financial results of medical professional liability insurers are influenced by many factors including changes in severity and frequency of claims, changes in applicable laws and regulatory reform, changes in judicial attitudes towards liability claims, and changes in inflation, interest rates, general economic and competitive conditions.

The availability of medical professional liability insurance, or the industry's underwriting capacity, is determined principally by the industry's level of capitalization, historical underwriting results, returns on investment and perceived premium rate adequacy. Historically, the financial performance of the medical professional liability insurance industry has fluctuated between soft insurance markets and hard insurance markets. In a soft insurance market, increased competitive conditions drive unfavorable premium rates and underwriting terms that can result in losses for insurance carriers. In a hard insurance market, competitive conditions provide for more favorable premium rates and underwriting terms that can result in increased profitability for insurance carriers. Beginning in the early 1990s, the medical professional liability insurance industry in Texas and Arkansas operated in a soft market. Similarly, the industry experienced soft markets at the national level. However, beginning in 2001 and continuing throughout 2003, the medical professional liability insurance market hardened, with a number of carriers withdrawing from the Texas market. Prices for coverage rose substantially as insurers raised premium rates in reaction to increasing losses suffered in the industry.

Tort reform, enacted in Texas in 2003, has generally benefited medical professional liability insurers in the state by limiting certain damages that could be awarded in a medical professional liability claim. In September 2003, Texas voters approved a state constitutional amendment which gives the Texas legislature authority to set limits on damages in medical malpractice and other lawsuits. This coincided with the passage of state legislation which became effective on September 1, 2003 and which places a cap on non-economic damages in medical malpractice cases. Texas law now places a \$250,000 cap for all physicians on a per case basis and a \$250,000 cap for each health care institution, which collectively cannot exceed \$500,000, resulting in an overall stacked cap of \$750,000 for non-economic damages. It limits damages awarded for a plaintiff's non-economic damages such as damages for mental anguish, pain and suffering, and loss of companionship. However, there is no limit on the amount of economic or actual damages that could be received in a claim or suit. The tort reform legislation also limits liability of physicians in cases involving product liability or mass action cases.

As a result of tort reform, new competitors entered the Texas market while existing insurers grew their capital due to generally favorable underwriting results for policies covering post-tort reform periods. We believe these factors resulted in softening market conditions in Texas beginning in 2005. We continue to experience increased price competition from existing competitors in the Texas market.



### *Competition*

Our primary competitors in Texas are Medical Protective Insurance Services Inc. ( MedPro ), (a subsidiary of Berkshire Hathaway), Texas Medical Liability Trust ( TMLT ), ProAssurance Corporation, The Doctors Company, Advocate MD Insurance of the Southwest, Inc. (a subsidiary of First Professionals Insurance Company or FPIC ), and Texas Medical Liability Insurance Underwriting Association, which is the state-sponsored insurer of last resort. We consider these companies to be our competitors because they are the companies to which policyholders typically move when cancelling policies with us. In Arkansas, our primary competitors are State Volunteer Mutual Insurance Company ( SVMIC ) and FPIC and in Oklahoma, our primary competitors are Physicians Liability Insurance Company of Oklahoma ( PLICO ) and MedPro. We consider these companies competitors because they are the dominant insurance providers in Arkansas and Oklahoma. We compete with these companies on a variety of factors including price, customer service, expertise in claims handling, policy coverage, risk management services and financial strength. Many of our competitors have greater financial strength and broader resources than us. In premiums written and asset size, MedPro, TMLT, ProAssurance Corporation, SVMIC, FPIC and The Doctors Company are significantly larger than us. We believe that our long-term presence in the medical professional liability market, the physician involvement in our claims management process, our innovation in policy customization and our strong focus on customer relationship management allow us to successfully attract and retain insurance customers.

We believe an emerging competitive threat to the medical professional liability insurance industry is alternative risk transfer structures such as risk retention groups, captive insurers and other self-insurance vehicles. We believe larger physician groups and other healthcare providers may consider alternative risk transfer products as they grow in both size and the insurance premiums they pay. We believe that we have been successful at retaining many of our large physician groups due to our relationship-focused model and our willingness to tailor coverage terms that meet our clients' needs and our underwriting objectives.

### *Marketing and Distribution*

We market our insurance products through a direct sales force and an established network of independent insurance agents who have specialized knowledge in our markets. We have a long-standing relationship with one agency through which we wrote approximately 41% of our 2009 written premium. In addition to utilizing independent agents, we generated approximately 18% of our 2009 written premiums from policies sold directly to policyholders. Over 92% of our written premiums are generated in Texas with the remainder in Arkansas and Oklahoma. Our business is composed of both solo practitioners and physicians in group practices, which we define as three or more physicians in practice together. No single customer represented more than 4.1% of premiums written in 2009.

Approximately 92% of our sole practitioner and physician group premiums are written through purchasing groups, which can be any group of individuals with similar or related liability risks who form an organization, one of whose purposes is to purchase liability insurance coverage on a group basis. In some states, such as Texas, state insurance departments have less stringent regulation of premium rates and policy forms for insurance written through purchasing groups. However, the policies must contain the same legislatively mandated provisions included in the policies that the insurer must submit for approval on a regulated basis. Arkansas and Oklahoma are not exempt states and insurers



selling to purchasing groups are subject to regulation on policy forms and insurance rates.

