

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **2006-08-14** | Period of Report: **2006-06-30**  
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FILER

**Republic Companies Group, Inc.**

CIK: **1320092** | IRS No.: **300175923** | State of Incorporation: **DE** | Fiscal Year End: **1231**  
Type: **10-Q** | Act: **34** | File No.: **000-51455** | Film No.: **061030296**  
SIC: **6331** Fire, marine & casualty insurance

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2006.

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-51455

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**REPUBLIC COMPANIES GROUP, INC.**

(Exact name of registrant as specified in its charter)

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Delaware

(State or other jurisdiction of Incorporation or organization)

30-0175923

(I.R.S. Employer Identification No.)

222 Delaware Avenue, Suite 900

Wilmington, Delaware

(Address of principal executive offices)

19801

(Zip Code)

(302) 658-3613

(Registrant's telephone number, including area code)

N/A

(Former name, former address, and former fiscal year, if changed since last report)

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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 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

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

Shares outstanding of the Registrant' s common stock:

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**Class**

**Outstanding at August 4, 2006**

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Common Stock, \$0.01 par value

14,099,390

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## PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTSREPUBLIC COMPANIES GROUP, INC.  
AND SUBSIDIARIESCondensed Consolidated Balance Sheets  
(Dollars in thousands, except share amounts)

	June 30, 2006 (Unaudited)	December 31, 2005
<b>Assets</b>		
Investments:		
Fixed maturities available for sale, at fair value (amortized cost \$305,763 in 2006 and \$303,157 in 2005)	\$294,723	\$298,169
Equity securities available for sale, at fair value (cost \$1,036 in 2006 and \$1,110 in 2005)	1,053	1,139
Investment in unconsolidated foreign insurance company (cost \$27,855 in 2006 and 2005)	35,950	35,890
Other invested assets	991	991
Short-term investments, at cost (which approximates market)	42,278	63,901
Total investments	374,995	400,090
Cash and cash equivalents	8,175	4,621
Accrued interest and dividends receivable	3,289	2,778
Premiums receivable from agents and insureds (net of allowance of \$450 in 2006 and \$833 in 2005)	67,872	60,654
Balances due from reinsurance companies (net of allowance of \$103 in 2006 and \$330 in 2005)	191,244	217,150
Prepaid reinsurance premiums	103,614	102,165

Deferred policy acquisition costs	30,952	29,003
Net deferred tax asset	16,827	16,231
Federal income tax recoverable	2,544	1,707
Other assets (less accumulated depreciation of \$2,059 in 2006 and \$1,242 in 2005)	<u>18,002</u>	<u>17,310</u>
Total assets	<u>\$817,514</u>	<u>\$851,709</u>
<b>Liabilities and Stockholders' Equity</b>		
Liabilities:		
Losses and loss adjustment expenses	\$300,218	\$315,216
Unearned premiums	245,226	235,646
Senior debt (including accrued interest of \$296 in 2006 and \$257 in 2005)	20,296	20,257
Subordinated notes payable (including accrued interest of \$263 in 2006 and 2005)	31,192	31,192
Accrued expenses and other liabilities	44,583	57,653
Cash overdraft	<u>11,569</u>	<u>27,277</u>
Total liabilities	<u>\$653,084</u>	<u>\$687,241</u>
Minority interest in consolidated subsidiary, net of tax	172	13
Commitments and contingencies (notes 3, 9 and 11)		

Stockholders' equity:

Common stock, \$0.01 par value: Authorized 200,000,000 shares; issued 14,106,632 and outstanding 14,099,662 in 2006; issued 14,022,422 and outstanding 14,020,222 in 2005	141	140
Additional paid-in capital	116,918	115,968
Accumulated other comprehensive loss, net of taxes	(10,658 )	(5,532 )
Retained earnings	<u>57,857</u>	<u>53,879</u>
Total stockholders' equity	<u>\$164,258</u>	<u>\$164,455</u>
Total liabilities and stockholders' equity	<u>\$817,514</u>	<u>\$851,709</u>

See accompanying notes to condensed consolidated financial statements.



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**REPUBLIC COMPANIES GROUP, INC.**  
**AND SUBSIDIARIES**  
Condensed Consolidated Statements of Income  
(Dollars in thousands, except share amounts)  
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Revenues:				
Net insurance premiums earned	\$66,933	\$59,196	\$130,170	\$116,370
Net investment income	3,642	2,727	7,154	5,049
Net realized (losses) gains	(86 )	75	(143 )	76
Other income	1,589	1,632	3,270	3,200
	<u>72,078</u>	<u>63,630</u>	<u>140,451</u>	<u>124,695</u>
Expenses:				
Net losses and loss adjustment expenses incurred	46,588	37,349	79,841	67,030
Underwriting, acquisition and operating expenses	24,219	22,361	49,712	42,629
Interest expense	988	775	1,923	1,510
	<u>71,795</u>	<u>60,485</u>	<u>131,476</u>	<u>111,169</u>
Income from continuing operations before income taxes, minority interest and equity in earnings of unconsolidated foreign insurance company	283	3,145	8,975	13,526
Income tax expense	799	1,116	3,828	4,749
Minority interest in earnings of consolidated subsidiary, net of tax	(116 )	-	(159 )	-

Equity in earnings of unconsolidated foreign insurance company	<u>1,073</u>	<u>838</u>	<u>2,371</u>	<u>1,541</u>
Net income	<u>\$441</u>	<u>\$2,867</u>	<u>\$7,359</u>	<u>\$10,318</u>
Net income (loss) available to common stockholders	<u>\$441</u>	<u>\$(463 )</u>	<u>\$7,359</u>	<u>\$3,423</u>
Earnings (loss) per common share:				
Basic	<u>\$0.03</u>	<u>\$(0.09 )</u>	<u>\$0.53</u>	<u>\$0.68</u>
Diluted	<u>\$0.03</u>	<u>\$(0.09 )</u>	<u>\$0.53</u>	<u>\$0.68</u>
Cash dividends declared per common share	<u>\$0.12</u>	<u>\$-</u>	<u>\$0.24</u>	<u>\$-</u>

See accompanying notes to condensed consolidated financial statements.

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**REPUBLIC COMPANIES GROUP, INC.**  
**AND SUBSIDIARIES**  
Condensed Consolidated Statements of Cash Flows  
(Dollars in thousands)  
(Unaudited)

	Six Months Ended	
	June 30,	
	2006	2005
Cash flows from operating activities:		
Net income from operations	\$7,359	\$10,318
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization and depreciation	821	484
Equity in earnings of unconsolidated foreign insurance company	(2,371 )	(1,541 )
Dividends received from unconsolidated foreign insurance company	487	736
Net accretion of bond discount	617	995
Net loss (gain) on sale of fixed maturities	157	(76 )
Net gain on sale of equity securities	(14 )	-
Deferred federal income tax expense	2,165	2,117
Share-based compensation	820	510
Change in:		
Premiums receivable from agents and insureds	(7,218 )	(8,476 )

Accrued interest and dividends receivable	(511 )	(37 )
Prepaid reinsurance premiums	(1,449 )	5,936
Deferred policy acquisition costs	(1,949 )	(2,511 )
Balances due from reinsurance companies, net	25,906	(10,889 )
Losses and loss adjustment expenses	(14,998)	17,344
Unearned premiums	9,580	1,978
Accrued expenses and other liabilities	(13,070)	903
Other, net	(112 )	(1,384 )
Net cash provided by operating activities	6,220	16,407
Cash flows from investing activities:		
Purchase of fixed assets	(2,269 )	(6,024 )
Sale of fixed assets	–	60
Sale and maturities of fixed maturities, available for sale	82,535	100,342
Purchase of fixed maturities, available for sale	(85,914)	(114,002)
Purchase of equity securities	(387 )	(1,110 )
Sale of equity securities	475	–
Net change in other short-term assets	21,623	10,974

Net cash provided by (used in) investing activities	16,063	(9,760 )
Cash flows from financing activities:		
Redemption of preferred shares	–	(98 )
Issuance of common stock	192	–
Preferred dividends paid	–	(20,018 )
Minority interest	159	–
Common dividends paid	(3,372 )	–
Proceeds from senior debt	–	20,000
Net change in cash overdraft	<u>(15,708)</u>	<u>1,413</u>
Net cash (used in) provided by financing activities	(18,729)	1,297
Net increase in cash and cash equivalents	3,554	7,944
Cash and cash equivalents, at beginning of period	<u>4,621</u>	<u>2,900</u>
Cash and cash equivalents, at end of period	<u><u>\$8,175</u></u>	<u><u>\$10,844</u></u>
Supplemental disclosures of cash flow information:		
Interest paid	<u>\$1,884</u>	<u>\$1,304</u>
Income taxes paid	<u>\$2,500</u>	<u>\$3,896</u>
Dividends declared, not paid	<u>\$1,690</u>	<u>\$–</u>

See accompanying notes to condensed consolidated financial statements.

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**REPUBLIC COMPANIES GROUP, INC.  
AND SUBSIDIARIES**

Notes to Condensed Consolidated Financial Statements

(Unaudited)

**(1) Basis of Presentation and Nature of Operations**

The consolidated financial statements include the accounts of Republic Companies Group, Inc., an insurance holding company, and its wholly owned subsidiaries and certain affiliated companies (“Company”). The Company markets and underwrites personal and commercial property and casualty risks located primarily in the southwestern United States.

The Company has prepared the condensed consolidated financial statements pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”) and U.S. generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of management, the condensed consolidated financial statements include all normal adjustments necessary to present the financial information in accordance with GAAP. All significant intercompany balances and transactions have been eliminated in consolidation. The results of operations for the interim periods should not be considered indicative of results to be expected for the full year. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

Certain amounts in prior periods have been reclassified to conform to the presentation adopted in the current year. Such reclassification did not affect net income or total stockholders’ equity.

***Adoption of New Accounting Pronouncements***

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (“SFAS”) No.123 (revised), *Share-Based Payment*, (“SFAS No. 123R”) which revised SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123R requires companies to adopt the fair value method of accounting for share-based employee compensation plans. The fair value method of accounting for share-based employee compensation plans as defined in SFAS No. 123R is similar in most respects to the fair value method defined in SFAS No. 123. The Company incorporated a forfeiture rate assumption and reclassified “Unearned compensation from restricted stock awards” to “Additional paid in capital” as a result of the adoption of SFAS No. 123R. Since the Company had previously adopted the fair value method of accounting for share-based employee compensation plans, the adoption of SFAS No. 123R did not have a significant effect on the Company’s financial position or results of operations.

Effective January 1, 2006, the Company adopted Financial Accounting Standards Board Staff Position (“FSP”) Nos. 115-1 and 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. The FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other-than-temporary and the measurement of an impairment loss. The FSP clarifies that an investor shall recognize an impairment loss when the impairment is deemed to be other-than-temporary even if a decision to sell the impaired security has not been made. The FSP nullifies certain requirements and carries forward other requirements of Emerging Issues Task Force Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. The implementation of the guidance in the FSP did not have a significant effect on the Company’s financial position or results of operations.

In July 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48 (“FIN 48”), *Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109*. FIN 48 defines a two-step approach for recognizing and measuring tax benefits and requires disclosures of uncertainties in their income tax positions. It also defines the recognition threshold as “more-likely-than not.” FIN 48 is effective for financial years beginning after December 15, 2006. The Company will adopt FIN 48 effective January 1, 2007 and is in the process of evaluating the effect, if any, this pronouncement will have on the financial position and results of operations.





**REPUBLIC COMPANIES GROUP, INC.  
AND SUBSIDIARIES**

Notes to Condensed Consolidated Financial Statements

(Unaudited)

**(2) Unconsolidated Investment**

The investment in unconsolidated foreign insurance company represents the Company's 30% interest in Seguros Atlas, S.A., a Mexican insurance company ("Atlas"). The Company records its equity in the earnings of Atlas on the basis of estimated GAAP income for the six months ended May 31, 2006, as that is the most recently available financial information. Summarized financial information for Atlas as of and for the six months ended June 30, 2006 and June 30, 2005 is presented below (amounts in thousands):

	2006	
	Pesos	Dollars
Assets	5,495,545	495,496
Liabilities	4,043,070	364,536
Equity	1,452,475	130,960
Net Income	87,511	8,135

	2005	
	Pesos	Dollars
Assets	4,276,032	397,881
Liabilities	2,899,712	269,816
Equity	1,376,320	128,065
Net Income	55,552	5,168

The exchange rates used to convert the balance sheet information as of June 30, 2006 and June 30, 2005 were 11.091 pesos and 10.747 pesos, respectively, to one dollar. For 2006, net income was converted using an average exchange rate of 10.757 pesos to one dollar. For the six months ended June 30, 2005, net income was converted using an average exchange rate of 10.750 pesos to one dollar. The Company recorded \$2,371,000 and \$1,541,000 as equity in the earnings of Atlas for the six months ended June 30, 2006 and June 30, 2005, respectively. The equity earnings for the second quarter included a true-up reduction of \$69,000 for the 2005 equity earnings following receipt of final 2005 results from Atlas. The 2006 equity earnings represents an estimate of the Company's share of Atlas' earnings adjusted for estimated differences between Mexican statutory accounting requirements and GAAP.

The Company has not recognized a deferred tax liability for the excess of the carrying value over the tax basis of its investment in Atlas. The unrecognized deferred tax liability is treated as a permanent difference as prescribed by SFAS No. 109, *Accounting for Income Taxes*, which is consistent with the criteria of indefinite reversal described in Accounting Principles Board Opinion (“APB”) No. 23, *Accounting for Income Taxes—Special Areas*. Hence, a deferred tax liability has not been recognized in the accompanying condensed consolidated financial statements. Should the Company no longer meet the indefinite reversal criterion, a deferred tax expense of approximately \$2.9 million at June 30, 2006 would need to be recognized.

As of June 30, 2006, undistributed earnings of the Company’ s unconsolidated foreign insurance company were \$8.6 million.

### **(3) Reinsurance**

The Company’ s insurance subsidiaries and affiliates assume reinsurance from and cede reinsurance to other insurance companies, primarily under treaty reinsurance agreements. Reinsurance does not discharge or diminish the primary liability to insureds of the Company’ s insurance subsidiaries and affiliates as direct insurers. However, it does permit those

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**REPUBLIC COMPANIES GROUP, INC.  
AND SUBSIDIARIES**

Notes to Condensed Consolidated Financial Statements

(Unaudited)

companies to recover losses from the reinsurer. To the extent that reinsuring companies are unable to meet obligations arising under reinsuring agreements, the Company would remain liable. The effect of reinsurance on premiums written and earned is as follows (dollars in thousands):

	Three Months Ended			Three Months Ended		
	June 30, 2006			June 30, 2005		
	Written Premium	Earned Premium	Losses and Loss Adjustment Expense	Written Premium	Earned Premium	Losses and Loss Adjustment Expense
Direct business	\$139,198	\$130,072	\$90,467	\$121,056	\$117,862	\$75,165
Reinsurance assumed	1	-	(393 )	11	772	(5,777 )
Reinsurance ceded	(64,626 )	(63,139 )	(43,486 )	(55,585 )	(59,438 )	(32,039 )
Net amounts	<u>\$74,573</u>	<u>\$66,933</u>	<u>\$46,588</u>	<u>\$65,482</u>	<u>\$59,196</u>	<u>\$37,349</u>
	Six Months Ended			Six Months Ended		
	June 30, 2006			June 30, 2005		
	Written Premium	Earned Premium	Losses and Loss Adjustment Expense	Written Premium	Earned Premium	Losses and Loss Adjustment Expense
Direct business	\$265,458	\$255,878	\$151,962	\$231,739	\$227,209	\$141,795
Reinsurance assumed	40	39	650	13	2,563	(5,869 )
Reinsurance ceded	(127,197)	(125,747)	(72,771 )	(107,467)	(113,402)	(68,896 )
Net amounts	<u>\$138,301</u>	<u>\$130,170</u>	<u>\$79,841</u>	<u>\$124,285</u>	<u>\$116,370</u>	<u>\$67,030</u>

Ceding commissions, which are netted with acquisition costs in the condensed consolidated statements of income, were \$27,019,000 and \$23,824,000 for the six months ended June 30, 2006 and June 30, 2005, respectively.

The table below shows the components of balances due from reinsurance companies as of June 30, 2006 and December 31, 2005 (dollars in thousands):

	<u>June 30,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>
Reinsurance recoverable on paid losses	\$9,261	\$ 13,997
Reinsurance recoverable on outstanding losses	109,741	113,486
Reinsurance recoverable on incurred but not reported losses	72,345	89,997
Allowance for uncollectible reinsurance	<u>(103 )</u>	<u>(330 )</u>
Balances due from reinsurance companies	<u>\$191,244</u>	<u>\$217,150</u>

#### (4) Earnings per Share

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding for each period, including all vested restricted shares issued under the Company' s share-based compensation plans (see Note 6). Diluted earnings per share includes the potential dilution that could occur if outstanding contracts to issue common stock were exercised and converted to common stock using the treasury stock method prescribed by SFAS No. 128, *Earnings per Share*, and SFAS No.123R.

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**REPUBLIC COMPANIES GROUP, INC.  
AND SUBSIDIARIES**

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Following are the basic and diluted per share calculations for the three and six months ended June 30, 2006 and June 30, 2005 (dollars in thousands except per share data):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Basic and fully diluted earnings per share computation:				
Net income from continuing operations	\$441	\$2,867	\$7,359	\$10,318
Less: Preferred stock dividends accrued	—	(3,330 )	—	(6,895 )
Net income (loss) available to common stockholders	<u>\$441</u>	<u>\$(463 )</u>	<u>\$7,359</u>	<u>\$3,423</u>
Weighted average common shares outstanding:				
Basic	<u>13,856,069</u>	<u>5,012,421</u>	<u>13,842,504</u>	<u>4,998,114</u>
Diluted	<u>13,952,015</u>	<u>5,033,880</u>	<u>13,946,544</u>	<u>5,024,775</u>
Earnings (loss) per share:				
Basic	<u>\$0.03</u>	<u>\$(0.09 )</u>	<u>\$0.53</u>	<u>\$0.68</u>
Diluted	<u>\$0.03</u>	<u>\$(0.09 )</u>	<u>\$0.53</u>	<u>\$0.68</u>

### (5) Comprehensive Income

Comprehensive income consists of two components: net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains and losses that under GAAP are recorded as an element of stockholders' equity but are excluded from net income. The Company's other comprehensive income consists of unrealized investment gains/losses and foreign currency translation adjustments

related to the Company' s investment in an unconsolidated foreign insurance company. The following are the components of other comprehensive income (loss), net of income taxes, for the three and six months ended June 30, 2006 and 2005 (dollars in thousands):

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 30,</u>		<u>June 30,</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Net income	\$441	\$2,867	\$7,359	\$10,318
Other comprehensive income:				
Net change in unrealized investment gains/losses	(1,536 )	3,762	(3,847)	527
Reclassification adjustment for realized gains/losses included in net income	(56 )	48	(93 )	49
Change in foreign currency translation	(732 )	702	(1,186)	650
Total comprehensive (loss) income	<u>\$(1,883 )</u>	<u>\$7,379</u>	<u>\$2,233</u>	<u>\$11,544</u>

#### **(6) Share-Based Compensation Plans**

In 2004, the Company adopted the measurement and expense recognition provisions of SFAS No. 123 and has recognized share-based compensation expense over award vesting periods based on the fair value at the date the awards were granted. On January 1, 2006, the Company adopted SFAS No. 123R using the modified prospective approach.

**REPUBLIC COMPANIES GROUP, INC.  
AND SUBSIDIARIES**

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Share-based compensation expense charged against income for the plans was \$360,000 and \$255,000 for the three months ended June 30, 2006 and 2005, respectively. Share-based compensation expense charged against income for the plans was \$820,000 and \$510,000 for the six months ended June 30, 2006 and June 30, 2005, respectively. The total income tax benefit recognized in the income statement for share-based compensation arrangements was \$39,000 and \$89,000 for the three months ended June 30, 2006 and June 30, 2005, respectively. Income tax benefit recognized in the income statement for share-based compensation arrangements was \$61,000 and \$179,000 for the six months ended June 30, 2006 and June 30, 2005, respectively. As of June 30, 2006, there was approximately \$2,704,000 of total unrecognized compensation related to the Company's share-based compensation plans.

As of June 30, 2006, 1,206,366 shares were reserved for future awards under all compensation plans.

**(a) Incentive compensation**

The Company's stockholders approved share-based compensation plans in 2005 and 2004 that allow the award of employee equity incentives at the discretion of the Board of Directors and management. The equity compensation plans provide for compensation to be granted in several forms, including incentive stock options, stock awards, stock appreciation rights, and phantom stock. Share-based compensation expense related to incentive compensation charged against income for the plans was \$335,000 and \$255,000 for the three months ended June 30, 2006 and 2005, respectively. Share-based compensation expense related to incentive compensation charged against income for the plans was \$771,000 and \$510,000 for the six months ended June 30, 2006 and 2005, respectively.

As of June 30, 2006, 720,881 shares were reserved for future awards under the 2005 Equity-Based Compensation Plan.

**Non-vested Stock**

The Company has issued non-vested stock under the 2005 and 2004 incentive compensation plans. Non-vested stock awards generally vest ratably on the anniversary date over periods of three to five years. A summary of the Company's total shares granted and related changes under the plans during the six months ended June 30, 2006, along with the portion of these shares that are non-vested, is presented below:

	<b>Total Non-vested Shares</b>	<b>Weighted- Grant-Date Exercise Fair-Value</b>
Outstanding as of January 1, 2006	236,280	\$ 8.37
Granted after January 1, 2006 but before July 1, 2006	66,043	15.25
Vested after January 1, 2006 but before July 1, 2006	(44,220 )	8.37
Forfeited after January 1, 2006 but before July 1, 2006	(4,770 )	8.90

Outstanding as of June 30, 2006

253,333

\$ 10.15

As of June 30, 2006, there was approximately \$1,787,000 of total unrecognized compensation from the Company's non-vested stock awards. The cost is expected to be recognized over a weighted-average period of 2.16 years. The fair value of shares that vested during the three and six-month periods ended June 30, 2006 was \$754,000. The fair value of shares that vested during the three and six-month periods ended June 30, 2005 was \$657,000.

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**REPUBLIC COMPANIES GROUP, INC.  
AND SUBSIDIARIES**

Notes to Condensed Consolidated Financial Statements

(Unaudited)

**Stock Options**

The stock options vest ratably on the anniversary of the grant date over periods of three to five years and expire ten years from the grant date.

The Company uses the Black-Scholes model to determine fair value of stock options under SFAS Nos. 123 and 123R. The model values stock options based on the stock price at the grant date, the expected life of the stock option, the estimated volatility of the underlying stock, the expected dividend payments and the risk-free interest rate over the expected life of the stock option. The Company estimates the risk-free rate by using the U.S. Treasury Bond rate that most closely matches the expected life of the stock option granted. Expected volatility of common stock is estimated based on a study of the Company's peers. The dividend yield is calculated using the historical dividend rate, since the Company's initial public offering, divided by the stock price at the date of grant. The assumptions used in the Black-Scholes model for stock options granted are:

	<b>Options with Exercise Price of \$10.00</b>	<b>Options with Exercise Price of \$14.13</b>	<b>Options with Exercise Price of \$15.25</b>
Risk-free interest rate	4.42%-4.54%	4.42%	4.60%
Expected volatility of common stock	0%	40%	35%
Dividend yield	0%-3.40%	3.40%	3.15%
Expected life of options	10 years	10 years	6.0-6.5 years

A summary of option activity and changes during the six months ended June 30, 2006 is presented below:

	<b>Share Options</b>	<b>Weighted- Average Exercise Price</b>	<b>Weighted- Average Remaining Contractual Term</b>	<b>Aggregate Intrinsic Value</b>
Outstanding at January 1, 2006	102,096	\$ 11.72	9.35	
Granted	162,419	15.25	9.58	
Outstanding at June 30, 2006	<u>264,515</u>	<u>13.89</u>	<u>9.30</u>	<u>\$1,010,447</u>

Exercisable at June 30, 2006

17,175      \$ 10.00      8.67      \$132,419

The weighted-average grant-date fair value of options granted during the six months ended June 30, 2006 and June 30, 2005 was \$4.56 and \$3.59, respectively. As of June 30, 2006, unrecognized compensation cost of \$917,000 was associated with stock options. The cost is expected to be recognized over a weighted-average period of 3.8 years. No options were exercised during the six months ended June 30, 2006 and June 30, 2005.

***Deferred Compensation Plan for Directors and Director Compensation***

The Company awarded 1,585 and 3,403 shares under the Deferred Compensation Plan for Directors for the three and six-months ended June 30, 2006. Additionally, the Company awarded 3,652 shares to a director during the six months ended June 30, 2006 as director compensation. No such awards were issued in 2005. Such shares have been treated as phantom stock awards, recorded as a liability award and adjusted to fair-value at the end of each period. The Company does not have any unrecognized compensation cost for such awards.

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**REPUBLIC COMPANIES GROUP, INC.  
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Notes to Condensed Consolidated Financial Statements

(Unaudited)

**(b) Employee Stock Purchase Plan**

The Company's stockholders approved the Employee Stock Purchase Plan ("ESPP") in May 2005. The ESPP allows employees to purchase shares of common stock at 85% of the lesser of the fair market value on the first day or the fair market value on the last day of a six-month plan period. More than 50% of the eligible employees elected to participate in the first option period, which started on January 1, 2006 and concluded on June 30, 2006. The Company has issued 14,515 shares of stock under this plan as of June 30, 2006. The compensation cost charged against income for the ESPP offering period ended June 30, 2006 was \$49,000. The Company received cash of \$192,000 from ESPP participants for the period ended June 30, 2006 and accounts for the ESPP as a liability award plan. The second offering period begins on July 1, 2006 and ends December 31, 2006.

As of June 30, 2006, 485,485 shares are reserved for future award under the ESPP.

**(7) Pension Plans**

The Company sponsors a qualified defined benefit plan for employees of the Company and certain affiliates that was frozen with benefits accrued through December 31, 2003. Pension costs for this pension plan are as follows (dollars in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Service cost	\$ -	\$ -	\$ -	\$ -
Interest cost	682	663	1,365	1,326
Amortization of unrecognized transition obligation	-	-	-	-
Recognized net actuarial loss	-	-	-	-
Expected return on plan assets	(892 )	(840 )	(1,783)	(1,680)
Curtailment	-	-	-	-
Prior service cost	-	-	-	-
Net periodic pension benefit	<u>\$ (210 )</u>	<u>\$ (177 )</u>	<u>\$ (418 )</u>	<u>\$ (354 )</u>



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**REPUBLIC COMPANIES GROUP, INC.  
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Notes to Condensed Consolidated Financial Statements

(Unaudited)

The Company sponsors a noncontributory nonqualified defined benefit pension restoration plan for a select group of management employees of the Company and its subsidiaries that was frozen with benefits accrued through December 31, 2003. This plan restores the benefit lost by these employees due to cap limits of the qualified plan. Pension costs for this pension plan are as follows (dollars in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Service cost	\$ -	\$ -	\$ -	\$ -
Interest cost	30	31	61	62
Amortization of unrecognized transition obligation	-	-	-	-
Recognized net actuarial loss	6	3	11	6
Expected return on plan assets	-	-	-	-
Curtailment	-	-	-	-
Prior service cost	-	-	-	-
Net periodic pension cost	<u>\$ 36</u>	<u>\$ 34</u>	<u>\$ 72</u>	<u>\$ 68</u>

**(8) Income Tax**

The Company's tax expense for the three months ended June 30, 2006 included a true-up of \$722,000 for nondeductible amounts related to the Company's share-based compensation plans. This is the primary reason for an effective tax rate of 42.7% for the six months ended June 30, 2006.

**(9) Contingent Liabilities and Commitments**

The Company is subject to claims and lawsuits that arise in the ordinary course of business. Based on information presently available in connection with claims and lawsuits presently pending, it is the opinion of the Company's management that the disposition or ultimate determination of such claims and lawsuits will not have a material adverse effect on the financial position or results of operations of the Company.

The Company is subject to assessments from state FAIR Plans and windpools. Plans such as the Louisiana Citizens Property Insurance Corporation and Texas Windstorm Insurance Association have levied assessments against several of the Company's insurance subsidiaries following Hurricanes Katrina and Rita and additional assessments may follow. These assessments are expected to be recoverable from the Company's catastrophe reinsurers. Such assessments may also be recoverable through surcharges to policyholders, wherein any recoveries would be reimbursed to the reinsurers or paid directly to the applicable windpool association.

One of the Company's subsidiaries is currently defending a statewide putative class action lawsuit pending in the District Court of the Parish of Orleans, Louisiana filed on April 12, 2006 in the aftermath of Hurricane Katrina. The plaintiffs generally allege that Republic Fire and Casualty Insurance Company and other unaffiliated insurer defendants breached their policies by failing to pay the face value of policies to insureds who sustained a total loss of their homes and improvements in part as a result of a non-covered loss from Hurricane Katrina. Plaintiffs seek to recover face value of the policies regardless of the anti-concurrence provisions of the Company's policies or the fact the Company timely paid covered losses in accordance with the policies' provisions. This lawsuit seeks declaratory relief and unspecified monetary damages, statutory penalties and attorneys' fees. This matter is in the early stages of development, and the Company is defending it vigorously. No class has been certified in this matter. The Company cannot at this time predict the outcome of this matter, is unable to estimate a range of possible loss, if any, and cannot predict whether or not the outcome will have a material adverse effect on the Company's business, financial position or results of operations.

#### **(10) Segment Information**

The Company classifies its business into the following segments: Independent Agents - Personal Lines ("Personal Lines"),

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**REPUBLIC COMPANIES GROUP, INC.  
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Notes to Condensed Consolidated Financial Statements

(Unaudited)

Independent Agents - Commercial Lines (“Commercial Lines”), Program Management, and Insurance Services and Corporate (“Insurance Services”). Segments are designated based on the respective similarities in distribution systems, internal processing and management reporting systems and organizational management structure.

Income (loss) from continuing operations before income taxes by segment consists of revenues, including allocated investment income, less expenses, plus realized gains and losses related to the respective segment’s operations. Taxes are allocated to each segment at the Company’s effective tax rate. Interest expense and the equity earnings of the unconsolidated foreign insurance company are reflected in the Insurance Services segment. Segment results for the three and six-month periods ended June 30, 2006 and 2005 are as follows (dollars in thousands):

**Three months ended June 30, 2006**

	Total Revenues					Income (Loss)	
	Gross Written Premium	Net Insurance Premium Earned	Net Investment Results	Other	Total	from Continuing Operations Before Taxes	Net Income (Loss)
	(Dollars in thousands)						
Personal Lines	\$38,245	\$31,989	\$ 1,193	\$384	\$33,566	\$ (643 )	\$(610 )
Commercial Lines	25,649	19,229	1,227	53	20,509	(2,265 )	(1,411)
Program Management	33,138	15,715	1,026	521	17,262	3,259	1,432
Insurance Services	42,167	-	110	631	741	(68 )	1,030
Consolidated	<u>\$139,199</u>	<u>\$66,933</u>	<u>\$ 3,556</u>	<u>\$1,589</u>	<u>\$72,078</u>	<u>\$ 283</u>	<u>\$441</u>

**Three months ended June 30, 2005**

	Total Revenues					Income (Loss)	
	Gross Written Premium	Net Insurance Premium Earned	Net Investment Results	Other	Total	from Continuing Operations Before	Net Income

						Taxes	
	(Dollars in thousands)						
Personal Lines	\$35,636	\$31,821	\$ 1,211	\$414	\$33,446	\$ 379	\$235
Commercial Lines	21,044	16,987	925	51	17,963	1,018	660
Program Management	30,947	10,388	589	653	11,630	1,971	1,286
Insurance Services	33,440	–	77	514	591	(223 )	686
Consolidated	<u>\$121,067</u>	<u>\$59,196</u>	<u>\$ 2,802</u>	<u>\$1,632</u>	<u>\$63,630</u>	<u>\$ 3,145</u>	<u>\$2,867</u>

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**REPUBLIC COMPANIES GROUP, INC.  
AND SUBSIDIARIES**

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Six months ended June 30, 2006

	Total Revenues					Income (Loss)	
	Gross Written Premium	Net Insurance Premium Earned	Net Investment Results	Other	Total	from Continuing Operations Before Taxes	Net Income (Loss)
	(Dollars in thousands)						
Personal Lines	\$70,900	\$63,085	\$ 2,385	\$793	\$66,263	\$ 3,694	\$2,173
Commercial Lines	47,351	36,590	2,402	100	39,092	(830 )	(476 )
Program Management	66,586	30,495	1,996	1,021	33,512	6,115	3,293
Insurance Services	80,661	—	228	1,356	1,584	(4 )	2,369
Consolidated	<u>\$265,498</u>	<u>\$130,170</u>	<u>\$ 7,011</u>	<u>\$3,270</u>	<u>\$140,451</u>	<u>\$ 8,975</u>	<u>\$7,359</u>

Six months ended June 30, 2005

	Total Revenues					Income (Loss)	
	Gross Written Premium	Net Insurance Premium Earned	Net Investment Results	Other	Total	from Continuing Operations Before Taxes	Net Income
	(Dollars in thousands)						
Personal Lines	\$67,347	\$64,122	\$ 2,173	\$828	\$67,123	\$ 10,296	\$6,681
Commercial Lines	40,894	33,384	1,613	97	35,094	882	572

Program Management	59,119	18,864	1,113	1,222	21,199	2,613	1,703
Insurance Services	<u>64,392</u>	<u>—</u>	<u>226</u>	<u>1,053</u>	<u>1,279</u>	<u>(265)</u>	<u>1,362</u>
Consolidated	<u>\$231,752</u>	<u>\$116,370</u>	<u>\$ 5,125</u>	<u>\$3,200</u>	<u>\$124,695</u>	<u>\$ 13,526</u>	<u>\$10,318</u>

Identifiable assets by segment are those assets used in or allocated to the operation of each segment. Identifiable assets by segment are as follows (dollars in thousands):

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
Personal Lines	\$226,243	\$224,992
Commercial Lines	172,922	161,736
Program Management	226,576	195,219
Insurance Services	191,773	183,453
Consolidated	<u>\$817,514</u>	<u>\$765,400</u>

**REPUBLIC COMPANIES GROUP, INC.  
AND SUBSIDIARIES**

Notes to Condensed Consolidated Financial Statements

(Unaudited)

**(11) Subsequent Events**

On August 4, 2006, the Company entered into a definitive merger agreement pursuant to which a subsidiary of Delek Capital Ltd. (“Delek”) would acquire all of the outstanding shares of the Company’s common stock for \$20.40 per share in cash. The transaction is expected to close by the end of 2006 subject to certain conditions, including approval by the Company’s stockholders and customary regulatory approvals.

One of the Company’s subsidiaries is currently defending a statewide putative class action lawsuit pending in the District Court of the Parish of Calcasieu, Louisiana filed on July 20, 2006 in the aftermath of Hurricane Rita, and the Company was served on August 7, 2006. The plaintiffs generally allege that Republic Fire and Casualty Insurance Company breached its policies by improperly adjusting and paying claims over the last ten years. These plaintiffs also alleged bad faith claims handling practices. This lawsuit seeks declaratory relief and unspecified monetary damages, statutory penalties and attorneys’ fees. This matter is in the early stages of development. The Company plans to defend it vigorously. No class has been certified in this matter. The Company cannot at this time predict the outcome of this matter, is unable to estimate a range of possible loss, if any, and cannot predict whether or not the outcome will have a material adverse effect on the Company’s business, financial position or results of operations.

On August 8, 2006, the Board of Directors declared a quarterly common stock dividend of 12 cents per share payable on October 13, 2006 to shareholders of record at the close of business on September 29, 2006.

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### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

In addition to the information discussed below, you should read the Company's consolidated and combined financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission ("SEC"). The Annual Report includes information regarding the Company not discussed in this Quarterly Report on Form 10-Q, such as an overview of our organizational structure and businesses, a summary of our principal revenue and expense items, a summary of our key financial measures (which includes information about insurance industry recognized metrics in addition to traditional GAAP measures) and a summary of our critical accounting policies. You should also read the Risk Factors described in Part II, Item 1A of this Quarterly Report on Form 10-Q and in Part I, Item 1A of our Annual Report on Form 10-K in conjunction with this Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### **Forward Looking Statements**

A number of the statements in this Quarterly Report on Form 10-Q are forward-looking statements, as that term is defined in the Private Securities Litigation Reform Act of 1995 ("PSLRA"), that reflect our current views with respect to future events and financial performance. These forward-looking statements, which may apply to us specifically or the insurance industry in general, are subject to risks and uncertainties, as described in our Annual Report on Form 10-K under the caption "Risk Factors" and elsewhere in this report, and made pursuant to the safe harbor provisions of the PSLRA and include estimates and assumptions related to economic, competitive, regulatory, judicial, legislative and other developments. Statements that include the words "expect," "intend," "plan," "believe," "project," "estimate," "may," "should," "anticipate," "will" and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise.