We employ comprehensive customer relationship practices in our marketing process where we maintain regular contact directly with our larger insurance customers and track the interaction we have with all of our policyholders. We believe this helps ensure that we maintain a strong, direct customer relationship with policyholders that come through our direct distribution as well as those from our independent agent distribution. We visit the majority of our physician group clients on an annual basis in order to provide face-to-face interaction with their key insurance decision makers. We also seek regular feedback from our insurance customers to help strengthen our customer relationships and improve the quality of our insurance operations.

*Underwriting*

Our underwriting process begins with our efforts to understand the specific risks and needs of an applicant. We conduct a comprehensive review on every new application and new group submission, in addition to an on-site visit to each new group considering applying with us for insurance coverage. Our underwriting process for new accounts incorporates our underwriting team, which includes our medical director. During this process, among other pertinent information, we review every application and submission to determine the applicant's specific risks, such as:

the nature of the physician's practice;

claims history, including the frequency and severity of claims reported;

medical specialty;

training;

board certification;

practice territory;

disciplinary actions; and

hospital privileges.

Based on our evaluation of this information and on-site visits for group applicants, we determine the policy terms and pricing utilizing a rating model that applies specific factors for these risks. We then customize and tailor coverage and policy terms to address the specific needs of an applicant and insurance risks.

We utilize a consistent evaluation process for the approval of renewal policies that involves multiple levels of review before a policy is approved and issued. Every individual physician renewed is reviewed by our underwriting staff and medical director. Renewal policies are subject to a rating model that considers similar factors as those used for underwriting new policies.

Throughout the underwriting process, we leverage our management reporting technology and our management team's expertise to tailor policy and coverage terms. Our exclusive focus on medical professional liability insurance, supported by over 33 years of experience, allows us to design new product offerings and modify existing policy provisions, such as coverage limits, prior acts coverage, deductibles and experience renewal incentives, to service the unique needs of our policyholders while managing the risks we insure.

#### *Claims Management*

Our claims department manages claims arising from insurance policies we have underwritten. Our claims management team is comprised of nine claims managers who average 15 years of claims management experience. We utilize a claims committee which includes qualified physicians in various medical specialties to assess the medical standard of care and various strategies of defense and resolution for claims made against our policyholders. We utilize external defense counsel with experience in medical professional liability cases to consult with us on claims and to defend lawsuits based on claims. Our claims staff oversees external defense counsel's defense strategy and execution.

All potential claims go through a process by which coverage is verified prior to the vice president of claims accepting and approving the opening of a claim file. Once a claim is opened, our claims specialists will review the medical information, type of injury, amount of damages, venue, other defendant exposure and other available information to recommend an initial claim reserve amount. The initial reserve is an estimate until more information is developed and is commonly set based on our experience with similar cases. As additional information is received, claims reserves are adjusted and any adjustment in excess of \$100,000 must be approved by the vice president of claims. On an as needed basis, the vice president of claims and the medical director determine which claims reserved at \$150,000 or greater or any other claims as deemed necessary are presented to the physicians on the claims committee to assess the medical standard of care and the defensibility of the case.

#### *Loss Prevention Services*

We provide our policyholders with risk management and patient safety services designed to help reduce the risk of incidence and severity of claims and improve defensibility in the event our insured is named in a lawsuit. These services also enhance our underwriting process by allowing us to better understand the risk management and patient safety practices utilized by our policyholders. These products and services include:

**On-site practice assessments** We require on-site assessments of all physicians in which there are concerns with practice and other loss performance issues. We also provide proactive on-site assessments at the request of any of our policyholders.

**Peer-to-peer training** We provide training by medical specialists to address specific practice concerns, emerging risk issues, standards of care, patient/physician communication, and other medical practice oriented topics.

**On-line continuing medical education training** We provide online courses that allow our policyholders to meet annual continuing medical education requirements. Our on-line educational services include various medical/legal courses aimed at reducing risk and enhancing patient safety.

In addition, we provide a quarterly risk management and patient safety newsletter and offer an around the clock hotline for policyholders to discuss practice issues or concerns.

*Investment Portfolio*

As of December 31, 2009, total investments, at fair value, were \$241,061,000 with \$40,164,000 held at the holding company and the remainder at API.

Our entire fixed-income portfolio consists of investment grade securities rated BBB or higher by the Standard and Poor's, Moody's or Fitch rating agencies with the exception of one corporate bond and six collateralized mortgage obligations (CMOs) with a combined fair market value of approximately \$2,455,000. The following table reflects the composition of our fixed-income portfolio by security rating category of the issuer, as of December 31, 2009. In cases where the rating agencies had a different rating assigned to a security, the classification in the table is the lower rating.

	<b>Fair Value</b>	
<b>Rating Category</b>	<b>(in thousands)</b>	<b>Percentage</b>
AAA / Aaa	\$ 167,010	74%
AA / Aa	23,927	10%
A / A	22,547	10%
BBB	10,644	5%
Non-investment grade	2,455	1%
Total	\$ 226,583	100%

Our Insurance Services segment has an investment strategy that is reviewed and approved by the API board of directors annually. The primary goal of our investment strategy for our Insurance Services segment is to ensure that we have sufficient assets to meet our obligations to our policyholders and to provide investment income. The investment plan for our Insurance Services segment provides guidance on diversification, duration of the portfolio, sector allocation and specific restrictions, such as the size of investment in any one issue and limitations on the purchases of securities rated lower than investment grade by Moody's, Standard and Poor's or a comparable rating institution.