#### **RESULTS OF OPERATIONS**

##### **Financial Summary**

We are a provider of personal and commercial property and casualty insurance products to individuals and small to medium-size businesses primarily in Texas, Louisiana, Oklahoma and New Mexico. Our business is conducted through four segments organized primarily by distribution channel:

Independent Agents-- Personal Lines ("Personal Lines")

Independent Agents-- Commercial Lines ("Commercial Lines")

Program Management

Insurance Services and Corporate ("Insurance Services")

Our Personal Lines and Commercial Lines segments operate through our network of independent agents, our two affiliated managing general agents ("MGAs") and one unaffiliated MGA. Our Program Management segment includes products distributed through unaffiliated MGAs that bind and underwrite insurance policies in conformity with our underwriting guidelines on our behalf within designated programs. Our Insurance Services segment is primarily comprised of fee-based fronting business, interest expense on our long-term debt and the equity earnings of our unconsolidated foreign insurance company.

##### *2006 Consolidated Results of Operations Overview*

Quarterly gross written premiums were \$139.2 million, an increase of 15.0%,

Quarterly revenues were \$72.1 million, an increase of 13.3%,

Quarter over quarter growth in gross written premium was the strongest since our initial public offering ("IPO"),

Quarterly net income of \$0.4 million impacted by spring storms,

Year-to-date gross written premiums were \$265.5 million, an increase of 14.6%,

Year-to-date revenues were \$140.5 million, an increase of 12.6%, and

Year-to-date net income was \$7.4 million

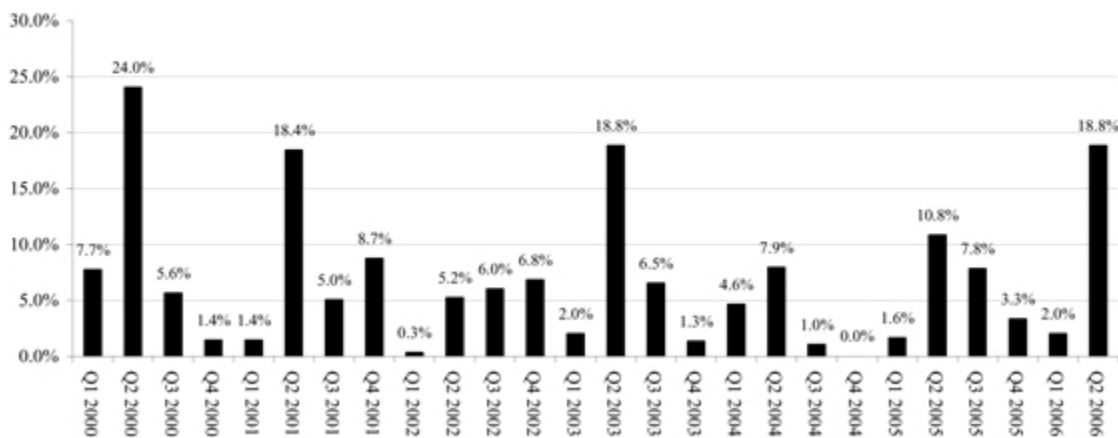
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*Catastrophe Loss Events*

We experienced a substantial number of weather-related catastrophe loss events during the three months ended June 30, 2006. The Company defines a catastrophe loss event as a natural or man-made incident with losses aggregating at least \$400,000 within a 72-to-96-hour period. The frequency and severity of catastrophe losses in any period is inherently unpredictable and may be material to our results of operations and financial position. Our catastrophe net loss ratio for the three months ended June 30, 2006 was 18.8% compared to 10.8% for the same period in 2005, an increase of 8.0 percentage points. Our average second quarter net catastrophe ratio for the previous six years was 14.2%. Net of reinsurance catastrophe loss expense was \$12.6 million for the three months ended June 30, 2006 compared to \$6.4 million for the same period in 2005, an increase of 96.6%. The second quarter 2006 catastrophe losses impacted both the Personal and Commercial Lines segments on a proportionate basis primarily due to damage to property from hail, tornados, wind and falling tree limbs. The graph below presents our catastrophe loss ratio by quarter since the year 2000.

**Historical Catastrophe Loss Ratios by Quarter  
(after reinsurance)**



*Recent Developments*

On August 4, 2006, the Company entered into a definitive merger agreement pursuant to which a subsidiary of Delek Capital Ltd. (“Delek”) would acquire all of the outstanding shares of the Company’s common stock for \$20.40 per share in cash. The transaction is expected to close by the end of 2006 subject to certain conditions, including approval by the Company’s stockholders and customary regulatory approvals.

On June 26, 2006, we entered into an MGA agreement with FirstComp Underwriters Group, Inc. (“FirstComp”). FirstComp writes workers’ compensation through independent agents in 25 states. The FirstComp book of business is estimated to be \$80 million of gross written premiums in the 2006/2007 underwriting year. We will retain 35% of the net premium and underwriting risk and cede a portion of the business under a new quota share reinsurance agreement. In addition, we will receive fee income for the 65% quota share reinsurance placements.

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Texas Select, major homeowner insurer in Texas, was placed in receivership by the Texas Department of Insurance (“TDI”) and ordered to cease writing new and renewal insurance business. TDI plans to cancel all policies by August 24, 2006. We have created a policy acceptance unit to assist independent agents in quickly and easily transferring selected business to Republic. We believe the market disruptions such as this, along with other major carriers’ decisions to withdraw from Texas coastal areas, create opportunities for Republic to balance our coastal exposures, minimize involuntary pool assessments and prudently grow our personal property book of business.

### *Regulatory Examination*

In the second quarter of 2006, the Texas Department of Insurance completed its regularly scheduled statutory financial and market conduct examinations of our Texas-domiciled insurance subsidiaries and affiliates and their statutory financial statements and business practices for the five-year period ended December 31, 2004. All of the examination reports were issued with no material findings or adjustments to surplus.

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## CONSOLIDATED RESULTS OF OPERATIONS

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
	(Dollars in thousands)			
Net insurance premiums earned	\$66,933	\$59,196	\$130,170	\$116,370
Net investment income	3,642	2,727	7,154	5,049
Net realized (losses) gains	(86 )	75	(143 )	76
Other income	1,589	1,632	3,270	3,200
Total revenues	72,078	63,630	140,451	124,695
Net losses and loss adjustment expenses incurred	46,588	37,349	79,841	67,030
Underwriting, acquisition and operating expenses:				
Commissions	13,483	11,746	26,972	22,072
Other underwriting, acquisition and operating expenses	10,736	10,615	22,740	20,557
Total underwriting, acquisition and operating expenses	24,219	22,361	49,712	42,629
Interest expense	988	775	1,923	1,510
Total expense	71,795	60,485	131,476	111,169
Income from continuing operations before income taxes, minority interest and equity in earnings of consolidated foreign insurance company	283	3,145	8,975	13,526
Income tax expense	799	1,116	3,828	4,749



Minority interest	(116 )	-	(159 )	-
Equity in earnings of unconsolidated foreign insurance company	<u>1,073</u>	<u>838</u>	<u>2,371</u>	<u>1,541</u>
Net income	<u>\$441</u>	<u>\$2,867</u>	<u>\$7,359</u>	<u>\$10,318</u>
Net income (loss) available to common stockholders	<u>\$441</u>	<u>\$(463 )</u>	<u>\$7,359</u>	<u>\$3,423</u>
Earnings per common share:				
Basic	<u>\$0.03</u>	<u>\$(0.09 )</u>	<u>\$0.53</u>	<u>\$0.68</u>
Diluted	<u>\$0.03</u>	<u>\$(0.09 )</u>	<u>\$0.53</u>	<u>\$0.68</u>
<b>Key Measures:</b>				
Gross written premiums	\$139,199	\$121,067	\$265,498	\$231,752
Net written premiums	74,573	65,482	138,301	124,285
GAAP Ratios:				
Net ex-catastrophe loss ratio	50.8 %	52.3 %	50.7 %	51.3 %
Net catastrophe loss ratio	18.8 %	10.8 %	10.6 %	6.3 %
Net expense ratio	<u>36.2 %</u>	<u>37.8 %</u>	<u>38.2 %</u>	<u>36.6 %</u>
Net combined ratio	<u>105.8 %</u>	<u>100.9 %</u>	<u>99.5 %</u>	<u>94.2 %</u>
Total assets	\$817,514	\$765,400	\$817,514	\$765,400
Statutory surplus	177,324	164,196	177,324	164,196

Return on average equity	n/a	n/a	8.6	%	12.1	%
Net underwriting leverage	1.7x	1.6x	1.6x		1.5x	

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### COMPARISON OF THE THREE MONTHS ENDED JUNE 30, 2006 TO THE THREE MONTHS ENDED JUNE 30, 2005

#### **Consolidated Revenues**

**Gross written premiums**--Gross written premiums for the three months ended June 30, 2006 were \$139.2 million, compared to \$121.1 million in the same period in 2005, an increase of 15.0%. We recorded gross written premiums growth in all segments in the second quarter. The growth was primarily driven by a:

26.1%, or \$8.7 million, increase in the Insurance Services segment, primarily from growth from two programs fronted by us for large, national carriers where we do not retain any of the underwriting risk;

7.1%, or \$2.2 million, increase in the Program Management segment, primarily due to growth in our non-subscriber program and the commercial auto/small casualty program of our largest MGA;

21.9%, or \$4.6 million, increase in Commercial Lines, including a 30.7% increase in commercial liability and a \$1.9 million increase in workers compensation; and

7.3%, or \$2.6 million, increase in Personal Lines, including a 21.4% increase in personal property premiums, primarily from our low-value dwelling initiative that included \$2.6 million of additional written premiums, which offset a 14.8% decrease in personal auto premiums.

We experienced growth in all of our segments; however, we experienced a 14.8% decrease in our nonstandard and standard personal auto premiums. Our decline in nonstandard and standard personal auto premiums was expected because the margins in this product continue to be compressed through increasing competition. We have purposefully decided not to compete heavily for this low-margin business.

We have received approval from regulatory authorities for a 7.0% increase for Texas homeowners and a 17.3% average increase for Louisiana personal property to offset the higher cost of reinsurance. Such average increases vary by territory based on actuarial justification. The increases were effective in the second quarter and will significantly affect net insurance premiums earned starting in the third quarter of 2006. Other Texas carriers have also filed for rate increases for personal property products that will make the market rates more comparable with our rates.

**Net written premiums**--Net written premiums for the three months ended June 30, 2006 were \$74.6 million, compared to \$65.5 million in the same period in 2005, an increase of 13.9%. The difference in the growth of both the gross and net premiums is influenced by higher reinsurance costs following the heavy catastrophe losses from Hurricanes Katrina and Rita. The estimated additional cost for catastrophe and excess per risk reinsurance in the second quarter of 2006 was approximately \$2.3 million. For the 2006 year, Republic substantially replicated its 2005 catastrophe reinsurance coverage and also increased the reinsurance protection to \$100 million. Higher reinsurance costs were incurred beginning January 1, while the offsetting benefits from rate increases on the Company's policies in Texas and Louisiana will not begin to be earned until later in 2006. Net written premiums also increased by 31.0% in our Program Management segment primarily due to our increased retention in the business produced by our largest unaffiliated MGA. The Insurance Services segment does not contribute any net written premiums because this business is 100% ceded pursuant to fronting arrangements with unaffiliated national or regional carriers.

**Net insurance premiums earned**--Net insurance premiums earned for the three months ended June 30, 2006 were \$66.9 million compared to \$59.2 million in the same period in 2005, an increase of 13.1%. Net insurance premiums earned also increased significantly in our Program Management segment due to our increased retention in the business produced by our largest unaffiliated MGA and premium growth from our non-subscriber program. The Insurance Services segment does not contribute any net insurance premiums earned, because this business is 100% ceded pursuant to fronting arrangements with unaffiliated national or regional carriers.

**Investment income**--Investment income for the three months ended June 30, 2006 was \$3.6 million, compared to \$2.7 million in the same period in 2005, an increase of 33.6%. The increase primarily resulted from the higher invested asset base and increases in short-term interest rates. The annualized net investment yield on average invested assets, excluding our investment in Atlas, was 4.2% for the second quarter of 2006 compared to 3.2% for the same period in 2005.

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**Other income**--Other income for the three months ended June 30, 2006 was \$1.6 million and largely unchanged from the same period in 2005. Other income from the Program Management segment declined 20.2% during the quarter primarily due to a change in the contractual basis for determining the fronting fee received from our largest MGA program, while other income from the Insurance Services segment increased 22.8% in part due to increased premium volume for fronting programs for several large national carriers. Other income also includes installment billing fee income, which was largely unchanged for the same period from the prior year, as well as minor amounts of miscellaneous income.

## Expenses

**Net losses and loss adjustment expenses incurred**--Net losses and loss adjustment expenses incurred for the three months ended June 30, 2006 were \$46.6 million, compared to \$37.3 million in the same period in 2005, an increase of 24.7%. The net loss ratio for the three months ended June 30, 2006 was 69.6% compared to 63.1% for the same period in 2005, an increase of 6.5 points.

The net ex-catastrophe loss ratio for the second quarter of 2006 was 50.8%, compared to 52.3% in the same period in 2005, a decrease of 1.5 points.

The net catastrophe loss ratio for the second quarter of 2006 was 18.8%, compared to 10.8% in the same period in 2005, an increase of 8.0 points.

Higher reinsurance costs increased the net loss ratio by 1.6 points for the three months ended June 30, 2006.

We continued to process the few pending claims remaining from Hurricanes Katrina and Rita. Our previously reported estimated ultimate loss and loss adjustment expenses from Hurricanes Katrina and Rita of \$45.3 million and \$47.2 million, respectively, appear to be adequate since these estimates included the effects of contingencies such as a surge in demand for products and services. The financial effects of these storms remain well within the protections provided by our catastrophe reinsurance treaties as previously reported. Further, the support of our reinsurance partners continues to be exemplary and we have not experienced any collectibility issues regarding reinsurance recoverables. Our net reinsurance recoverable asset has now returned to pre-hurricane levels. The Louisiana legislature has extended the prescriptive period for filing hurricane claims from twelve months to eighteen months; however, we do not anticipate any significant change in the losses incurred from the 2005 hurricanes.

We partially mitigate fluctuations in weather event frequency and severity with an aggregate reinsurance treaty, with severe weather deductibles and by spreading geographic concentrations. During the three months ended June 30, 2006, we experienced seven weather events that qualified for coverage under our aggregate catastrophe reinsurance treaty compared to three events for the same period in 2005, and two events for the same period in 2004. The aggregate catastrophe reinsurance treaty in 2006 provides \$5.0 million of protection when the sum of qualifying storms exceeds \$12.5 million. We ceded \$2.0 million of storm losses to this treaty in the second quarter of 2006 and have an additional \$3.0 million capacity of third and fourth qualifying storms to this treaty.

**Underwriting, acquisition and operating expenses**--Underwriting, acquisition and operating expenses for the three months ended June 30, 2006 were \$24.2 million, compared to \$22.4 million in the same period in 2005, an increase of 8.3%. The net expense ratio for the second quarter of 2006 was 36.2%, compared to 37.8% for the same period in 2005, an improvement of 1.6 points. The net expense ratio decreased primarily due to growth in earned premiums. The expense dollars increased primarily due to:

increased commissions associated with the higher commission low-value dwelling program plus higher commissions associated with the Program Management segment where commissions fluctuate inversely with the loss ratio;

compliance costs associated with the implementation of the Sarbanes-Oxley Act of 2002 ("SOX"), the ongoing cost of which should be substantially lower after we have completed the initial implementation; and

incremental public company expenses, including higher audit and legal fees.

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**Interest expense**--Interest expense for the three months ended 2006 was \$1.0 million, compared to \$0.8 million in the same period in 2005, an increase of 27.5%. Rising interest rates on our floating rate debt contributed to the increase in interest expense.

### **Income**

**Underwriting results**--Underwriting results for the three months ended June 30, 2006 were a loss of (\$3.9) million, compared to a loss of (\$0.5) million in the same period in 2005. The total net combined ratio for the second quarter of 2006 was 105.8% compared to 100.9% in the same period in 2005. Despite improvements in the ex-catastrophe loss ratio and expense ratio, the net combined ratio increased primarily due to:

- increased catastrophe losses from weather related storms, which contributed 8.0 percentage points;
- costs of being a public company (particularly the cost of compliance with SOX) which contributed 1.7 percentage points;
- increased reinsurance costs which contributed 1.6 percentage points; and
- two large commercial property fire losses that also impacted the ex-catastrophe loss ratio.

**Income from continuing operations before income taxes, minority interest, and equity in earnings of consolidated foreign insurance company**--Income from continuing operations before income taxes, minority interest, and equity in earnings of consolidated foreign insurance company expense for the three months ended June 30, 2006 was \$0.3 million, compared to \$3.1 million for the same period in 2005. The decline in income is attributable to the decline in underwriting results.

**Income tax expense**--Income tax expense for the three months ended June 30, 2006 was \$0.8 million, compared to \$1.1 million in the same period in 2005, a decrease of 28.4%. We generally pay tax at a 35% effective rate; however, our effective tax rate is higher, primarily due to the inclusion of a \$0.7 million true-up of nondeductible expenses related to share-based compensation plans. Income tax expense also does not include any expense resulting from the equity in the earnings of our unconsolidated foreign insurance company or expense for the excess of the carrying value over the tax basis of our investment in the unconsolidated foreign insurance company as described in the next section.

**Equity in earnings of unconsolidated foreign insurance company**--Equity in earnings of unconsolidated foreign insurance company for the three months ended June 30, 2006 was \$1.1 million compared to \$0.8 million in the same period in 2005, an increase of 28.0%. The increase from 2005 to 2006 was driven primarily by Atlas' improved investment results. Although Atlas' investment performance has resulted in a higher equity share of their income over the prior year, we believe that the Mexican insurance industry is becoming increasingly competitive and underwriting margins will be pressured in 2006.

We recorded a true-up to the prior year earnings of Atlas in the second quarter based on the receipt of final year-end results, adjusted for U.S. GAAP. The adjustment recorded in the second quarter of 2006 was a reduction of less than \$0.1 million.

We do not recognize a deferred tax liability for the excess of the carrying value over the tax basis of our investment in Atlas, since the difference is treated as a permanent difference under GAAP as prescribed by SFAS No. 109, *Accounting for Income Taxes*, and APB No. 23, *Accounting for Income Taxes-Special Areas*. Hence, a deferred tax liability has not been recognized in the accompanying condensed consolidated financial statements. If we no longer meet the indefinite reversal criterion, a deferred tax expense of approximately \$2.9 million at June 30, 2006 would need to be recognized.

**Minority interest**--Minority interest was (\$0.1) million for the three months ended June 30, 2006. The minority interest is related to our 80% owned MGA that manages our low-value dwelling program, Republic Home Protectors, Inc.

**Net income**--Net income for the three months ended June 30, 2006 was \$0.4 million compared to \$2.9 million in the same period in 2005, a decrease of \$2.5 million. The drop in income primarily resulted from the higher frequency of weather related catastrophe losses, partially offset by higher investment results.

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### **Key Financial Measures**

**Earnings per share**--Basic and fully diluted earnings per share were \$0.03 for the three months ended June 30, 2006 and \$(0.09) for the same period in 2005. Reported earnings per share comparisons between the second quarters of 2006 and 2005 are distorted for comparative purposes by the effects of the preferred stock that was outstanding prior to our August 2005 IPO and the additional shares issued in the IPO to retire this preferred stock. Since all IPO net proceeds were used to redeem the existing preferred stock, we believe a meaningful supplemental comparison of the second quarter 2005 earnings per share can be computed using the pro forma 13.7 million basic and diluted weighted average shares that would have been outstanding during the second quarter 2005 if the IPO had occurred on January 1, 2005. On this pro forma basis, the second quarter 2005 basic and diluted earnings per share would have been \$0.21.

A reconciliation of the reported second quarter 2005 net loss per common share of (\$0.09) (Basic and Diluted) to the pro forma net income per common share of \$0.21 (Basic and Diluted) is as follows:

Reported second quarter 2005 net loss available to common shareholders of (\$0.4) million is increased by the accrued preferred stock dividends of \$3.3 million to equal consolidated net income of \$2.9 million.

Reported second quarter 2005 weighted average common shares outstanding of 5.0 million (Basic and Diluted) are increased by 8.7 million of additional common shares issued in the IPO for total pro forma weighted average common shares outstanding of 13.7 million.

Consolidated net income of \$2.9 million is then divided by pro forma weighted average common shares outstanding of 13.7 million to obtain the pro forma second quarter 2005 net income per share of \$0.21 (Basic and Diluted).

We believe this presentation provides useful supplemental information in evaluating the operating results of our business; however, these disclosures should not be viewed as a substitute for net earnings per share determined in accordance with GAAP.

The 2006 quarterly net earnings per share after taxes were impacted by approximately \$0.05 per share for higher reinsurance costs, approximately \$0.03 per share for higher expenses associated with the implementation of the provisions of SOX and \$0.02 per share for the other additional costs of being a public company that were not incurred in the second quarter of 2005. The higher reinsurance costs should be recoverable when the earned impact of approved premium rate increases begins to flow into earnings later in the year.

On June 30, 2006, the Company's Employee Stock Purchase Plan ("ESPP") issued 14,515 shares of the Company's common stock. The issuance of shares under the ESPP in the future will have a dilutive impact.

### **Other Consolidated Information**

**Comprehensive income (loss)**--Comprehensive loss for the three months ended June 30, 2006 was a loss of (\$1.9) million compared to \$7.4 million of comprehensive income for the same period in 2005. Total comprehensive loss for the second quarter of 2006 included net income of \$0.4 million, a net after tax unrealized investment loss of (\$1.6) million and a foreign currency translation loss of (\$0.7) million related to a change in the value of the Mexican peso relative to the U.S. dollar associated with our investment in unconsolidated foreign insurance company.

**Share-based compensation**--We adopted the provisions of SFAS No. 123R effective January 1, 2006. Since we have recognized stock compensation expense using a fair-value approach under SFAS No. 123 following the approval of our share-based compensation plans, there was no material impact to our financial position or results of operations from the adoption of SFAS No. 123R.

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### COMPARISON OF THE SIX MONTHS ENDED JUNE 30, 2006 TO THE SIX MONTHS ENDED JUNE 30, 2005

#### **Revenues**

**Gross written premiums**--Consolidated gross written premiums for the six months ended June 30, 2006 were \$265.5 million compared to \$231.8 million in the same period in 2005, an increase of 14.6 %. We recorded gross written premiums growth in all segments in the six months ended June 30, 2006. The growth was primarily driven by a:

25.3% growth in Insurance Services, primarily from growth in the premium volume on two programs fronted by us for large, national carriers where we do not retain any of the underwriting risk;

12.6% increase in Program Management, primarily due to growth in our non-subscriber program and the commercial auto/small casualty program of our largest MGA;

15.8% increase in Commercial Lines, including a 26.4% increase in commercial liability; and

5.3% increase in Personal Lines, including a 21.2% increase in personal property premiums, primarily from our low-value dwelling initiative that included a growth of \$5.6 million of gross written premiums, which offset a 15.4% decrease in personal auto premiums.

We did experience a decline in nonstandard and standard personal auto premiums that was expected as the margins in this product continue to be compressed through increasing competition and declining rates. We have purposefully decided not to compete heavily for this low-margin business. Therefore, our personal auto premiums declined by 15.4% in the six months ended June 30, 2006 as compared to the same period in 2005.

We also recently received approval from regulatory authorities in Texas and Louisiana for rate increases for personal property business to offset the increased costs of reinsurance. The increases were effective in the second quarter and will begin to affect net insurance premiums earned starting in the third quarter of 2006.

**Net written premiums**--Consolidated net written premiums for the six months ended June 30, 2006 were \$138.3 million compared to \$124.3 million in the same period in 2005, an increase of 11.3%. The difference in both the gross and net premiums is influenced by higher reinsurance costs following the heavy catastrophe losses from Hurricanes Katrina and Rita. The estimated additional cost for catastrophe and excess per risk reinsurance in the six months ended June 30, 2006 was approximately \$4.8 million. For the 2006 year, Republic substantially replicated its 2005 catastrophe reinsurance covers and also increased the reinsurance protection to \$100 million. These higher reinsurance costs were incurred beginning January 1, while the offsetting benefits from rate increases on the Company's policies in Texas and Louisiana will not begin to be earned until later in 2006. Net written premiums also increased significantly in our Program Management segment due to our increased retention in the business produced by our largest unaffiliated MGA. The Insurance Services segment does not generate any net written or earned premiums since all business in this segment is 100% ceded pursuant to fronting arrangements with unaffiliated national or regional carriers.

**Net insurance premiums earned**--Net insurance premiums earned for the six months ended June 30, 2006 were \$130.2 million compared to \$116.4 million in the same period in 2005, an increase of 11.9%. Net earned premiums increased significantly in our Program Management segment due to our increased retention in the business produced by our largest unaffiliated MGA.

**Investment income**--Investment income for the six months ended June 30, 2006 was \$7.2 million compared to \$5.0 million in the same period in 2005, an increase of 41.7%. The increase primarily resulted from the higher invested asset base and increases in short-term interest rates. The annualized net investment yield on average invested assets, excluding our investment in Atlas, was 4.2% for the six months ended June 30, 2006 compared to 3.2% for the same period in 2005.

**Other income**--Other income for the six months ended June 30, 2006 was \$3.3 million compared to \$3.2 million in the same period in 2005, an increase of 2.2%. Other income from the Program Management segment declined 16.4% during the quarter primarily due to a change in the contractual basis for determining the fronting fee received from our largest MGA program, while other income from the Insurance Services segment increased 28.8% in part due to increased premium volume for fronting programs related to several large national carriers.





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### Expenses

**Net losses and loss adjustment expenses incurred**--Net losses and loss adjustment expenses incurred for the six months ended June 30, 2006 were \$79.8 million compared to \$67.0 million in the same period in 2005, an increase of 19.1%. The net loss ratio for the six months ended June 30, 2006 was 61.3% compared to 57.6% in the same period in 2005, an increase of 3.7 points.

The net ex-catastrophe loss ratio for the six months ended June 30, 2006 was 50.7% compared to 51.3% in the same period in 2005, a decrease of 0.6 points.

The net catastrophe loss ratio for the six months ended June 30, 2006 was 10.6% compared to 6.3% in the same period in 2005, an increase of 4.3 points.

We continued to process the few pending claims remaining from Hurricanes Katrina and Rita. Our previously reported estimated ultimate loss and loss adjustment expenses from Hurricanes Katrina and Rita of \$45.3 million and \$47.2 million, respectively, appear to be adequate since these estimates included the effects of contingencies such as a surge in demand for products and services. The financial effects of these storms remain well within the protections provided by our catastrophe reinsurance treaties as previously reported. Further, the support of our reinsurance partners continues to be exemplary and we have not experienced any collectibility issues regarding reinsurance recoverables. Our net reinsurance recoverable asset has now returned to pre-hurricane levels.

**Underwriting, acquisition and operating expenses**--Underwriting, acquisition and operating expenses for the six months ended June 30, 2006 were \$49.7 million compared to \$42.6 million in the same period in 2005, an increase of 16.6%. The net expense ratio for the six months ended June 30, 2006 was 38.2% compared to 36.6% for the same period in 2005, an increase of 1.6 percentage points. The moderate increase in the expense ratio was due to increased earned premiums offset by higher commissions and higher operating expenses associated with SOX compliance, new public company expenses and new technology costs.

**Interest expense**--Interest expense for the six months ended June 30, 2006 was \$1.9 million compared to \$1.5 million in the same period in 2005, an increase of 27.4%. The primary reason for the increase was the acquisition of the \$20.0 million senior credit facility in late February 2005. In addition, rising interest rates on our floating rate debt contributed to the increase in interest expense.

### Income

**Underwriting results**--Underwriting results for the six months ended June 30, 2006 were \$0.6 million compared to \$6.7 million in the same period in 2005, a decrease of \$6.1 million. The total net combined ratio for the six months ended June 30, 2006 was 99.5% compared to 94.2% in the same period in 2005. The decrease is primarily due to:

higher-than-normal catastrophe losses;

higher reinsurance costs in 2006;

higher personal auto losses and increased personal and commercial property severities; and

costs of being a public company (particularly the cost of compliance with SOX) combined with other operating expense increases.

Higher catastrophe losses and four large ex-catastrophe commercial property fire losses in excess of \$0.4 million resulted in the Commercial Lines segment combined ratio of 109.1% for the six months ended June 30, 2006. All other segments achieved underwriting profits for the six months ended June 30, 2006. We believe the balance in profit among our segments is important to our ability to manage fluctuations in market conditions, product underwriting cycles and weather conditions over the long run.

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***Income from continuing operations before income taxes, minority interest and equity in earnings of consolidated foreign insurance company***--Income from continuing operations before income taxes, minority interest and equity in earnings of consolidated foreign insurance company for the six months ended June 30, 2006 was \$9.0 million compared to \$13.5 million for the same period in 2005, an decrease of 33.6%. The decrease was due primarily to the decline in underwriting results outpacing the increase in premiums and investment income.

***Income tax expense***--Income tax expense in the six months ended June 30, 2006 was \$3.8 million compared to \$4.7 million in the same period in 2005, a decrease of 19.4%. We generally pay tax at a 35% effective rate. The higher effective rate for the six months ended June 30, 2006 includes the effect of nondeductible amounts related to our share-based compensation plans. Income tax expense does not include any expense resulting from the equity in the earnings of our unconsolidated foreign insurance company or expense for the excess of the carrying value over the tax basis of our investment in the unconsolidated foreign insurance company as described in the next section.

***Equity in earnings of unconsolidated foreign insurance company***--Equity in earnings of unconsolidated foreign insurance company for the six months ended June 30, 2006 was \$2.4 million compared to \$1.5 million in the same period in 2005, an increase of 53.9%. The increase was driven primarily by Atlas' improved investment results. Although Atlas' investment performance has resulted in a higher equity share of their income over the prior year, we believe that the Mexican insurance industry is becoming increasingly competitive and that underwriting margins will be pressured in 2006.

We do not recognize a deferred tax liability for the excess of the carrying value over the tax basis of our investment in Atlas, since the difference is treated as a permanent difference under GAAP as prescribed by SFAS No. 109, *Accounting for Income Taxes*, and APB No. 23, *Accounting for Income Taxes-Special Areas*. Hence, a deferred tax liability has not been recognized in the accompanying condensed consolidated financial statements. If we no longer meet the indefinite reversal criterion, a deferred tax expense of approximately \$2.9 million at June 30, 2006 would need to be recognized.

***Minority interest***--Minority interest for the six months ended June 30, 2006 was (\$0.2) million. The minority interest is related to our 80% owned MGA that manages our low-value dwelling program, Republic Home Protectors, Inc.

***Net income***--Net income for the six months ended June 30, 2006 was \$7.4 million compared to \$10.3 million in the same period in 2005, a decrease of 28.7%. The drop in income essentially follows the decline in underwriting results.

### **Key Financial Measures**

***Return on average equity***--Return on average equity for the six months ended June 30, 2006 was an annualized 8.6% compared to 12.1% for the same period in 2005. The return on average equity in 2006 was lower than the prior year due to lower net income.

***Earnings per share***--Basic and fully diluted earnings per share were \$0.53 for the six months ended June 30, 2006. Reported basic and fully diluted earnings per share for the six months ended June 30, 2005 were \$0.68. On June 30, 2006, the ESPP issued 14,515 shares. The issuance of shares under the ESPP in the future will have a dilutive impact on our earnings per share.

### **Other Consolidated Information**

***Stockholders' Equity***--Stockholders' equity as of June 30, 2006 was \$164.3 million compared to \$164.5 million at December 31, 2005, or a decrease of \$0.2 million. The principal elements of this decrease were: \$7.4 million of income partially offset by an increase in net-of-tax unrealized losses of (\$3.9) million from the investment portfolio as a result of rising interest rates and common stock dividends of \$3.4 million; a change in net-of-tax foreign currency translation of (\$1.2) million and an increase due to share-based compensation of \$0.9 million.

***Comprehensive Income***--Comprehensive income for the six months ended June 30, 2006 was \$2.2 million compared to \$11.5 million for the same period in 2005, a decrease of 80.7%. Total comprehensive income in 2006 primarily included net

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income of \$7.4 million, a net after tax unrealized investment loss of (\$3.9) million and a foreign currency translation loss of (\$1.2) million related to a change in the value of the Mexican peso relative to the U.S. dollar associated with our investment in unconsolidated foreign insurance company.

### **Consolidated Financial Condition**

***Balances due from reinsurance companies***--Amounts due from reinsurers decreased \$26.0 million from \$217.2 million at December 31, 2005 to \$191.2 million at June 30, 2006, primarily due to the collection of amounts associated with Hurricanes Katrina and Rita.

***Liabilities for losses and loss adjustment expenses***--Liabilities and loss adjustment expenses decreased \$15.0 million from \$315.2 million at December 31, 2005 to \$300.2 million at June 30, 2006 primarily due to the settlement of claims liabilities related to the 2005 hurricanes. On a net basis, after reinsurance, the liability for losses and loss adjustment expenses was \$118.1 million at June 30, 2006 compared to \$111.7 million at December 31, 2005, an increase of \$6.4 million. This increase was primarily attributable to higher retention in 2006 in our largest MGA program.

***Share-Based Compensation***--We adopted the provisions of SFAS No. 123R effective January 1, 2006. Since we recognized stock compensation expense using a fair-value approach under SFAS No. 123 following the approval of our share-based compensation plans, there was no material impact to our financial position or results of operations from the adoption of SFAS No. 123R.

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## INDEPENDENT AGENTS—PERSONAL LINES RESULTS OF OPERATIONS

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
	(Dollars in thousands)			
Net insurance premiums earned	\$31,989	\$31,821	\$63,085	\$64,122
Net investment income	1,222	1,178	2,434	2,140
Net realized losses (gains)	(29 )	33	(49 )	33
Other income	<u>384</u>	<u>414</u>	<u>793</u>	<u>828</u>
Total revenues	<u>33,566</u>	<u>33,446</u>	<u>66,263</u>	<u>67,123</u>
Net losses and loss adjustment expenses incurred	23,310	22,221	39,808	35,394
Underwriting, acquisition and operating expenses:				
Commissions	5,798	5,675	11,476	11,238
Other underwriting, acquisition and operating expenses	<u>5,101</u>	<u>5,171</u>	<u>11,285</u>	<u>10,195</u>
Total underwriting, acquisition and operating expenses	<u>10,899</u>	<u>10,846</u>	<u>22,761</u>	<u>21,433</u>
Total expense	<u>34,209</u>	<u>33,067</u>	<u>62,569</u>	<u>56,827</u>
Income (loss) from continuing operations before income taxes and minority interest	(643 )	379	3,694	10,296
Income tax expense (benefit)	(149 )	144	1,362	3,615
Minority interest	<u>(116 )</u>	<u>—</u>	<u>(159 )</u>	<u>—</u>

Net income (loss)	<u>\$(610 )</u>	<u>\$235</u>	<u>\$2,173</u>	<u>\$6,681</u>
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### Key Measures:

Gross written premiums	\$38,245	\$35,636	\$70,900	\$67,347
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Net written premiums	34,740	33,571	64,091	63,574
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### GAAP Ratios:

Net ex-catastrophe loss ratio	48.6 %	50.8 %	49.4 %	44.6 %
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Net catastrophe loss ratio	24.3 %	19.0 %	13.7 %	10.6 %
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Net expense ratio	<u>34.1 %</u>	<u>34.1 %</u>	<u>36.1 %</u>	<u>33.4 %</u>
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Net combined ratio	<u>107.0 %</u>	<u>103.9 %</u>	<u>99.2 %</u>	<u>88.6 %</u>
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Total assets	\$226,243	\$224,992	\$226,243	\$224,992
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### COMPARISON OF THE THREE MONTHS ENDED JUNE 30, 2006 TO THE THREE MONTHS ENDED JUNE 30, 2005

The Personal Lines segment accounted for 27.5% and 29.4% of our gross written premiums in the three months ended June 30, 2006 and 2005, respectively. This segment also accounted for 47.8% and 53.8% of our net insurance premiums earned in the second quarter of 2006 and 2005, respectively.

### Revenues

**Gross written premiums**—Gross written premiums for the three months ended June 30, 2006 were \$38.2 million compared to \$35.6 million in the same period in 2005, an increase of 7.3%. The growth was primarily the result of:

- a \$2.6 million increase from our high margin, low-value dwelling initiative, which was not fully operational until the second quarter of 2005;
- a 10.6% increase in property markets primarily due to the introduction of new insurance products, rate increases and new business opportunities from market disruptions in Texas; and
- a 14.8% decrease in the highly competitive standard and nonstandard personal auto markets due to a conscious decision not to aggressively pursue this low-margin, highly competitive business.

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The personal property market is increasingly competitive in parts of Texas and Louisiana that are less exposed to catastrophe losses. At the same time, there are other market disruptions in our geographic target area that we believe may provide opportunities to write additional premiums. We also introduced our new HO-3 policy form in Texas in the second quarter of 2006. This new product, which provides broader coverage, underwriting credits and pricing alternatives, combined with additional commission incentives and increased companion auto policy credits, should generate additional premiums for both our standard and low-value dwelling programs. We also introduced our low-value dwelling Guardian tier product in Louisiana that should be competitive with the FAIR plan.