Our Insurance Services segment employs an investment strategy that emphasizes asset quality to minimize the credit risk of our investment portfolio and also matches fixed-income maturities to anticipated claim payments and expenditures or other liabilities. The amounts and types of investments that may be made by our Insurance Services segment are regulated under the Texas Insurance Code. We utilize APS Asset Management, our investment advisor subsidiary, as our fixed-income advisor. We utilize two outside investment managers to manage our Insurance Services segment's equity portfolio.

### *Insurance Ratings*

Insurance-specific ratings represent the opinion of rating agencies about the financial strength of a company and its capacity to meet its insurance obligations. Many large medical professional liability insurance buyers, agents and brokers use the ratings assigned by A.M. Best and other rating agencies to assist them in assessing the financial strength and overall quality of the company from which they purchase insurance. These ratings are based on factors most relevant to policyholders, agents and reinsurance intermediaries and are not specifically directed towards the protection of investors. While these ratings may be of interest to investors, they are not recommendations to buy, sell or hold any security.

An insurance company's rating, and particularly its A.M. Best rating, is a potential source of competitive advantage or disadvantage in the marketplace. In addition, certain independent agents and brokers may establish a minimum A.M. Best rating for participation in a potential market. The significance of an A.M. Best rating to a given company varies depending upon the products involved, the customers and agents involved and the competition and market conditions. In addition, the significance of an A.M. Best rating may vary from state to state.

API currently has a financial strength rating from A.M. Best of "A" (Excellent) with a stable outlook, which is within the secure range of available ratings and represents the fourth highest of 16 rating levels. The rating process is dynamic and ratings can change. If you are seeking updated information about our rating, please visit the rating agency website at [www.ambest.com](http://www.ambest.com).

### *Regulation*

General. We are regulated by insurance regulatory agencies in the states in which we conduct business, currently Texas, Arkansas and Oklahoma. State insurance laws and regulations generally are designed to protect the interests of policyholders, consumers or claimants rather than shareholders or other investors. The nature and extent of state regulation varies by jurisdiction, and state insurance regulators generally have broad administrative power relating to, among other matters, setting capital and surplus requirements, licensing of insurers and agents, establishing standards for reserve adequacy, protecting the disclosure of private consumer information, prescribing statutory accounting methods and the form and content of statutory financial reports, regulating certain transactions with affiliates, prescribing the types and amounts of investments, restricting payments of dividends and distributions and reviewing proposed acquisitions of control of domestic or licensed insurers.

Required Licensing. API is organized under the laws of Texas and is authorized in Texas, Arkansas and Oklahoma to transact certain lines of property and casualty insurance. We must apply for and obtain appropriate new licenses before we can expand into a new state on an admitted basis or offer new lines of insurance that require separate or additional licensing.

As an admitted insurer, in many cases, API must file premium rate schedules and policy or coverage forms for review and approval by the insurance regulators. In many states, rates and policy forms must be approved prior to use, and insurance regulators have broad discretion in judging whether an insurer's rates are adequate, not excessive and not unfairly discriminatory. In some states, there has been deregulation, which may reduce or eliminate form and rate approval requirements in certain circumstances. The fact that our current business model involves sales through certain purchasing groups may lessen the rate filing and rate approval obligations of API in certain states.

*Insurance Holding Company Laws.* We operate as an insurance holding company and are subject to regulation in the State of Texas, where API is domiciled. These laws require us to register with the Texas Department of Insurance and furnish information about the operations of the companies held by us that may materially affect API's operations, management or financial condition. These laws also provide that all transactions between API and us or any of our subsidiaries must be fair and reasonable. Transactions between insurance company subsidiaries and their parents and affiliates generally must be disclosed to the state regulators, and notice to and prior approval or absence of disapproval by the applicable state insurance regulator generally is required for any material transaction.

*Payment of Dividends.* State insurance laws restrict the ability of API to pay dividends or to make other payments to us. State insurance regulators require insurance companies to maintain specified levels of statutory capital and surplus. Generally, dividends may only be paid out of earned surplus, and the amount of an insurer's surplus following payment of any dividends must be reasonable in relation to the insurer's outstanding liabilities and adequate to meet its financial needs.

In connection with our acquisition of API, we entered into an agreement with the Texas Department of Insurance that prohibits API from paying dividends or other distributions to us with respect to API's capital stock in any calendar year unless and until we have first complied with our redemption and dividend payment obligations to the holders of our Series A redeemable preferred stock for that year. Our agreement with the Texas Department of Insurance also provides that, until all of the Series A redeemable preferred stock has been fully redeemed and all dividends have been paid, API will not make aggregate annual dividends to us with respect to API's common stock in excess of the lesser of 10% of API's prior year-end policyholder statutory surplus or API's prior year statutory net income, and in no event may such distributions exceed API's statutory earned surplus.