We have also created a policy acceptance unit to assist agents in writing business with Republic following a major Texas personal property insurer being placed in receivership by the TDI. We anticipate additional growth in this segment as we pursue this opportunity.

**Net written premiums**—Net written premiums for the three months ended June 30, 2006 were \$34.7 million compared to \$33.6 million in the same period in 2005, an increase of 3.5%. The net written premiums growth in the personal property lines was impacted by the higher reinsurance costs (the bulk of the higher catastrophe reinsurance costs are allocated to the Personal Lines Segment) and the reductions in the personal auto lines.

**Net insurance premiums earned**—Net insurance premiums earned for the three months ended June 30, 2006 were \$32.0 million compared to \$31.8 million in the same period in 2005. We received approval for a 7.0% average increase for Texas homeowners and a 17.3% average increase for Louisiana personal property to offset the higher cost of reinsurance in the first quarter of 2006. These average increases vary by territory based upon actuarial justification. The impact on net insurance premiums earned from the approved increases in Texas and Louisiana should become significant starting in the third quarter 2006.

### Expenses

**Net losses and loss adjustment expenses incurred**—Net losses and loss adjustment expenses incurred for the three months ended June 30, 2006 were \$23.3 million compared to \$22.2 million in the same period in 2005, an increase of 4.9%. The net total loss ratio for the three months ended June 30, 2006 was 72.9% compared to 69.8%, an increase of 3.1 points.

The net ex-catastrophe loss ratio for the three months ended June 30, 2006 was 48.6% compared to 50.8% in the same period in 2005, a decrease of 2.2 points.

The net catastrophe loss ratio for the three months ended June 30, 2006 was 24.3% compared to 19.0% in the same period in 2005, an increase of 5.3 points.

The primary drivers for the increased loss ratio are higher catastrophe losses partially reduced by an improvement in ex-catastrophe results in the second quarter of 2006. Personal auto also reported increases in its net loss ratio due to continually narrowing margins that are consistent with much of the personal auto market. Our low-value dwelling program continues to produce excellent results with a net loss ratio of 34.1%.

**Underwriting, acquisition and operating expenses**—Underwriting, acquisition and operating expenses for the three months ended June 30, 2006 were \$10.9 million compared to \$10.8 million in the same period in 2005, an increase of 0.5%. The expense ratio for this segment held constant at 34.1%.

### Income

**Underwriting results** – Underwriting results for the three months ended June 30, 2006 were a loss of (\$2.2) million compared to a loss of (\$1.2) million in the same period in 2005, an increase of 78.2%. The net combined ratio for the second quarter 2006 was 107.0% compared to 103.9% for the same period in 2005, an increase of 3.1 percentage points. The increase is primarily due to an increase in the total net loss ratio by 3.1 points. The overall increase in gross written premiums was offset by increased costs of reinsurance and higher catastrophe experience, resulting in the decline in underwriting results.

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**Net income (loss)**—Net loss for the three months ended June 30, 2006 was (\$0.6) million compared to net income of \$0.2 million in the same period in 2005. The decline can be attributed to less favorable underwriting results primarily caused by increased catastrophe losses and increased expenses due to being a public company.

### **COMPARISON OF THE SIX MONTHS ENDED JUNE 30, 2006 TO THE SIX MONTHS ENDED JUNE 30, 2005**

The Personal Lines segment accounted for 26.7% and 29.1% of our gross written premiums in the six months ended June 30, 2006 and 2005, respectively. This segment also accounted for 48.5% and 55.1% of our net insurance premiums earned in the six months ended June 30, 2006 and 2005, respectively.

### **Revenues**

**Gross written premiums**—Gross written premiums for the six months ended June 30, 2006 were \$70.9 million compared to \$67.3 million in the same period in 2005, an increase of 5.3%. The growth was primarily caused by:

- a \$5.6 million increase for our high margin-low value dwelling initiative, which was not fully operational until the second quarter of 2005;
- a 7.0% increase in property primarily due to the introduction of new insurance products and rate increases; and
- a 15.4% decrease in the highly competitive standard and nonstandard personal auto markets due to a conscious decision not to aggressively pursue this low-margin and highly competitive business.

The personal property market is increasingly competitive in parts of Texas and Louisiana that are less exposed to catastrophe losses. At the same time, there are other market disruptions in our geographic target area that we believe may provide opportunities to write additional premiums. We have introduced several new policy forms in our standard and low-value dwelling business and established a policy acceptance unit to take advantage of several market opportunities.

**Net written premiums**—Net written premiums for the six months ended June 30, 2006 were \$64.1 million compared to \$63.6 million in the same period in 2005, an increase of 0.8%. The net written premium growth in the personal property lines was impacted by the higher reinsurance costs (the bulk of the higher catastrophe reinsurance costs are allocated to the Personal Lines segment) and the reductions in the personal auto lines.

**Net insurance premiums earned**—Net insurance premiums earned for the six months ended June 30, 2006 were \$63.1 million compared to \$64.1 million in the same period in 2005, a decrease of 1.6%. We received approval for a 7.0% average increase for Texas homeowners and a 17.3% average increase for Louisiana personal property to offset the higher cost of reinsurance. These average increases vary by territory based upon actuarial justification. The impact on net insurance premiums earned from the approved increase in Texas and Louisiana should become significant starting with the third quarter of 2006. Additionally, the earned effect of new business in our low-value dwelling program and other new personal property business will accelerate as the year progresses.

### **Expenses**

**Net losses and loss adjustment expenses incurred**—Net losses and loss adjustment expenses incurred for the six months ended June 30, 2006 were \$39.8 million compared to \$35.4 million in the same period in 2005, an increase of 12.5%. The total net loss ratio for the six months ended June 30, 2006 was 63.1% compared to 55.2%, an increase of 7.9 percentage points.

The net ex-catastrophe loss ratio for the six months ended June 30, 2006 was 49.4% compared to 44.6% in the same period in 2005, an increase of 4.8 percentage points.

The net catastrophe loss ratio for the six months ended June 30, 2006 was 13.7% compared to 10.6% in the same period in 2005, an increase of 3.1 percentage points.

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The primary drivers of the higher loss ratio are higher personal auto losses, increased average loss severity and higher demand for materials and contractors from hurricane claims. The latter factor has also impacted the cost of subsequent non-catastrophe related losses. Our low-value dwelling program continues to produce excellent results with a net loss ratio of 33.3%. Personal auto also reported increases in its net loss ratio due continually narrowing margins that are consistent with much of the personal auto market. Catastrophe losses for this segment are higher than historical patterns and the prior year.

***Underwriting, acquisition and operating expenses***—Underwriting, acquisition and operating expenses for the six months ended June 30, 2006 were \$22.8 million compared to \$21.4 million in the same period in 2005, an increase of 6.2%. The expense ratio for this segment was 36.1% in the six months ended June 30, 2006 compared to 33.4% for the same period in 2005. The increase primarily from the costs of implementing SOX and additional costs associated with being a public company.

### **Income**

***Underwriting results***—Underwriting results for the six months ended June 30, 2006 were \$0.5 million compared to \$7.3 million in the same period in 2005. The net combined ratio for the first six months ended June 30, 2006 was 99.2% compared to 88.6% for the same period in 2005, an increase of 10.6 percentage points. The increase can be attributable to several factors including: higher reinsurance costs not yet recovered through rate increases; increases in the loss ratios of both personal property and personal auto; and increases in the expense ratio caused by the additional costs of being a public company.

***Net income***—Net income for the six months ended June 30, 2006 of 2006 was \$2.2 million compared to \$6.7 million in the same period in 2005, a decrease of 67.5%. The decline can be attributed to less favorable underwriting results primarily caused by increased catastrophe losses and increased expenses due to being a public company.



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## INDEPENDENT AGENTS-COMMERCIAL LINES RESULTS OF OPERATIONS

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
	(Dollars in thousands)			
Net insurance premiums earned	\$19,229	\$16,987	\$36,590	\$33,384
Net investment income	1,257	901	2,452	1,589
Net realized losses (gains)	(30 )	24	(50 )	24
Other income	53	51	100	97
Total revenues	20,509	17,963	39,092	35,094
Net losses and loss adjustment expenses incurred	15,079	9,842	24,347	20,701
Underwriting, acquisition and operating expenses:				
Commissions	3,317	3,127	6,701	6,030
Other underwriting, acquisition and operating expenses	4,378	3,976	8,874	7,481
Total underwriting, acquisition and operating expenses	7,695	7,103	15,575	13,511
Total expense	22,774	16,945	39,922	34,212
Income (loss) from continuing operations before income taxes	(2,265 )	1,018	(830 )	882
Income tax expense (benefit)	(854 )	358	(354 )	310
Net income (loss)	<u>\$(1,411 )</u>	<u>\$660</u>	<u>\$(476 )</u>	<u>\$572</u>

**Key Measures:**

Gross written premiums							
		\$25,649	\$21,044	\$47,351	\$40,894		
Net written premiums		22,087	18,363	40,516	35,784		
GAAP Ratios:							
Net ex-catastrophe loss ratio		53.4 %	55.8 %	52.2 %	60.3 %		
Net catastrophe loss ratio		25.0 %	2.1 %	14.3 %	1.7 %		
Net expense ratio		<u>40.0 %</u>	<u>41.8 %</u>	<u>42.6 %</u>	<u>40.5 %</u>		
Net combined ratio		<u>118.4 %</u>	<u>99.7 %</u>	<u>109.1 %</u>	<u>102.5 %</u>		
Total assets		\$172,922	\$161,736	\$172,922	\$161,736		

#### COMPARISON OF THE THREE MONTHS ENDED JUNE 30, 2006 TO THE THREE MONTHS ENDED JUNE 30, 2005

The Commercial Lines segment represents 18.4% and 17.4% of our gross written premiums for the three-month periods ended June 30, 2006 and June 30, 2005, respectively. This segment also represents 28.7% of our net insurance premiums earned for the first three months in 2006 and 2005.

#### **Revenues**

**Gross written premiums**—Gross written premiums for the three months ended June 30, 2006 were \$25.6 million compared to \$21.0 million in the same period in 2005, an increase of 21.9 %. The increase occurred as the result of well-diversified growth in target markets primarily in Texas and Louisiana, including our farm and ranch program. The increase was primarily due to a:

- 30.7% increase in our commercial liability business;
- 19.2% increase in our commercial auto business; and
- \$1.9 million increase in workers compensation business.

The commercial lines market continues to soften and is increasingly competitive in most market areas, except for commercial

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property risks located in catastrophe-prone areas. We recently released our new farm and ranch internet-based application and quoting system (FarmLink) and a new package policy (RePak) primarily for commercial risks in small-medium sized markets. RePak also features an internet-based rating and binding capability. We believe these new products will enable us to continue growing our commercial book of business.

**Net written premiums**--Net written premiums for the three months ended June 30, 2006 were \$22.1 million compared to \$18.4 million in the same period in 2005, an increase of 20.3%. The cost of reinsurance increased for the Commercial Lines segment, although the cost was much smaller than the cost allocated to the Personal Lines segment.

**Net insurance premiums earned**--Net insurance premiums earned for the three months ended June 30, 2006 were \$19.2 million compared to \$17.0 million in the same period in 2005, an increase of 13.2%. The growth in net insurance premiums earned also reflects the significant increase in written premiums that occurred in the second half of 2005.

### Expenses

**Net losses and loss adjustment expenses incurred**--Net losses and loss adjustment expenses incurred for the three months ended June 30, 2006 were \$15.1 million compared to \$9.8 million in the same period in 2005, an increase of 53.2%. The net loss ratio for the three months ended June 30, 2006 was 78.4% compared to 57.9% in the same period in 2005, an increase of 20.5 percentage points.

The net ex-catastrophe loss ratio for the three months ended June 30, 2006 was 53.4% compared to 55.8% in the same period in 2005, an improvement of 2.4 points.

The net catastrophe loss ratio for the three months ended June 30, 2006 was 25.0% compared to 2.1% in the same period in 2005, an increase of 22.9 points.

We experienced an unusually high number of weather-related catastrophe loss events during the second quarter of 2006 that caused the Commercial Lines net catastrophe loss ratio to be the highest it has ever been. The average net catastrophe loss ratio for the second quarter since the year 2000 is 12.1%. The ex-catastrophe ratio improved in every product line except for commercial property. We believe the decline in the ex-catastrophe ratio is a good indicator of future profitability.

**Underwriting, acquisition and operating expenses**--Underwriting, acquisition and operating expenses for the three months ended June 30, 2006 were \$7.7 million compared to \$7.1 million in the same period in 2005, an increase of 8.3%. The net expense ratio for the three months ended June 30, 2006 was 40.0% compared to 41.8% in the same period in 2005, an improvement of 1.8 percentage points.

### Income

**Underwriting results**--Underwriting results for the three months ended June 30, 2006 were a loss of (\$3.5) million compared to essentially a break-even result in the same period in 2005. The net combined ratio for the three month period ended June 30, 2006 was 118.4% compared to 99.7% in the prior period, an increase of 18.7 percentage points. Record commercial lines catastrophe losses were the primary source of the decrease in the underwriting results and increase in the net combined ratio.

**Net income (loss)**--Net loss for the three months ended June 30, 2006 was (\$1.4) million compared to net income of \$0.7 million in the same period in 2005. Exceptionally high weather-related catastrophe losses negated significant premium growth and a modest improvement in ex-catastrophe losses experience.

### **COMPARISON OF THE SIX MONTHS ENDED JUNE 30, 2006 TO THE SIX MONTHS ENDED JUNE 30, 2005**

Commercial Lines segment represents 17.8% and 17.6% of our gross written premiums for the six-month periods ended June 30, 2006 and June 30, 2005, respectively. This segment also represents 28.1% and 28.7% of our net insurance premiums earned for the first six months in 2006 and 2005, respectively.

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### Revenues

**Gross written premiums**--Gross written premiums for the six months ended June 30, 2006 were \$47.4 million compared to \$40.9 million in the same period in 2005, an increase of 15.8%. The increase occurred as the result of well-diversified growth in target markets primarily in Texas and Louisiana, including our farm and ranch program. We achieved gross written premiums growth in all lines including a 26.4% increase in commercial liability, a 27.5% increase in workers compensation and a 13.7% increase in commercial auto. Commercial property and farm and ranch grew at more modest rates.

The commercial lines market continues to soften and is becoming increasingly competitive in most market areas, except for commercial property risks located in catastrophe-prone areas. We believe that new products and our controlled expansion into Louisiana and New Mexico will enable us to continue growing our commercial book of business.

**Net written premiums**--Net written premiums for the six months ended June 30, 2006 were \$40.5 million compared to \$35.8 million in the same period in 2005, an increase of 13.2%. The cost of reinsurance increased for the Commercial Lines segment, although the cost was much smaller than the cost allocated to the Personal Lines segment.

**Net insurance premiums earned**--Net insurance premiums earned for the six months ended June 30, 2006 were \$36.6 million compared to \$33.4 million in the same period in 2005, an increase of 9.6%. The increase follows the growth in written premium.

### Expenses

**Net losses and loss adjustment expenses incurred**--Net losses and loss adjustment expenses incurred for the six months ended June 30, 2006 were \$24.3 million compared to \$20.7 million in the same period in 2005, an increase of 17.6%. The net loss ratio for the six months ended June 30, 2006 was 66.5% compared to 62.0% in the same period in 2005, an increase of 4.5 points.

The net ex-catastrophe loss ratio for the six months ended June 30, 2006 was 52.2% compared to 60.3% in the same period in 2005, an improvement of 8.1 points.

The net catastrophe loss ratio for the six months ended June 30, 2006 was 14.3% compared to 1.7% in the same period in 2005, an increase of 12.6 points.

The increase in the net loss ratio was primarily due to increased weather-related catastrophe loss events especially in the commercial property lines. The ex-catastrophe loss ratio improved in every product line except for the commercial property business where four large fire losses (greater than \$0.4 million) occurred during the first six months of 2006.

**Underwriting, acquisition and operating expenses**--Underwriting, acquisition and operating expenses for the six months ended June 30, 2006 were \$15.6 million compared to \$13.5 million in the same period in 2005, an increase of 15.3%. The net expense ratio for the six months ended June 30, 2006 was 42.6% compared to 40.5% in the same period in 2005, an increase of 2.1 percentage points. Expenses in 2006 are higher due to higher technology costs incurred for systems supporting the commercial line products prior to realizing the anticipated productivity benefits and due to the expenses associated with the implementation of SOX.

### Income

**Underwriting results**--Underwriting results for the six months ended June 30, 2006 were a loss of (\$3.3) million compared to a loss of (\$0.8) million in the same period in 2005. The net combined ratio for the six months ended June 30, 2006 was 109.1% compared to 102.5% in the same period in 2006, an increase of 6.6 percentage points. The increase was primarily due to higher weather catastrophe loss events in the second quarter of 2006.

**Net income (loss)**--Net loss for the six months ended June 30, 2006 of 2006 was (\$0.5) million compared to net income of \$0.6 million in the same period in 2005. Premium growth and increased investment income were overshadowed by record catastrophe experience and slightly higher operating expenses.

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## PROGRAM MANAGEMENT RESULTS OF OPERATIONS

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
	(Dollars in thousands)			
Net insurance premiums earned	\$15,715	\$10,388	\$30,495	\$18,864
Net investment income	1,051	572	2,037	1,096
Net realized losses (gains)	(25 )	17	(41 )	17
Other income	<u>521</u>	<u>653</u>	<u>1,021</u>	<u>1,222</u>
Total revenues	<u>17,262</u>	<u>11,630</u>	<u>33,512</u>	<u>21,199</u>
Net losses and loss adjustment expenses incurred	8,199	5,286	15,686	10,935
Underwriting, acquisition and operating expenses:				
Commissions	4,368	2,944	8,795	4,804
Other underwriting, acquisition and operating expenses	<u>1,436</u>	<u>1,429</u>	<u>2,916</u>	<u>2,847</u>
Total underwriting, acquisition and operating expenses	<u>5,804</u>	<u>4,373</u>	<u>11,711</u>	<u>7,651</u>
Total expense	<u>14,003</u>	<u>9,659</u>	<u>27,397</u>	<u>18,586</u>
Income from continuing operations before income taxes	3,259	1,971	6,115	2,613
Income tax expense	<u>1,827</u>	<u>685</u>	<u>2,822</u>	<u>910</u>
Net income	<u>\$1,432</u>	<u>\$1,286</u>	<u>\$3,293</u>	<u>\$1,703</u>

**Key Measures:**

Gross written premiums	\$33,138	\$30,947	\$66,586	\$59,119
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Net written premiums	17,746	13,548	33,694	24,927
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## GAAP Ratios:

Net loss ratio	52.2 %	50.9 %	51.4 %	58.0 %
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Net expense ratio	<u>36.9 %</u>	<u>42.1 %</u>	<u>38.4 %</u>	<u>40.6 %</u>
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Net combined ratio	<u>89.1 %</u>	<u>93.0 %</u>	<u>89.8 %</u>	<u>98.6 %</u>
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Total assets	\$226,576	\$195,219	\$226,576	\$195,219
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**COMPARISON OF THE THREE MONTHS ENDED JUNE 30, 2006 TO THE THREE MONTHS ENDED JUNE 30, 2005**

The Program Management segment accounted for 23.8% and 25.6% of our gross written premiums in the three months ended June 30, 2006 and June 30, 2005, respectively. This segment also accounted for 23.5% and 17.5% of our net insurance premiums earned in the three-month periods ended June 30, 2006 and June 30, 2005, respectively.

**Revenues**

**Gross written premiums**--Gross written premiums for the three months ended June 30, 2006 were \$33.1 million compared to \$30.9 million in the same period in 2005, an increase of 7.1%. The increase is primarily due to the development of our program for voluntary non-subscribers to the Texas Workers' Compensation system and growth in the commercial auto/small casualty premiums produced by Texas General Agency ("TGA"), our long-standing and largest MGA relationship. The non-subscriber program was implemented in the second quarter of 2005 and generated \$1.6 million gross written premiums in the second quarter of 2006. The gross written premium in the TGA program increased to \$29.5 million from \$28.1 million for the same period in 2005.

**Net written premiums**--Net written premiums for the three months ended June 30, 2006 were \$17.7 million compared to

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\$13.5 million in the same period in 2005, an increase of 31.0%. The increase is primarily due to our increased retention of the business produced by TGA (50% in 2006 compared to 40% in 2005) and growth in the non-subscriber program.

**Net insurance premiums earned**--Net insurance premiums earned for the three months ended June 30, 2006 were \$15.7 million compared to \$10.4 million in the same period in 2005, an increase of 51.3%. The increase in premiums earned is largely attributable to the increased retention of the TGA program over the past two years.

**Other income**--Other income for the three months ended June 30, 2006 was \$0.5 million compared to \$0.7 million in the same period in 2005, a decrease of 20.2%. Other income represents fronting fees retained for unaffiliated MGA programs and is presented net of expenses associated with the production of these fees. Fronting fees for the second quarter of 2006 were \$0.7 million, less fronting fee expense of \$0.2 million for a net total of \$0.5 million. Fronting fees for the second quarter of 2005 were \$0.8 million, less fronting fee expense of \$0.2 million for a net total of \$0.6 million. Fronting fees declined slightly in the second quarter of 2006 compared to the same period in 2005 due to a change in the fronting fee arrangement with TGA.

## Expenses

**Net losses and loss adjustment expenses incurred**--Net losses and loss adjustment expenses incurred for the three months ended June 30, 2006 were \$8.2 million compared to \$5.3 million in the same period in 2005, an increase of 55.1%. The net loss ratio for the three months ended June 30, 2006 was 52.2% compared to 50.9%, an increase of 1.3 percentage points. The increase in loss dollars is due to the increased retention for the TGA program. In actuality, the TGA business reflects an improved loss ratio, which in turn allows for higher commissions.

**Underwriting, acquisition and operating expenses**--Underwriting, acquisition and operating expenses for the three months ended June 30, 2006 were \$5.8 million compared to \$4.4 million in the same period in 2005, an increase of 32.7%. The net expense ratio for the three month period ended June 30, 2006 declined to 36.9% from 42.1% in the same period in 2005, a decrease of 5.2 percentage points. Commission expense is 48.4% higher, primarily due to the increased retention in the TGA program.

## Income

**Underwriting results**--Underwriting results for the three months ended June 30, 2006 were \$1.7 million compared to \$0.7 million in the same period in 2005, an increase of 134.8%. The net combined ratio for the period was 89.1% compared to 93.0% for the same period in 2005, a decrease of 3.9 percentage points. The improvement was due improved results of the TGA business combined with profitable growth in the non-subscriber program.

## **COMPARISON OF THE SIX MONTHS ENDED JUNE 30, 2006 TO THE SIX MONTHS ENDED JUNE 30, 2005**

The Program Management segment accounted for 25.1% and 25.5% of our gross written premiums in the six months ended June 30, 2006 and June 30, 2005, respectively. The segment also accounted for 23.4% and 16.2% of our net insurance premiums earned in the six-month periods ended June 30, 2006 and June 30, 2005, respectively.

## Revenues

**Gross written premiums**--Gross written premiums for the six months ended June 30, 2006 were \$66.6 million compared to \$59.1 million in the same period in 2005, an increase of 12.6%. The increase was primarily due to the development of our program for non-subscribers that began in 2005 and growth in the commercial auto/small casualty premiums produced by TGA. The non-subscriber program generated \$4.3 million in the six months ended June 30, 2006 compared to \$0.5 million for the same period in 2005, and the TGA program increased to \$58.5 million from \$54.1 million for the same period in 2005.

**Net written premiums**--Net written premiums for the six months ended June 30, 2006 were \$33.7 million compared to \$24.9 million in the same period in 2005, an increase of 35.2%. The increase in net premiums is primarily because of our increased retention of the business produced by TGA and growth in the non-subscriber program.

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**Net insurance premiums earned**--Net insurance premiums earned for the six months ended June 30, 2006 were \$30.5 million compared to \$18.9 million in the same period in 2005, an increase of 61.7%. The increase is primarily due to increased retention of business produced by TGA and the non-subscriber program.

**Other income**--Other income for the six months ended June 30, 2006 was \$1.0 million compared to \$1.2 million in the same period in 2005, a decrease of 16.4%. Fronting fees for the six month period ended June 30, 2006 were \$1.4 million, less fronting fee expense of \$0.4 million for a net total of \$1.0 million. Fronting fees for the first six month period ended June 30, 2005 were \$1.6 million, less fronting fee expense of \$0.4 million for a net total of \$1.2 million. Fronting fees declined slightly in the six months ended June 30, 2006 compared to the same period in 2005 due to a change in the fronting fee arrangement with TGA.

### Expenses

**Net losses and loss adjustment expenses incurred**--Net losses and loss adjustment expenses incurred for the six months ended June 30, 2006 were \$15.7 million compared to \$10.9 million in the same period in 2005, an increase of 43.4%. The net loss ratio was 51.4% for the six months ended June 30, 2006 compared with 58.0% in the same period in 2005, an improvement of 6.6%.

**Underwriting, acquisition and operating expenses**--Underwriting, acquisition and operating expenses for the six months ended June 30, 2006 were \$11.7 million compared to \$7.7 million in the same period in 2005, an increase of 53.1%. The expense ratio for this segment was 38.4% for the six months ended June 30, 2006 compared with 40.6% for the same period in 2005, a decrease of 2.2 percentage points.

### Income

**Underwriting results**--Underwriting results for the six months ended June 30, 2006 were \$3.1 million compared to \$0.3 million in the same period in 2005, an increase of \$2.8 million. The net combined ratio for the six month period ended June 30, 2006 was 89.8% compared to 98.6%, a decrease of 8.8 percentage points. The 8.8 percentage point improvement is attributable to the significant improvement in the total net loss ratio, primarily in the TGA program combined with growth in the non-subscriber program with corresponding favorable loss experience.



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## INSURANCE SERVICES AND CORPORATE RESULTS OF OPERATIONS

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
	(Dollars in thousands)			
Net investment income	\$112	\$76	\$231	\$224
Net realized (losses) gains	(2 )	1	(3 )	2
Other income	631	514	1,356	1,053
Total revenues	741	591	1,584	1,279
Underwriting, acquisition and operating expenses	(179 )	39	(335 )	34
Interest expense	988	775	1,923	1,510
Total expense	809	814	1,588	1,544
Loss from continuing operations before income taxes and equity in earnings of consolidated foreign insurance company	(68 )	(223 )	(4 )	(265 )
Income tax benefit	(25 )	(71 )	(2 )	(86 )
Equity in earnings of unconsolidated foreign insurance company	1,073	838	2,371	1,541
Net income	<u>\$1,030</u>	<u>\$686</u>	<u>\$2,369</u>	<u>\$1,362</u>
<b>Key Measures:</b>				
Gross written premiums	\$42,167	\$33,440	\$80,661	\$64,392
Total assets	191,773	183,453	191,773	183,453

## COMPARISON OF THE THREE MONTHS ENDED JUNE 30, 2006 TO THREE MONTHS ENDED JUNE 30, 2005

The Insurance Services segment accounted for 30.3% and 27.6% of our gross written premiums in the second quarters of 2006 and 2005, respectively.

### Revenues

**Gross written premiums**--Gross written premiums for the three months ended June 30, 2006 were \$42.2 million compared to \$33.4 million in the same period in 2005, an increase of 26.1%. The premiums come from fronting programs generally for national or regional carriers. The largest program generated an increase in gross written premium of 49.4% over the same quarter in 2005. The second largest program increased 15.7% over the same quarter in 2005. The third largest program in the second quarter of 2005 declined by 37.6% in the same period in 2006; however, that decline was offset by 46.2% growth in a similar sized program during the second quarter of 2006.

**Other income**--Other income for the three months ended June 30, 2006 was \$0.6 million compared to \$0.5 million in the same period in 2005, an increase of 22.8%. Other income primarily represents fronting fees received from national or regional insurance carriers. Fee income is presented net of our expenses associated with producing this business. Other income for the second quarter 2006 included fronting fees of \$0.8 million, less expenses of \$0.2 million for a net total of \$0.6 million. Other income for the same period in 2005 included fronting fees of \$0.6 million, less expenses of \$0.1 million for a net total of \$0.5 million. The increase in 2006 parallels the increase in gross written premiums. Other income also includes net miscellaneous other income, including sales of certain unused assets.

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### Expenses

**Underwriting, acquisition and operating expenses**--Underwriting, acquisition and operating expenses for the three months ended June 30, 2006 were a credit of (\$0.2) million compared to an expense of \$0.04 million in the same period in 2005. There are no underwriting or acquisition expenses associated with this segment since there is no underwriting retention. Total expenses for this segment generally show as credits or as minimal net expenses due to the nature of intercompany leasing arrangements of certain fixed assets. The increase in the credit for the second quarter of 2006 compared to the same period in 2005 is primarily due to the increase in fixed assets related to our relocation to a new home office late in the first quarter of 2005. The amounts reflect a full quarter of activity in 2006. All intercompany transactions are eliminated in consolidation.

### Income

**Net income**--Net income for the three months ended June 30, 2006 of 2006 was \$1.0 million compared to \$0.7 million in the same period in 2005, an increase of 50.1%. The increase in income was primarily due to growth in the equity earnings of our unconsolidated foreign insurance company and increased fronting fee income offset by increased interest expense.

### **COMPARISON OF THE SIX MONTHS ENDED JUNE 30, 2006 TO THE SIX MONTHS ENDED JUNE 30, 2005**

The Insurance Services segment accounted for 30.4% and 27.8% of our gross written premiums in the six months ended June 30, 2006 and June 30, 2005, respectively.

### Revenues

**Gross written premiums**--Gross written premiums for the six months ended June 30, 2006 were \$80.7 million compared to \$64.4 million in the same period in 2005, an increase of 25.3%. The largest program generated an increase in gross written premiums of 48.4% over the same period in 2005. The second largest program increased 11.5% over the same period in 2005. The third largest program in the second period of 2005 declined by 37.5% in the same period in 2006; however, that decline was offset by a 42.1% growth in a similar sized program during the first six months of 2006.

**Other income**--Other income for the six months ended June 30, 2006 was \$1.4 million compared to \$1.1 million in the same period in 2005, an increase of 28.8%. Fronting fees for the six month period ended June 30, 2006 were \$1.6 million, less expenses of \$0.5 million for a net total of \$1.1 million. Fronting fees for the same period in 2005 were \$1.3 million, less expenses of \$0.3 million for a net total of \$1.0 million. The increase in 2006 parallels the increase in gross written premiums.

Other income also includes net miscellaneous other income, including sales of certain unused assets.

### Expenses

**Underwriting, acquisition and operating expenses**--Underwriting, acquisition and operating expenses for the six months ended June 30, 2006 were a credit of (\$0.3) million compared to an expense of \$0.03 million in the same period in 2005. The increase in the credit for the six months ended June 30, 2006 compared to the same period in 2005 is primarily due to the increase in fixed assets related to our relocation to a new home office late in the first quarter of 2005. The amounts reflect a full quarter of activity in 2006. All intercompany transactions are eliminated in consolidation.

### Income

**Net income**--Net income for the six months ended June 30, 2006 were \$2.4 million compared to \$1.4 million in the same period in 2005, an increase of 73.9%. The increase is essentially due to growth in the equity earnings of our unconsolidated foreign insurance company and increased fronting fees income offset by higher interest expense.

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### LIQUIDITY AND CAPITAL RESOURCES

#### **Cash Flows**

Republic Companies Group, Inc. is a holding company with no business operations of its own. Consequently, our ability to pay dividends to stockholders, meet debt service obligations, pay taxes and pay administrative expenses is largely dependent on dividends or other distributions from our subsidiaries and affiliates. Generally, we do not have any restrictions on the payment of dividends by our non-insurance company subsidiaries and affiliates other than state corporate laws regarding solvency and those imposed pursuant to the terms of our senior debt credit facility. As a result, our non-insurance company subsidiaries and affiliates generate revenues, profits and net cash flows that are generally unrestricted as to their availability for the payment of dividends, and we expect to use those revenues to service our corporate obligations, such as debt service payments and to pay stockholder dividends. We had \$4.5 million and \$5.4 million of cash and short-term invested assets at our holding company and our non-insurance company subsidiaries as of June 30, 2006 and December 31, 2005, respectively.

Our insurance company subsidiaries are restricted by statute as to the amount of dividends that they may pay without prior approval of their domiciliary state insurance departments. Generally, Texas-domiciled insurers may pay dividends without advance regulatory approval only from unassigned surplus, and then only to the extent that all dividends paid in the twelve months ending on the date in question do not exceed the greater of (1) 10% of their policyholders' surplus as of December 31 of the preceding year or (2) 100% of their net income for the calendar year preceding the year in which the value is being determined and subject to available earned surplus as defined by the domiciliary state insurance department. In addition, insurance companies are required by law to maintain a minimum level of surplus on a statutory basis. Statutory surplus is calculated by subtracting total liabilities from total admitted assets computed under accounting principles prescribed or permitted by the insurer's state of domicile. As of January 1, 2006, the maximum dividend that Republic Underwriters Insurance Company could pay without prior approval was \$16.9 million. Any dividend in excess of this amount would be considered an "extraordinary dividend," which would require advance approval by the Texas Insurance Commissioner.

Sources of funds consist primarily of net premiums received, commission fronting fee income, collected reinsurance recoverables on hurricane losses, net investment income and proceeds from the sales and maturity of investments. Funds are used primarily to pay claims, operating expenses, purchase investments and pay dividends. The Company generated net cash in operations of \$6.2 million for the six months ended June 30, 2006. The primary source of funds from operations during the first six months of 2006 was the collection of reinsurance recoverables and growth in unearned premium. The Company's management believes that we have adequate financial resources to satisfy all claims and meet all other cash needs for the next 12 months.

#### **Investment Portfolio**

Our primary investment objectives are to preserve capital and manage for a total rate of return in excess of a specified benchmark portfolio. BlackRock Financial Management, Inc. ("BlackRock") manages all of our fixed-income investments except for certain short-term investments that we manage internally and are intended to meet near-term operating cash requirements. Our investment portfolio has an average duration of 3.5 years that provides a high degree of liquidity since it is comprised principally of readily marketable fixed income and short-term securities. We review our investment portfolio with BlackRock monthly to ensure compliance with our investment guidelines. The net annualized net investment yield on average invested assets, excluding our investment in Atlas, was 4.2% for the six month period ended June 30, 2006 compared to 3.2% for the same period in 2005.

Fixed investments are classified as available-for-sale and we report these securities at their estimated fair values based on quoted market prices. Changes in unrealized gains and losses on these securities are reported as a separate component of comprehensive net income, and accumulated unrealized gains and losses are reported as a component of accumulated other comprehensive net income (loss) in stockholder's equity, net of deferred taxes. We regularly evaluate our investment portfolio to identify other-than-temporary impairments of individual securities. We consider many factors in determining if an other-than-temporary impairment exists, including:

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the length of time and extent to which the fair value of the security has been less than cost;  
the financial condition and near-term prospects of the issuer of the security; and  
our ability and intent to hold the security until the fair value is expected to recover.

While higher interest rates are expected to continue to increase the number of fixed-maturity holdings trading below 100% of amortized cost, lower fixed-maturity security values caused by interest rate changes would not necessarily signal a decline in credit quality. We believe we have the ability to hold most fixed maturity investments until maturity because of our historical cash flow experience with catastrophe events, operating results, regulatory surplus and cash flows.