Following the redemption of all of the Series A redeemable preferred stock, API's ability to pay dividends and distributions to us on its capital stock will continue to be subject to rules and regulations generally applicable to Texas insurance companies. Under those regulations, API may not pay an extraordinary dividend, which is defined as any dividend or distribution, the fair market value of which, together with that of other dividends or distributions made within the preceding 12 months, exceeds the greater of (i) 10% of statutory surplus as of the prior year end or (ii) statutory net income for such prior year, until thirty days after the Insurance Commissioner of the State of Texas has received notice of such dividend and has either not disapproved such dividend within such thirty day period or approved such dividends within such thirty day period. In addition, API must provide notice to the Insurance Commissioner of all ordinary dividends and other distributions to shareholders within two business days after declaration and at least ten days prior to the proposed payment.



The regulatory dividend and distribution limitations described above are based on the statutory financial results of API as determined in accordance with statutory accounting principles, which differ from GAAP in various ways. Key differences relate to, among other things, deferred policy acquisition costs, limitations on deferred income taxes, admitted versus non-admitted assets and differences in reserves. Insurance regulators can block payments to us from API that would otherwise be permitted without prior approval if the regulators determine that the payments (such as payments under our underwriting management agreements or payments for employee or other services) would be adverse to the interests of policyholders or creditors.

The Texas Department of Insurance also requires that, in addition to complying with all requirements relevant to its appointed actuary, we provide 30 days prior written notice to the department for any change in our appointed actuary until such time as we have complied with the redemption and dividend payment obligations to our preferred stockholders.

Finally, we must obtain prior approval from the Texas Department of Insurance of any material change in reserving practices or methodologies, including but not limited to any change in the level of our carried reserves in relation to the appointed actuary's range or point estimate until such time as we have complied with the redemption and dividend payments and obligations to our preferred stockholders.

*Change in Control.* Many state insurance laws contain provisions, intended primarily for the protection of policyholders, that require advance approval by the state insurance commissioner of any change in control of an insurance company that is domiciled, or, in some cases, has such substantial business that it is deemed to be commercially domiciled, in that state. Before granting approval of an application to acquire control of an insurer, the state insurance commissioner will typically consider such factors as the financial strength of the applicant, the integrity of the applicant's board of directors and executive officers, the applicant's plans for the future operations of the insurer and any anti-competitive results that may arise from the consummation of the change in control. Generally, state statutes provide that control of an insurer is presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, 10% or more of the voting shares of the insurer or of any company that controls the insurer, although this presumption of control may be rebutted. Any person who acquires 10% or more of our voting shares without the prior approval of the Texas Department of Insurance will be in violation of the laws of the State of Texas, and may be subject to remedies, penalties and sanctions, including the suspension and revocation of API's certificate of authority to engage in business, and injunctive action requiring the disposition or seizure of the common stock or prohibiting the voting of the common stock and other actions determined by the Texas Department of Insurance.

These requirements may discourage, delay or prevent acquisition proposals, including unsolicited transactions, that some or all of our shareholders may consider desirable.

*Guaranty Association Assessments.* The states in which API is licensed to transact business require property and casualty insurers doing business within that state to participate in guaranty associations. These associations are organized to pay benefits owed to policyholders and claimants pursuant to insurance policies issued by insurers that have become impaired or insolvent. Typically, a state assesses each licensed insurer an amount related to the licensed insurer's proportionate share of premiums written by all licensed insurers in the state in the particular line of business in which the impaired or insolvent insurer was engaged. The states in which API operates permit licensed insurers to recover a portion of these payments through full or partial premium tax credits.

Although the amount and timing of future assessments are not predictable, such assessments under current state insurance regulations applicable to API are fully deductible from future premium taxes. As of December 31, 2009, API has \$178,000 in guaranty fund assessment credits that are available to offset future premium taxes.



*Risk-based Capital.* In order to enhance the regulation of insurer solvency, the National Association of Insurance Commissioners ("NAIC") has adopted a formula and a model law to implement risk-based capital ( RBC ) requirements to assess the minimum amount of capital that an insurance company needs to support its overall business operations and to assure that it has an acceptably low likelihood of becoming financially impaired. The RBC formula takes into account various risk factors including asset risk, credit risk, underwriting risk and interest rate risk. As the ratio of an insurer's total adjusted capital and surplus decreases relative to its risk-based capital, the RBC laws provide for increasing levels of regulatory intervention such as supervision and rehabilitation, and culminating with mandatory control of the operations of the insurer by the domiciliary insurance department at the so-called authorized control level. As of December 31, 2009, the RBC ratios for API are in excess of the levels that would require any regulatory or corrective action. The NAIC has set a no action required level if a company's adjusted capital and surplus exceeds 200% of its RBC calculated surplus. Texas law requires certain trend testing if a company's adjusted capital and surplus is less than 300% of its RBC calculated surplus. We had RBC calculated at an authorized control level of \$5,940,000 and statutory capital and surplus of \$103,241,000, or over 17 times the minimum amount required as of December 31, 2009.

*Statutory Accounting Principles.* Statutory accounting principles ( SAP ) is a basis of accounting developed to assist insurance regulators in monitoring and regulating the solvency of insurance companies. SAP is primarily concerned with measuring an insurer's ability to pay all its current and future obligations to policyholders and creditors. SAP focuses on valuing the assets and liabilities of insurers in accordance with standards specified by the insurer's domiciliary jurisdiction.

Generally Accepted Accounting Principles are designed to measure a business on a going-concern basis. It gives more consideration to the matching of revenue and expenses than SAP does and, as a result, certain expenses are capitalized when incurred and then amortized over the life of the associated policies. The valuation of assets and liabilities under GAAP is based in part upon best estimates made by the insurer, and shareholder's equity represents both amounts currently available and amounts expected to become available over the life of the business. As a result, the values for assets, liabilities and equity reflected in financial statements prepared in accordance with GAAP may be different from those reflected in financial statements prepared under SAP.

The NAIC has established uniform statutory accounting principles. Regulators in Texas have adopted these principles, with certain modifications. SAP and related regulations determine the basis for measuring the amount of statutory surplus and statutory net income of API available to pay dividends when applying the dividend restrictions established by the Texas Department of Insurance.

## **Financial Services Operations**

### *Corporate Overview*

Through our Financial Services subsidiaries, we provide brokerage and investment services to institutions and high net worth individuals, trading and analysis of syndicated bank loans and trade claims, and management of fixed-income and equity assets for institutional and individual clients. We generally focus on niche markets within the financial industry where we can bring value to our customers by providing ideas, analysis and liquidity to under-followed or specialized investment situations. In our trading operations, we primarily act in a riskless principal or agent capacity, and carefully manage the limited amount of proprietary positions we assume.

The impact of our Financial Services segment upon total revenues and earnings of the Company has significantly decreased since our acquisition of API in April 2007, due primarily to the contribution of our acquired insurance operations and the decline in the financial services industry created by the global economic crisis. Since the acquisition of API, revenues generated from the Financial Services segment declined from 25% for the year ended December 31, 2007 to approximately 10% and 9% for the years ended December 31, 2009 and 2008, respectively. Similarly, the percentage of total pre-tax earnings contributed by our Financial Services segment declined to 7% for the year ended December 31, 2007. While our Financial Services segment returned to profitability in 2009 after a significant pre-tax loss in 2008, substantially all of our pre-tax earnings in 2009 were derived from our Insurance Services segment.

Through our broker-dealer subsidiary, APS Financial Corporation ("APS Financial"), we focus on providing fixed-income sales and trading services targeted to institutional customers such as hedge funds, mutual funds, insurance companies, other money managers and high net worth individuals. We have established a focus on high yield corporate bonds where our research analyst provides proprietary research and our sales and trading personnel provide trading services to these and other clients. We also provide trading services for other types of debt instruments requiring specialized knowledge and analytics, including mortgage and asset backed debt, municipal debt, investment grade corporate bonds and structured debt. We clear trades through Southwest Securities, Inc. on a fully disclosed basis and we pay a fee based on the number and type of transactions executed. APS Financial is a member of the Financial Industry Regulatory Authority ( FINRA ) and the Securities Investor Protection Corporation ( SIPC ), and, in addition, is licensed in forty-four states and the District of Columbia.

APS Asset Management, Inc. ("Asset Management"), our investment advisory subsidiary, provides management services of fixed-income and equity assets for institutional and individual clients on a fee basis. We can provide complete investment accounting, portfolio analytics, and performance measurement as well as trade execution for managed accounts. Asset Management is a registered investment adviser under the Investment Advisers Act of 1940.

APS Capital Corp. ("APS Capital") is our subsidiary dedicated to the trading of bank loans, trade claims and distressed private loan portfolios. APS Capital provides transaction services for trade claims and bank debt of institutions that are in distressed situations or have entered into bankruptcy. This subsidiary does not trade in securities and is not registered with FINRA or any other regulatory body. APS Capital locates and matches buyers and sellers of these instruments, rather than acquiring and re-selling the instruments directly for our own account.

In our Financial Services segments, we compete with other securities broker-dealers, financial advisory firms and registered investment advisors, as well as commercial banks and thrift institutions. Competition in the segment is principally based on the experience and relationships of our professionals, our ability to efficiently and effectively execute transactions, the price of our products and services, the quality and relevance of our research, our business reputation and the strength of our customer relationships. Many of the institutions we compete with are very well known firms in our markets with much greater financial resources than us.

There is also significant competition in the financial services industry for qualified employees. We compete with other securities firms for investment bankers, sales representatives, securities traders, analysts and other professionals. Our

ability to compete effectively depends on our ability to attract, retain and motivate qualified employees.

## *Regulation*

APS Financial and Asset Management are subject to extensive regulation under both federal and state laws. The SEC is the federal agency charged with administration of the federal securities and investment advisor laws. Much of the regulation of broker/dealers, however, has been delegated to self-regulatory organizations, principally FINRA and the national securities exchanges. These self-regulatory organizations adopt rules (subject to approval by the SEC) which govern the industry and conduct periodic examinations of member broker/dealers. Asset Management is an SEC registered investment advisor and subject to SEC examinations. APS Financial is also subject to regulation by state and District of Columbia securities commissions.

The regulations to which APS Financial is subject cover all aspects of the securities business, including sales methods, trade practices among broker/dealers, uses and safekeeping of customers' funds and securities, capital structure of securities firms, record keeping and the conduct of directors, officers and employees. Additional legislation, changes in rules promulgated by the SEC and by self-regulatory organizations, or changes in the interpretation or enforcement of existing laws and rules, may directly affect the method of operation and profitability of APS Financial and Asset Management. The SEC, self-regulatory organizations and state securities commissions may conduct administrative proceedings that can result in censure, fine, suspension or expulsion of APS Financial, Asset Management and/or our officers or employees. The principal purpose of regulation and discipline of broker/dealers and investment advisors is the protection of customers and the securities markets, rather than protection of creditors and shareholders.