The fair value of our fixed maturity investments available for sale was \$294.7 million as of June 30, 2006 compared to \$298.2 million as of December 31, 2005, a decrease of \$3.5 million, or 1.2%. Net change in unrealized investment losses before tax was \$6.1 million for the six month period ended June 30, 2006. The unrealized losses are largely attributable to market price changes due to interest rate increases since the investments were purchased, and are not considered to be impaired, temporary or otherwise, given our ability and intent to hold the securities to recovery. None of our fixed maturities trade below 80% of their amortized cost. The following table summarizes fixed maturities available for sale (dollars in thousands):

	As of June 30, 2006			As of December 31, 2005		
	Amortized Cost	Estimated Fair Value	Unrealized Gain/ (Loss)	Amortized Cost	Estimated Fair Value	Unrealized Gain/ (Loss)
Percent trading of amortized cost:						
below 80%	\$-	\$-	\$-	\$-	\$-	\$-
between 80% to less than 100%	301,727	290,525	(11,202)	262,946	257,421	(5,525)
100% or above	4,036	4,198	162	40,211	40,748	537
Total	<u>\$305,763</u>	<u>\$294,723</u>	<u>\$(11,040)</u>	<u>\$303,157</u>	<u>\$298,169</u>	<u>\$(4,988)</u>

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The following table represents our fixed maturities available for sale, in an unrealized loss position by amount of time in a continuous unrealized loss positions (dollars in thousands):

	As of June 30, 2006					
	Less than 12 Months		12 Months or Longer		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies and authorities	\$44,093	\$(1,351 )	\$10,777	\$(219 )	\$54,870	\$(1,570 )
Obligations of states and political subdivisions	1,623	(73 )	2,167	(58 )	3,790	(131 )
Corporate securities	57,762	(2,519 )	65,222	(2,581 )	122,984	(5,100 )
Mortgage and asset backed securities	70,521	(2,676 )	38,360	(1,725 )	108,881	(4,401 )
<b>Total</b>	<b>\$173,999</b>	<b>\$(6,619 )</b>	<b>\$116,526</b>	<b>\$(4,583 )</b>	<b>\$290,525</b>	<b>\$(11,202)</b>

	As of December 31, 2005					
	Less than 12 Months		12 Months or Longer		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. Government agencies and authorities	\$32,802	\$(238 )	\$3,768	\$(102 )	\$36,570	\$(340 )
Obligations of states and political subdivisions	–	–	3,837	(92 )	3,837	(92 )
Corporate securities	59,018	(1,168 )	52,952	(1,565 )	111,970	(2,733 )
Mortgage and asset backed securities	69,900	(1,244 )	35,144	(1,116 )	105,044	(2,360 )
<b>Total</b>	<b>\$161,720</b>	<b>\$(2,650 )</b>	<b>\$95,701</b>	<b>\$(2,875 )</b>	<b>\$257,421</b>	<b>\$(5,525 )</b>

The following table represents our fixed maturities available for sale classified by credit quality (dollars in thousands):

	As of June 30, 2006	As of December 31, 2005
--	---------------------	-------------------------

	<u>Rating</u>	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>% of Total Fair Value</u>	<u>Unrealized Gain/ (Loss)</u>	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>% of Total Fair Value</u>	<u>Unrealized Gain/ (Loss)</u>
U.S. Treasury obligations and direct obligations of U.S. Government agencies and authorities	AAA	\$59,595	\$58,153	19.7 %	\$(1,442 )	\$42,997	\$42,906	14.4 %	\$(91 )
Obligations of states and political subdivisions	AAA	4,152	4,024	1.4 %	(128 )	4,160	4,074	1.4 %	(86 )
Corporate securities	A	99,004	95,259	32.3 %	(3,745 )	97,973	95,831	32.1 %	(2,142 )
Corporate securities	BBB	29,078	27,724	9.4 %	(1,354 )	27,525	27,095	9.1 %	(430 )
Mortgage and asset backed securities	AAA	113,600	109,223	37.1 %	(4,377 )	130,154	127,909	42.9 %	(2,245 )
Mortgage and asset backed securities	BBB	334	340	0.1 %	6	348	354	0.1 %	6
<b>Total</b>		<u>\$305,763</u>	<u>\$294,723</u>	<u>100.0%</u>	<u>\$(11,040)</u>	<u>\$303,157</u>	<u>\$298,169</u>	<u>100.0%</u>	<u>\$(4,988 )</u>

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### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There were no material changes in the Company's market risk during the six months ended June 30, 2006. Market risk relates to changes in the value of financial instruments that arise from adverse movements in factors such as interest rates and equity prices. We are mainly exposed to changes in interest rates that affect the fair value of our investments in fixed maturity securities. Based on our average portfolio duration of 3.5 years, we estimate that a 50-basis point increase in interest rates would result in an unrealized investment of loss, net of tax, of approximately \$4.0 million.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### ***(a) Evaluation of disclosure controls and procedures.***

Under the supervision and with the participation of management, including our Chief Executive Officer ("CEO") and our Chief Financial Officer ("CFO"), we have carried out an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). The evaluation included certain internal control areas in which we have made and are continuing to make changes to improve and enhance controls in preparation for management's assessment of internal controls over financial reporting required for the annual period ending December 31, 2006. Based on that evaluation, our CEO and our CFO concluded that, subject to the limitations noted in this Item 4, our disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance that information we are required to disclose in reports that are filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms specified by the SEC and that material information regarding the Company and its consolidated subsidiaries is made known to our CEO and CFO, particularly during the period when our periodic reports are being prepared.

#### ***(b) Changes in internal control over financial reporting.***

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that occurred during the period covered in this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We continue to prepare for our first management report on internal control over financial reporting, as required by Section 404 of SOX for the annual period ending December 31, 2006, as well as continue to make improvements in areas such as information technology change control processes and access controls. These initiatives may result in changes to our internal control over financial reporting.

#### ***(c) Inherent limitations on effectiveness of controls***

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations of all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of control effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.



## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

#### **Hurricane Katrina Litigation**

One of the Company's subsidiaries is currently defending a statewide putative class action lawsuit pending in the District Court of the Parish of Orleans, Louisiana filed on April 12, 2006 in the aftermath of Hurricane Katrina. The plaintiffs generally allege that Republic Fire and Casualty Insurance Company and other unaffiliated insurer defendants breached their policies by failing to pay the face value of policies to insureds who sustained a total loss of their homes and improvements in part as a result of a non-covered loss from Hurricane Katrina. Plaintiffs seek to recover face value of the policies regardless of the anti-concurrence provisions of the Company's policies or the fact the Company timely paid covered losses in accordance with the policies' provisions. This lawsuit seeks declaratory relief and unspecified monetary damages, statutory penalties and attorneys' fees. This matter is in the early stages of development, and the Company is defending it vigorously. No class has been certified in this matter. The Company cannot at this time predict the outcome of this matter, is unable to estimate a range of possible loss, if any, and cannot predict whether or not the outcome will have a material adverse effect on the Company's business, financial position or results of operations.

#### **Hurricane Rita Litigation**

One of the Company's subsidiaries is currently defending a statewide putative class action lawsuit pending in the District Court of the Parish of Calcasieu, Louisiana filed on July 20, 2006 in the aftermath of Hurricane Rita, and the Company was served on August 7, 2006. The plaintiffs generally allege that Republic Fire and Casualty Insurance Company breached its policies by improperly adjusting and paying claims over the last ten years. These plaintiffs also alleged bad faith claims handling practices. This lawsuit seeks declaratory relief and unspecified monetary damages, statutory penalties and attorneys' fees. This matter is in the early stages of development. The Company plans to defend it vigorously. No class has been certified in this matter. The Company cannot at this time predict the outcome of this matter, is unable to estimate a range of possible loss, if any, and cannot predict whether or not the outcome will have a material adverse effect on the Company's business, financial position or results of operations.

#### **Other Litigation**

The Company and its subsidiaries are parties to various other lawsuits incidental to and arising in the ordinary course of their businesses. The Company believes that there are meritorious defenses to all of these lawsuits and is defending them vigorously. The Company believes that resolution of its pending litigation, other than the Hurricanes Katrina and Rita litigation, for which it is too early to predict, will not, individually or in the aggregate, have a material adverse effect on the Company's financial position. However, given the unpredictability of litigation, there can be no assurance that any litigation will not have a material adverse effect on the Company's financial results for any given period.

### ITEM 1A. RISK FACTORS

In addition to other information set forth in this report, you should carefully consider the risks described in Part I, "Item IA. *Risk Factors*," contained in our Annual Report on Form 10-K for the period ending December 31, 2005, which could impair our business, financial condition or results of operations. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks not presently known to us or that we currently deem immaterial may also impair our business, financial condition or results of operations.

As described in Note 11 to our Condensed Consolidated Financial Statements and in the "Recent Developments" section of "Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*" in this Quarterly Report on Form 10-Q, we entered into a definitive merger agreement pursuant to which a subsidiary of Delek Capital Ltd. ("Delek") would acquire all of the outstanding shares of the Company for \$20.40 in cash. The transaction is expected to close by the end of 2006, subject to certain conditions, including approval by the Company's stockholders and customary regulatory approvals. As the result of this proposed transaction, we are exposed to new risks that could impact our business, financial position or results of operations, particularly if the transaction is delayed or not completed. These additional risks include, but may not be limited to:

***If the proposed merger is not completed, our business could be materially and adversely affected, and our stock price could decline***

The merger is subject to customary closing conditions, including the approval by the holders of a majority of our outstanding common stock, certain regulatory agencies and other closing conditions. Therefore, the merger may not be completed or may not be completed in the expected time period. If the merger agreement is terminated, the market price of our common stock will likely decline, as we believe that our market price reflects an assumption that the merger will be completed. In addition, our stock price may be adversely affected because we have incurred and will continue to incur significant expenses related to the merger prior to its closing that will not be recovered if the merger is not completed. If the merger agreement is terminated under certain circumstances, we may be obligated to pay Delek a termination fee of \$9.0 million and reimburse Delek for its expenses in connection with the merger, up to a maximum of \$1.5 million. As a consequence of the failure of the merger to be completed, as well as of some or all of these potential effects of the termination of the merger agreement, our business could be materially and adversely affected, making it more difficult to retain employees and existing customers and to generate new business.

***The fact that there is a merger pending could have an adverse effect on our business, revenue and results of operations.***

While the merger proposal is pending, we are subject to a number of risks that may adversely affect our business, revenue and results of operations, including:

the diversion of management and employee attention and the unavoidable disruption to our relationships with our partners and customers may detract from our ability to grow revenues and minimize costs;

an unfavorable change in our A.M. Best rating could cause our revenues and earnings to decrease;

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some of our employees may choose to terminate their employment with us during this period of uncertainty, thereby disrupting the quality of our service;

we may be unable to respond effectively to competitive pressures, industry developments and future opportunities; and

we have incurred and will continue to incur significant expenses related to the merger prior to its closing.

***The “no solicitation” restrictions and the termination fee provisions in the merger agreement may discourage other companies from trying to acquire us.***

While the merger agreement is in effect, subject to specified exceptions, we are prohibited from entering into or soliciting, initiating or encouraging any inquiries or proposals that may lead to a proposal or offer for a merger or other business combination transaction with any person other than Delek. In addition, in the merger agreement, we agreed to pay a termination fee to Delek in specified circumstances. These provisions could discourage other parties from trying to acquire our company even though those other parties might be willing to offer greater value to our stockholders than Delek has offered in the merger agreement. The merger agreement does not, however, prohibit us or our board of directors from considering and potentially approving an unsolicited superior proposal from a third party, if we and our board of directors comply with the applicable provisions of the merger agreement.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Annual Meeting of Stockholders of the Company was held on May 17, 2006. Matters submitted to stockholders at the meeting and the voting results thereof were as follows:

*Election of Directors.* The stockholders of the Company elected each of the director nominees proposed by the Company’s Board of Directors to serve until his or her successor is duly elected and qualified. The following is a breakdown of the voting results as tabulated by Mellon Investor Services:

DIRECTOR	VOTES	
	VOTES FOR	WITHHELD
Bruce W. Schnitzer	12,565,168	47,157
Scott L. Bok	12,576,982	35,343
Patrick K. McGee	8,951,928	3,660,397
Robert H. Sheridan, III	12,545,802	66,523
John L. Ware	12,565,802	46,523

Robert H. Kullas

12,565,802 46,523

Parker W. Rush

12,565,802 46,523

*Appointment of KPMG LLP as Independent Auditor.* The stockholders of the Company ratified the appointment of KPMG LLP as the Company' s independent auditor. The following is a breakdown of the voting results as tabulated by Mellon Investor Services:

<b>VOTES FOR</b>	<b>VOTES AGAINST</b>	<b>ABSTAIN</b>	<b>NON VOTES</b>
12,611,376	789	160	0

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### ITEM 5. OTHER INFORMATION

None.

### ITEM 6. EXHIBITS

<u>Exhibit</u>		
<u>Number</u>	<u>Description</u>	<u>Reference</u>
3.1	Amended and Restated Certificate of Incorporation of Republic Companies Group, Inc.	(c)
3.2	Amended and Restated Bylaws of Republic Companies Group, Inc.	(c)
4.1	Form of Common Stock Certificate.	(c)
10.1	Stock Purchase Agreement, dated as of May 9, 2003, by and among Republic Financial Services, Inc. (Texas), Republic Financial Services, Inc. (Nevada), Winterthur U.S. Holdings, Inc., RTXA, Inc., and RTXA Sub Inc.	(a)
10.2	Securities Purchase Agreement and First Amendment thereto, effective May 9, 2003, among RTXA, Inc. and the investors party thereto.	(a)
10.3	Amended and Restated Registration Rights Agreement among Republic Companies Group, Inc. and the Investors party thereto, dated August 8, 2005.	(c)
10.4	Employment Agreement, dated as of November 17, 2003, between Republic Underwriters Insurance Company and Parker W. Rush.	(a)
10.5	Employment Agreement, dated as of May 9, 2003, between RTXA, Inc. and Martin B. Cummings.	(a)
10.6	Employment Agreement, dated as of April 9, 2004, between Republic Underwriters Insurance Company and Robert S. Howey.	(a)
10.7	Republic Companies Group, Inc. Stock Plan, effective May 1, 2004.	(d)
10.8	Republic Financial Services, Inc. Deferred Compensation Plan, effective July 1, 1995, as amended.	(d)
10.9	Excess of Loss Reinsurance Agreement and Addenda Nos. 1-3, effective January 1, 1994, between Winterthur Swiss Insurance Company and Republic Insurance Company.	(a)
10.10	Reinsurance Agreement, dated May 9, 2003, by and between Winterthur Swiss Insurance Company and Republic Underwriters Insurance Company.	(a)
10.11	Amended and Restated Investor Rights Agreement, dated as of December 9, 2004, between Republic Companies Group, Inc. and certain stockholders designated therein.	(a)
10.12	Credit Agreement, dated as of February 23, 2005, among Republic Companies, Inc., Republic Companies Group, Inc. and The Frost National Bank.	(a)
10.13	Lease Agreement, dated August 31, 2004, between TC Dallas #2, LP and Republic Underwriters Insurance Company.	(a)
10.14	Amended and Restated Managing General Agency Agreement, dated January 1, 2006, by and between Republic Lloyds, Republic-Vanguard Insurance Company, Southern County Mutual Insurance Company, Southern Insurance Company and Texas General Agency, Inc.	(e)

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10.15	2005 Equity-Based Compensation Plan, effective August 8, 2005.	(c)
10.16	Employee Stock Purchase Plan, effective August 8, 2005.	(c)
10.17	Deferred Compensation Plan for Directors, effective August 1, 2005.	(c)
10.18	Republic Underwriters Insurance Company Incentive Bonus Plan, effective January 1, 2005.	(c)
10.19	Incentive Stock Option Award Agreement.	(b)
10.20	Form of Restricted Stock Award Agreement	(f)
10.21	Managing General Agency Agreement by and between Southern Insurance Company, Southern Vanguard Insurance Company, Republic Underwriters Insurance Company, Republic Fire and Casualty Insurance Company and FirstComp Underwriters Group, Inc., effective July 1, 2006	†††
31.1	Rule 13a-14(a)/15d-14(a) Certification by Parker W. Rush	†
31.2	Rule 13a-14(a)/15d-14(a) Certification by Martin B. Cummings	†
32.1	Section 1350 Certifications by Parker W. Rush and <u>Martin B. Cummings</u>	††
†	Filed herewith.	
††	Furnished herewith.	
†††	Filed herewith. Portions of this document were omitted pursuant to a confidential treatment request filed with the Securities and Exchange Commission. Such portions have been provided separately to the Commission.	
(a)	Previously filed on May 10, 2005 as an Exhibit of like number to the Company' s registration statement on Form S-1 (File No. 333-124758) and incorporated herein by reference.	
(b)	Previously filed on August 12, 2005 as an Exhibit to the Company' s Current Report on Form 8-K (File No. 000-51455) and incorporated herein by reference.	
(c)	Previously filed on September 19, 2005 as an Exhibit of like number to the Company' s Form 10-Q for the quarterly period ended June 30, 2005 (File No. 000-51455) and incorporated herein by reference.	
(d)	Previously filed on July 19, 2005 as an Exhibit of like number to the Company' s registration statement on Form S-1/A (File No. 333-124758) and incorporated herein by reference.	
(e)	Previously filed on March 30, 2006 as an Exhibit of like number to the Company' s Form 10-K for the annual period ended December 31, 2005 (File No. 000-51455) and incorporated herein by reference. Portions of this document were omitted pursuant to a confidential treatment request filed with the Securities and Exchange Commission. Such portions have been provided separately to the Commission.	
(f)	Previously filed on February 16, 2006 as an Exhibit to the Company' s Current Report on Form 8-K (File No. 000-51455) and incorporated herein by reference.	

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Republic Companies Group, Inc.

Date: August 14, 2006

By: /s/ MARTIN B. CUMMINGS

**Martin B. Cummings**  
**Vice President and Chief Financial Officer**

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**Managing General Agency Agreement**

**Entered into by**

**and between**

**Southern Insurance Company**

**Southern Vanguard Insurance Company**

**Republic Underwriters Insurance Company**

**Republic Fire and Casualty Insurance Company**

(Hereinafter singularly and collectively referred to as "Company")

**and**

**FirstComp Underwriters Group, Inc.**

(Hereinafter "General Agent")

**Originally Effective: July 1, 2006**



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## MANAGING GENERAL AGENCY AGREEMENT

This Managing General Agency Agreement dated as of July 1, 2006 (“Effective Date”) is made and entered into by and between Southern Insurance Company, an insurance company domiciled in the State Texas, Southern Vanguard Insurance Company, an insurance company domiciled in the State of Texas, Republic Underwriters Insurance Company, an insurance company domiciled in the State of Texas, and Republic Fire and Casualty Insurance Company, an insurance company domiciled in the State of Oklahoma (singularly and collectively referred to herein as “Company”) and FirstComp Underwriters Group, Inc., a Nebraska Corporation with administrative offices in Omaha, Nebraska (referred to herein as “General Agent”).

In consideration of the agreements and obligations set forth herein and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Company and General Agent hereby agree as follows:

### **Article 1 - Appointment and Independent Contractor Relationship**

1.1 Appointment. Company appoints General Agent to act as its Managing General Agent, as defined in applicable Regulations. After execution or termination of this Agreement, Company shall make appropriate notifications of such appointment, or subsequent termination thereof, to applicable state insurance departments, as may be required of Company by Regulations. General Agent shall make appropriate notifications of such appointment, or subsequent termination thereof, to applicable state insurance departments, as may be required of General Agent by Regulations.

1.2 Exclusivity. General Agent acknowledges and agrees that Company’s appointment of General Agent is non-exclusive and does not restrict in any manner Company’s right to appoint agents for any lines of insurance Company writes directly or indirectly either through agents, sub-agents, managing general agents or otherwise. Company acknowledges and agrees that General Agent’s appointment by Company is non-exclusive and does not restrict in any manner General Agent’s right to be appointed by any other insurer or provide management or other services to any other person or entity, other than as provided in Article 4 of this Agreement.

1.3 Independent Contractor. General Agent shall act as an independent contractor. Company shall have no right of control over General Agent as to the time, means, or manner of General Agent’s performance or the conduct of its business within the authority granted by this Agreement. General Agent shall furnish and maintain, at [\*\*], the office and office equipment, vehicles, telephone service, books of accounts, personnel and employees deemed by it as necessary or desirable to the carrying on and promoting of the business of General Agent and shall [\*\*]. Nothing contained in this Agreement is intended to nor shall it be construed as creating the relationship of employer and employee, nor partner, nor joint venturer between Company and General Agent or between Company and any Agent with whom General Agent might contract.