APS Financial, as a registered broker/dealer and FINRA member organization, is required by federal law to belong to SIPC. When the SIPC fund falls below a certain minimum amount, members are required to pay annual assessments in varying amounts not to exceed 0.5% of their adjusted gross revenues to restore the fund. The SIPC fund provides protection for customer accounts up to \$500,000 per customer, with a limitation of \$100,000 on claims for cash balances. Customer accounts managed by Asset Management are maintained with registered broker dealers who are members of SIPC. APS Financial maintains its customer assets with Southwest Securities, Inc., which provides SIPC and purchased supplemental coverage with protection of \$20 million per account with an aggregate limit of \$80 million.

## **Employees**

As of December 31, 2009 we employed, on a full time basis, approximately 99 persons, including 60 in our Insurance Services segment, 27 in our Financial Services segment, and 12 at the holding company level. We consider our employee relations to be good. None of our employees is represented by a labor union and we have experienced no work stoppages.

## **Executive Officers of the Registrant**



As of March 1, 2010, our executive officers were as follows:

<b>Name</b>	<b>Age</b>	<b>Position(s)</b>
Kenneth S. Shifrin	60	Chairman of the Board and Chief Executive Officer, Director
Timothy L. LaFrey	54	President and Chief Operating Officer, Director
Marc J. Zimmermann	40	Senior Vice President and Chief Financial Officer

Our officers serve until the next annual meeting of our directors and until their successors are elected and qualified (or until their earlier death, resignation or removal).

Mr. Shifrin has been our chairman of the board since March 1990. He has been our chief executive officer since March 1989 and he was our president from March 1989 until April 2007. He was also our chief operating officer from June 1987 to February 1989. He has been a member of the board of directors since February 1987. From February 1985 until June 1987, Mr. Shifrin served as our senior vice president finance and treasurer. Mr. Shifrin is a director of HealthTronics, Inc. (NASDAQ: HTRN). He was vice chairman of HealthTronics, Inc. from November 2004 to March 2006, and served as the chairman of the board of Prime Medical Services, Inc. from 1989 until its merger into HealthTronics, Inc. in November 2004. Mr. Shifrin is a member of the World Presidents Organization.

Mr. LaFrey has been our president and chief operating officer as well as a director since April 2007. He previously served as a partner in the Austin office of Akin Gump Strauss Hauer & Feld LLP from April 1997 until April 2007, where his law practice focused on corporate governance, mergers and acquisitions, and debt and equity financings. Mr. LaFrey has extensive experience in the insurance, healthcare, technology and financial services industries. Prior to becoming an attorney, Mr. LaFrey, who also is a certified public accountant, was in the audit practice of KPMG Peat Marwick in Austin. He maintains memberships in the American Bar Association, The State Bar of Texas and the Travis County Bar Association. He also is a member of The American Institute of Certified Public Accountants, and the Texas Society of Certified Public Accountants, and is a member of the Board of Trustees of the Seton Healthcare System.

Mr. Zimmermann has been our senior vice president and chief financial officer since November 2007. He rejoined the Company in August 2003 as chief financial officer of API. He had previously been with the Company from 1997 to 1998 as director of business development of API. Prior to rejoining us, he was with Jefferson Wells, a financial and technology consulting firm. From January 1992 through February 1997, he was employed by Arthur Andersen LLP. Mr. Zimmermann is a certified public accountant.

There are no family relationships among any of our executive officers, and there is no arrangement or understanding between any of our executive officers and any other person pursuant to which he or she was selected as an officer. Each of our executive officers was elected by our board of directors to hold office until the next annual election of officers and until his or her successor is elected and qualified or until his or her earlier death, resignation or removal. Our board of directors elects our officers in conjunction with each annual meeting of our shareholders.

***Item 1A. Risk Factors.***

**RISK FACTORS**

There are a number of factors, many beyond our control, which may cause results to differ significantly from our expectations. There may also be a number of factors not described in this report that could also cause results to differ from our expectations. Any factor described in this report could by itself, or together with one or more other factors, have a negative effect on our business, results of operations and/or financial condition. The most significant of these

risks and uncertainties are listed below. You should consider carefully these risks together with all of the other information included in this Annual Report on Form 10-K and the documents that we have incorporated by reference.

*Our reliance on key executives could affect our results of operations.*

We believe that our success depends on the efforts and abilities of our relatively small group of executive officer personnel. The loss of services of one or more of these key executives could have a material adverse effect on our business. We do not maintain key man life insurance on any of our key executives. In 2000, Kenneth S. Shifrin, our chairman and chief executive officer, was diagnosed with chronic lymphocytic leukemia and he received chemotherapy treatment during 2007. Although he is currently in remission, a worsening of the effects of this condition could reduce our access to Mr. Shifrin's services, which could adversely affect our business.

***As a holding company, our financial condition and results of operations are dependent on our subsidiaries and our ability to pay expenses and dividends will be dependent on our ability to receive dividends from our subsidiaries, which may be restricted.***

We are principally a holding company with assets consisting primarily of cash, investment securities and the capital stock of our subsidiaries. Consequently, our ability to pay our operating expenses, make redemption payments on our redeemable preferred stock and service our other indebtedness is dependent upon the earnings of our subsidiaries and our ability to receive funds from such subsidiaries through loans, dividends or otherwise. Our subsidiaries are legally distinct entities and have no obligation, contingent or otherwise, to make funds available to us for such obligations. In addition, our subsidiaries' ability to make such payments is subject to applicable state laws and claims of our subsidiaries' creditors will generally have priority as to the assets of such subsidiaries. Accordingly, our subsidiaries may not be able to pay funds to us sufficient to enable us to meet our obligations.

The ability of API to pay dividends to us or redeem any of the API preferred stock that we hold is subject to regulation by the Texas Department of Insurance. In addition to restrictions on dividends and distributions applicable to all Texas stock insurance companies, for so long as any Series A redeemable preferred stock is outstanding, the Texas Department of Insurance prohibits API from paying dividends or other distributions to us in respect of API's capital stock that we hold in any calendar year unless and until we have complied with our redemption and dividend payment obligation to the holders of our Series A redeemable preferred stock for that year. Our agreement with the Texas Department of Insurance also provides that, until all of our Series A redeemable preferred stock has been fully redeemed and all dividends have paid, API will not make aggregate annual dividends to us with respect to API's capital stock in excess of the lesser of 10% of API's prior year-end policyholder statutory surplus or API's prior year statutory net income, and in no event may such distributions exceed API's statutory earned surplus. The dividend restriction for calendar year 2008 and 2009, based on API's prior year ended statutory surplus was \$7,717,000 and \$8,804,000, respectively, and for those respective years dividends paid to us were \$7,377,000 and \$8,804,000. For the calendar year 2010, the anticipated dividend restriction is \$10,324,000, based on 2009 year-end statutory surplus, and through March 1, 2010, no dividends have yet been paid to us. Accordingly, our subsidiaries may not be able to pay funds to us and, even if paid such funds may not be sufficient to enable us to meet our obligations.

***We are exposed to credit risk, equity price risk and interest rate risk and as a result, our revenues may fluctuate with interest rates, investment results and developments in the securities markets such as the recent economic crisis.***

We are principally exposed to three types of market risk related to our investment portfolio: credit risk, equity price risk and interest rate risk. We have exposure to credit risk primarily as a holder of fixed-income securities. Equity securities are subject to equity price risk, which is defined as the potential for loss in market value due to a decline in equity prices. A decline in the value of equity securities, evidenced by lower prices traded for the common stock of these companies, might occur for several reasons, including poor financial performance, obsolescence of the service or product provided or any other news deemed to be negative by the investing public. A decline in the value of our fixed maturities securities might occur for the same reasons above as well as due to an increase in interest rates. A material decline, other than temporary, in the value of any of our fixed maturities or equity securities or a going-concern problem regarding an issuer could have a material adverse effect on our financial condition and results of operations.

The values of our fixed-income securities are also subject to interest rate and other risks. As interest rates decrease, the value of the portfolio increases with the opposite holding true in rising interest rate environments. All of our fixed-income securities are designated as available-for-sale and, accordingly, are presented at fair value on our balance sheet. Fixed-income securities may have their fair market value adversely affected due to a change in interest rates, and we may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates.

The financial environment globally and in the United States continues to experience significant volatility. Our investment portfolio and the fair value of our investment holdings has been affected by these poor economic conditions and recent changes in the financial and credit markets, and we rely on the investment income produced by our investment portfolio to contribute to our profitability. Future changes in interest rates and credit quality caused by a continued market downturn may result in fluctuations in the income derived from, the valuation of, and in the case of declines in credit quality, payment defaults on our fixed maturities securities, which could have a material adverse affect on our financial condition, liquidity or results of operations. Our investment portfolio is also subject to credit and cash flow risk, including risks associated with our investments in mortgage-backed securities. Because our investment portfolio is the largest component of our consolidated balance sheet, further deterioration of the economy and the financial and credit markets could result in additional other-than-temporary impairments that are material to our financial condition and operating results. For examples, such economic changes could arise from overall changes in the financial markets or specific changes to industries, companies or municipalities in which we maintain our investment holdings. For the years ended December 31, 2009, 2008 and 2007, we recorded \$2,345,000, \$7,587,000 and \$5,259,000 of other-than-temporary impairments ( OTTI ), respectively.

Changes in interest rates as well as continued market instability due to a prolonged economic crisis could also have an impact at our broker-dealer subsidiary, APS Financial. Since revenues at APS Financial are primarily recorded based on trading fixed-income securities, the general level of interest rates trending higher or lower in 2010 could impact our level of business in different fixed-income sectors and thus negatively affect our commission earned. A volatile interest rate environment or continued poor economic conditions in 2010 could continue to impact our financial services business as this type of market condition can lead to investor uncertainty and their corresponding willingness to commit funds.

***In periods of market illiquidity and instability such as the current financial crisis, the fair value of our investments is more difficult to estimate, could result in assessments of fair value greater or less than amounts received in actual transactions and may have unforeseen consequences that we are currently unable to predict.***

Investment securities traded in active markets are valued at quoted market prices. Other investment securities are valued through the use of various pricing models or based on broker indications that require the application of judgment in selecting the appropriate assumptions based on observable or unobservable market data. Volatile or illiquid markets increase the likelihood that such assumptions may not behave in historically predictable manners, resulting in fair value estimates that are overstated compared with actual amounts that could be realized upon disposition or maturity of the security.

In addition, the ultimate effects of the recent market volatility, credit crises, and overall economic downturn may have unforeseen consequences on the credit quality, liquidity and financial stability of the issuers of securities we hold or reinsurers with which we do business. As recent market experience indicates, such deteriorations in financial condition can occur rapidly, leaving us unable to react to such a scenario in a prudent manner consistent with orderly markets. This in turn could adversely and negatively affect our financial condition or results of operations.

***Anti-takeover provisions in our organizational documents and Texas law could prevent or delay a change in control.***

Certain anti-takeover provisions applicable to our governance could prevent or delay an acquisition of our business at a premium price or at all. These provisions are contained in our articles of incorporation. Others are contained in the Texas statutory law governing corporations. These provisions may have the effect of delaying, making more difficult or preventing a change in control or acquisition of the Company by means of a tender offer, a proxy contest or otherwise. These provisions are expected to discourage certain types of coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of the Company first to negotiate with us.

Our articles of incorporation provide that we may not engage in certain business combinations with a corporation, subsidiary of a corporation, person, or other entity which is the beneficial owner, directly or indirectly, of twenty percent or more of our outstanding voting shares unless either certain requirements are first satisfied or the transaction is approved by the affirmative vote of no less than two-thirds of the shares of our common stock present in person or by proxy at a meeting where at least 80% of our common shares are represented (in person or by proxy).

Sections 21.601 through 21.610 of the Texas Business Organizations Code provide that a Texas corporation may not engage in certain business combinations, including mergers, consolidations, and asset sales, with a person, or an affiliate or associate of such person, who is an affiliated shareholder (generally defined as the holder of 20% or more of the corporation's voting shares) for a period of three years from the date such person became an affiliated shareholder unless (i) the business combination or purchase or acquisition of shares made by the affiliate shareholder was approved by the board of directors of the corporation before the affiliated shareholder became an affiliated shareholder; or (ii) the business combination was approved by the affirmative vote of the holders of at least two-thirds of the outstanding voting shares of the corporation not beneficially owned by the affiliated shareholder, at a meeting of shareholders called for that purpose, not less than six months after the affiliated shareholder became an affiliated shareholder. This anti-takeover statute may have the effect of inhibiting a non-negotiated merger or other business combination involving us, even if such event(s) would be beneficial to our shareholders.

***Our geographic concentration means that our Insurance Services business performance may be affected by economic, regulatory and demographic conditions of our operations within the State of Texas.***

Our insurance business is concentrated in Texas, in which we generated 92%, 95% and 99% of premiums written by API for the years ended December 31, 2009, 2008 and 2007, respectively. Accordingly, unfavorable economic, regulatory and demographic conditions in Texas would negatively impact our business. We focus exclusively on medical professional liability insurance. In the event there is meaningful change in the existing legislation and claims environment, our financial condition and results of operations could be adversely affected. We may be exposed to greater risks than those faced by insurance companies that conduct business over a larger geographic area. For example, our geographic concentration could subject us to pricing pressure as a result of market or regulatory forces only applicable to Texas.

***Our Insurance Services business is highly competitive and many of our competitors have greater financial, marketing, technological and other resources.***

The insurance industry is highly competitive. Many of our competitors possess greater financial, marketing, technological and other resources. We may not be able to continue to compete successfully.

All of our revenue from the Insurance Services segment is attributable to API. Our primary competitors in Texas are MedPro (a subsidiary of Berkshire Hathaway), TMLT, ProAssurance Corporation, The Doctors Company, Advocate MD Insurance of the Southwest, Inc. (a subsidiary FPIC), and Texas Medical Liability Insurance Underwriting



Association, which is the state-sponsored insurer of last resort. We consider these companies to be our competitors because they are the companies to which policyholders typically move when cancelling policies with us. In Arkansas, our primary competitors are SVMIC and FPIC and in Oklahoma, our primary competitors are PLICO and MedPro. We consider these companies to be our competitors because they are the dominant insurance providers in Arkansas and Oklahoma. We compete with these companies on a variety of factors including price, customer service, expertise in claims handling, policy coverage, risk management services and financial strength. Many of our competitors have greater financial strength and broader resources than us. In premiums written and asset size, MedPro, TMLT, ProAssurance Corporation, SVMIC, FPIC and The Doctors Company are significantly larger than us. We do not have the capacity to write the volume of business equal to that of some of the other major carriers. With the implementation of tort reform in late 2003, additional companies entered the Texas market, resulting in further increases in competition. As a result of this increased competition and the effects of tort reform, we continue to face price pressure on both existing renewals and new business.

Our largest insurance competitor in Texas, TMLT was established under the provisions of a statute that authorized a statewide association of physicians or dentists to create a trust to self-insure its members. TMLT has certain competitive advantages as a result. TMLT is subject to limited government regulation in comparison to other insurance companies, such as API, in regards to statutory financial reporting and financial examinations by the Texas Department of Insurance. TMLT further benefits from