[\*\*] CERTAIN INFORMATION ON THIS PAGE HAS BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION. CONFIDENTIAL TREATMENT HAS BEEN REQUESTED WITH RESPECT TO THE OMITTED PORTIONS.

**Article 2 - Definitions**

- 2.1 "Affiliated Reinsurance Agreements" means those certain reinsurance agreements, as may be amended from time to time, by and between Company and Republic Underwriters Insurance Company reinsuring the business produced pursuant to this Agreement.
- 2.2 "Agent" means any person or entity licensed as an insurance agent who acts in compliance with Regulations as an appointed sub-producer for General Agent and Policies are issued as a result.
- 2.3 "Agreement" means this Managing General Agency Agreement, including all Addenda hereto, as amended from time to time.
- 2.4 "Authorized Business" means lines of insurance and coverages, with the authority, limitations and underwriting guidelines, as set forth in the Schedule of Business Addendum attached to and incorporated into this Agreement by reference.
- 2.5 "Broker" means any person or entity who acts in compliance with Regulations as an un-appointed sub-producer for General Agent and Policies are issued as a result.
- 2.6 "Company" shall have the meaning set forth in the preamble of this Agreement.
- 2.7 "Effective Date" means the effective date of this Agreement and shall be July 1, 2006.
- 2.8 "Excess of Loss Reinsurance Agreement" means that certain excess of loss reinsurance agreement(s), as may be amended from time to time, by and between Republic Underwriters Insurance Company and one or more Excess of Loss Reinsurers providing excess of loss reinsurance for the Authorized Business.
- 2.9 "Excess of Loss Reinsurer" means the reinsurer or reinsurers under the Excess of Loss Reinsurance Agreement. General Agent and Company understand and agree that an Excess of Loss Reinsurer may change from time to time and such changes in Excess of Loss Reinsurer shall not require written amendment to this Agreement.
- 2.10 "General Agent" shall have the meaning set forth in the preamble of this Agreement.
- 2.11 "Installment Billing Fees" means the sum of the amounts identified as billing fees charged by General Agent to policyholders on behalf of Company for processing installment payments on Policies.
- 2.12 "Loss Adjustment Expenses" ("LAE") means expenses assignable to the investigation, appraisal, adjustment, settlement, litigation, defense or appeal of specific claims, regardless of how such expenses are classified for statutory reporting purposes. Loss Adjustment Expenses shall include, but not be limited to, interest on judgments, expenses of outside adjusters, *ex gratia* payments and declaratory judgment expenses or other legal expenses and costs incurred in connection with coverage questions and legal actions connected thereto but shall not include office expenses or salaries of Company' s or General Agent' s regular employees.
- 2.13 "Net Written Premium" means gross written premium on Policies (including endorsements and audits), less return premiums and cancellations.

2.14 "Party" shall mean General Agent or Company, as applicable.

2.15 "Policy" means any policy, endorsement, binder, certificate, or proposal for insurance or other document that binds Company.

2.16 "Quota Share Reinsurance Agreement" means that quota share reinsurance agreement(s), as may be amended from time to time, by and between Republic Underwriters Insurance Company and Quota Share Reinsurer reinsuring the Authorized Business.

2.17 "Quota Share Reinsurer" means a reinsurer subscribing to a Quota Share Reinsurance Agreement, as may be amended from time to time, reinsuring the business produced pursuant to this Agreement.

2.18 "Regulations" mean federal and state statutes, laws, rules, regulations, or orders which govern or regulate the operations or actions of Company, General Agent, Agents or Reinsurers.

2.19 "Reinsurer" means those companies subscribing to Affiliated Reinsurance Agreements, Quota Share Reinsurance Agreements or Excess of Loss Reinsurance Agreements reinsuring the business produced pursuant to this Agreement (reinsuring the Authorized Business) to which General Agent is not a party. General Agent and Company understand and agree that Reinsurers may change from time to time and such changes in Reinsurers shall not require written amendment to this Agreement.

2.20 "Unearned Premiums" means that portion of Net Written Premiums not earned because the Policy term has not expired as of the date for which the calculation is made.

### **Article 3 - Confidentiality**

3.1 During the term of this Agreement, one Party to this Agreement ("Disclosing Party") may reveal to the other Party ("Receiving Party") certain confidential or proprietary information related to its business operations, proprietary software applications and other intellectual property, and other information. All such information and all information related to the Authorized Business and this Agreement, whether oral, written, electronic or otherwise, furnished by Disclosing Party to Receiving Party, its directors, officers, employees, agents, consultants, or representatives ("Representatives"), together with analyses, working papers, notes, compilations, studies, or other documents or records prepared by Disclosing Party or its Representatives which contain or otherwise reflect or are generated from such information, are collectively referred to herein as "Confidential Information."

3.2 Receiving Party agrees to use Confidential Information solely for the purpose of this Agreement, the Affiliated Reinsurance Agreement, the Quota Share Reinsurance Agreement, or the Excess of Loss Reinsurance Agreement (and no other purposes) and shall keep Confidential Information confidential and not disclose Confidential Information to others, except that Disclosing Party may disclose Confidential Information to its Representatives who need to know Confidential Information, or to whom such disclosure is reasonably desirable, for the sole purpose of Receiving Party's performance under this Agreement, the Affiliated Reinsurance Agreement, the Quota Share Reinsurance Agreement, or the Excess of Loss Reinsurance Agreement.

3.3 Receiving Party may disclose Confidential Information to any of its affiliates and any of their respective directors, officers, employees, agents, consultants, or representatives (each an "Authorized Recipient") who need to know the Confidential Information solely for the purpose of Receiving Party's performance under this Agreement, the Affiliated Reinsurance Agreement, the Quota Share Reinsurance Agreement, or the Excess of Loss Reinsurance Agreement, provided that each Authorized Recipient shall have agreed to treat such Confidential Information in accordance with the terms of this Agreement as if such Authorized Recipient were Receiving Party (in the case of an entity) or a Representative (in the case of an individual) under this Agreement. Receiving Party shall be responsible for any breach of this Agreement by its Representatives or any of its Authorized Recipients.

3.4 Confidential Information shall not include:

- (a) information which at the time of disclosure by Disclosing Party is in the public domain or which later becomes part of the public domain through no act or omission of Receiving Party or its Representatives;
- (b) information received by Receiving Party or its Representatives from any third party not known by Receiving Party or its Representatives to be bound by a confidentiality agreement;
- (c) information already known by Receiving Party, provided that such information is not known by Receiving Party to be subject to another confidentiality agreement with or other obligation of secrecy to Disclosing Party;
- (d) information independently developed by Receiving Party or its Representatives not receiving disclosure hereunder or from a source known by Receiving Party or its Representatives to be bound by a confidentiality agreement with or other obligation of secrecy to Disclosing Party; or
- (e) information that is required to be disclosed in compliance with any Regulation, in response to any properly and lawfully issued summons or subpoena or other judicial process or at the request or demand of any governmental authority, including any regulator, administrative arbiter or court with authority or jurisdiction over Receiving Party's or any of its affiliates (it being agreed that Receiving Party shall promptly give Disclosing Party notice of any such request or grounds for disclosure, if permitted by applicable law).

3.5 Company and General Agent acknowledge and agree that Confidential Information is valuable information to Disclosing Party and unauthorized disclosure or use of Confidential Information by Receiving Party or its Representatives may cause irreparable harm and damage to Disclosing Party, and in the event of any breach of the provisions of this Article 3, Disclosing Party shall be entitled to seek equitable relief, including injunctions and orders for specific performance, in addition to all other remedies available to it at law or in equity.

3.6 Each Party shall keep in strict confidence and shall not use or disclose any nonpublic personal information the other Party furnishes to it, other than to carry out the purposes set forth in this Agreement for which such Party disclosed such information. For purposes of this Agreement, nonpublic personal information means nonpublic personal financial information and nonpublic personal health information as those terms are defined in applicable federal and state law, including the Gramm-Leach-Bliley Act (Financial Services Modernization Act of 1999) and comparable state laws. Nonpublic personal financial information includes personally identifiable financial information; and any list, description or other grouping of consumers (and publicly available information pertaining to them) that is derived using any personally identifiable financial information that is not publicly available. Nonpublic personal health information includes health information that identifies an individual who is the subject of the information or with respect to which there is a reasonable basis to believe that the information could be used to identify an individual.

#### **Article 4 - Non-competition**

In recognition of the significant time and expense incurred by Company in connection with this Agreement, during the term of this Agreement in states for which the Company is licensed, General Agent shall not act as a managing general agent for any entity other than Company or General Agent's affiliated insurer which is under common ownership with General Agent related to business which under this Agreement would qualify as Authorized Business nor directly or indirectly solicit business which under this Agreement would qualify as Authorized Business from agents, broker or other producers other than pursuant to this Agreement without the express, written approval of Company or upon 180 days written notice by General Agent to Company.

#### **Article 5 - General Agent's Authority**

5.1 General Authority. General Agent shall have the authority and the duty to act for and on behalf of Company insofar as necessary for General Agent to perform the functions of a managing general agent of Company, including, but not limited to, recruiting and supervising Agents and Brokers, underwriting, Policy issuance, accounting, billing and claims handling, all subject to the terms and conditions of this Agreement. General Agent, through its personnel, facilities, contractual arrangements and service providers, shall provide such services as set forth in this Agreement and Addenda as may be attached hereto and incorporated into this Agreement by reference.

5.2 Regulations. General Agent shall comply with all Regulations with respect to the placement of business with Company and in carrying out its duties and obligations under this Agreement. General Agent shall maintain current licenses and certificates of authority as required by Regulations for the conduct of business pursuant to this Agreement.

5.3 Company's Authority. Company shall have ultimate authority over the business placed with Company, including the right to accept any application or to underwrite any risk submitted or to reject, cancel or nonrenew any Policy or Policies produced by or through General Agent, subject to Policy provisions and applicable Regulations. Company may from time to time place written restrictions upon General Agent for the business produced pursuant to this Agreement, including restrictions on premium volume, concentration of risks, forms, rates, fees, and underwriting guidelines. General Agent shall make recommendations to Company regarding such restrictions.

5.4 Schedule of Business Addendum. The Schedule of Business Addendum attached to and incorporated into this Agreement by reference shall set forth the authority and limitations of General Agent with regard to Authorized Business, including, but not limited to, authority limitations, underwriting guidelines, maximum annual premium volume, basis of rates to be charged, types of risks which may be written, maximum limits of liability, applicable exclusions, territorial limitations, Policy cancellation provisions and maximum Policy periods. One or more Schedule of Business Addendum may be attached hereto and may be amended upon mutual agreement of the Parties without otherwise affecting the terms and conditions of this Agreement. Any amendment shall be in writing, executed by the Parties, and specify the effective date of the amendment. Underwriting guidelines developed in accordance with the authority and limitations set forth in the Schedule of Business Addendum shall be incorporated into this Agreement by reference.

5.5 Management of Business. Pursuant to the terms of this Agreement, General Agent shall have the responsibility to manage all business placed with Company under this Agreement, including business placed by Agents and Brokers. General Agent shall make every attempt to cure any unauthorized business placed with Company.

5.6 Agents and Brokers.

(a) General Agent shall assure that the original source of all business produced under this Agreement shall be properly licensed Agents or Brokers, who maintain appropriate licenses, certificates of authority and appointments as required by Regulations for the conduct of business under this Agreement. General Agent shall conduct and maintain proper background checks of Agents and Brokers. Upon discovery, General Agent shall immediately notify Company of any irregularities regarding any Agent or Broker. Company shall have the right to accept, reject or cancel any agent's appointment recommended or made by General Agent. General Agent shall not delegate its authority to underwrite and issue Policies or any risk changing endorsements or amendments to Policies to any Agent, Broker or other entity without the express written consent of Company.

(b) General Agent shall have authority to recruit, contract with, manage, train, and supervise Agents as producing agents acting for and on behalf of General Agent. General Agent may appoint Agents for Company at General Agent's expense, and upon execution of this Agreement, General Agent shall provide to Company all information necessary or requested by Company to substantiate the expertise and acceptability of each Agent appointed. General Agent shall maintain in force a written agreement, in a form acceptable to Company, with Agents and Brokers, who are not employees of General Agent. Each such agreement shall be made directly between General Agent and the Agent or Broker and shall provide that the Agent or Broker shall have no right, claim or cause of action against Company and shall look exclusively to General Agent for the payment of or satisfaction of any and all damages, losses, claims, costs, causes of action or expenses (including attorneys' fees), including, but not limited to, extra-contractual damages or losses in excess of policy limits, arising, directly or indirectly, out of or in connection with any action taken or not taken by Company or General Agent, unless such right, claim or cause of action arises solely and exclusively out of the negligence of Company.



5.7 Indemnification and Hold Harmless.

(a) GENERAL AGENT [\*\*].

(b) GENERAL AGENT SHALL COMPLY WITH ALL REGULATIONS WITH RESPECT TO ANY TERMINATION, SUSPENSION, OR REVOCATION OF AUTHORITY DELEGATED TO ANY AGENT AND SHALL INDEMNIFY AND HOLD COMPANY HARMLESS, SINGULARLY AND COLLECTIVELY, AGAINST ANY DAMAGES, LOSSES, CLAIMS, COSTS, CAUSES OF ACTION, OR EXPENSES, INCLUDING ATTORNEYS' FEES, ARISING, DIRECTLY OR INDIRECTLY, OUT OF OR IN CONNECTION WITH ANY ACTION TAKEN OR NOT TAKEN BY GENERAL AGENT, AGENT OR BROKER IN THIS REGARD, EXCEPT FOR ANY SUCH ACTION TAKEN OR NOT TAKEN SOLELY AT THE AUTHORIZED, WRITTEN DIRECTION OF COMPANY. GENERAL AGENT SHALL INDEMNIFY AND HOLD COMPANY, SINGULARLY AND COLLECTIVELY, HARMLESS AGAINST ANY PENALTIES AND FINES IMPOSED BY REGULATORY AUTHORITIES, INCLUDING ATTORNEYS' FEES AND EXPENSES, ARISING DIRECTLY OR INDIRECTLY, OUT OF OR IN CONNECTION WITH COMPANY' S ACCEPTANCE OF BUSINESS FROM ANY AGENT OR BROKER AND AGAINST ANY DAMAGES, LOSSES, CLAIMS, COSTS, CAUSES OF ACTION, OR EXPENSES, INCLUDING ATTORNEYS' FEES, ARISING, DIRECTLY OR INDIRECTLY, OUT OF OR IN CONNECTION WITH COMPANY' S ACCEPTANCE OF BUSINESS FROM ANY AGENT OR BROKER, UNLESS AND TO THE EXTENT SUCH PENALTIES, FINES, DAMAGES, LOSSES, CLAIMS, COSTS, CAUSES OF ACTION, OR EXPENSES ARE THE SOLE RESULT OF THE AUTHORIZED INSTRUCTIONS OR ACTS OF COMPANY.

5.8 Regulatory Filings. Forms, rates, and rules for Authorized Business as mutually agreed upon by General Agent and Company shall be filed by Company as required with the proper regulatory agency. Upon completion of filing and receipt of approval from the applicable regulatory agency or according to approval granted by Regulations, Company shall notify General Agent of the effective date of such filing.

5.9 Applications and Policies. General Agent shall have the authority to accept applications for Policies and to issue Policies for Authorized Business submitted by or through Agents or Brokers on forms, at rates, and under rules approved by Company. Company may refuse to accept any application or to underwrite any risk submitted and shall have the right to cancel or non-renew any Policy, subject to Regulations and Policy provisions. General Agent shall ensure that all applications, binders, policies or other forms are approved by Company and the required applicable state regulatory official prior to use.

5.10 Policy Renewals and Cancellations. According to Regulations and Policy provisions, as well as delegations of authorities herein, General Agent shall be responsible for the proper renewal, non-renewal or cancellation of Policies in accordance with Regulations, Policy provisions, and delegations of authority as provided in this Agreement. General Agent shall timely communicate to policyholders any renewal quotes or notices of non-renewal or cancellation to preclude the extension of coverages beyond the expiration dates or cancellation dates of in-force Policies.

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5.11 Policy Issuance. General Agent shall not delegate its authority to issue Policies to any Agent or Broker or other third party, unless otherwise approved in writing by Company in advance of the delegation of authority by General Agent. General Agent's request to Company for approval to delegate such authority shall include a copy of the agreement between General Agent and Agent or Broker which includes Agent's or Broker's authorities to be delegated by General Agent.

5.12 Premiums and Fees. General Agent shall have the authority to receive and receipt for premiums and to retain commissions and other fees, as specified in this Agreement, out of such collected premiums and fees, subject to the terms and conditions of this Agreement. General Agent shall have the authority to bill premiums to policyholders on an installment basis and charge policyholders Installment Billing Fees as allowed by Regulations. General Agent shall have the authority to accept premiums financed by premium finance companies or other lending institutions. General Agent shall be solely responsible and liable for premiums financed and shall cause any unearned premium or commission refunds to be paid directly to said premium finance company or lender and shall not pay or credit any Agent's or Broker's account.

5.13 Reserves. General Agent or its designated claims adjustment contractor approved by Company shall have the authority to set loss, Loss Adjustment Expenses (LAE), and incurred but not reported (IBNR) reserves on Policies for Company according to accepted statutory accounting principles, actuarial loss reserving standards, and Regulations, subject to review and adjustment by Company.

5.14 Involuntary Risks. General Agent shall process and administer in accordance with the provisions of this Agreement all involuntary business (e.g., assigned risk plans), if any, arising as a result of business produced pursuant to this Agreement and shall continue to do so after the termination of this Agreement, at the election of Company.

5.15 Communications with Regulators. Each Party hereto shall, immediately upon its receipt, send to the other Party all communications or copies of communications received from insurance departments or other regulatory authorities, including complaints, related to the business written pursuant to this Agreement. General Agent shall cooperate with Company in responding to such communications and shall provide the detail information necessary for Company to respond to such communications in a complete and timely manner. Company, not General Agent, shall correspond directly with the regulatory authorities regarding such communications.

5.16 Suspension of Authority.

(a) Company shall have the unilateral right, exercisable in its sole and absolute discretion, to suspend the authority of General Agent pursuant to this Agreement during the pendency of any dispute between Company and General Agent arising out of or in connection with any alleged breach or failure of performance or any material uncertainty of future performance on the part of General Agent under this Agreement, including, but not limited to:

- (i) General Agent' s failure to follow or adhere to limitations on its underwriting authority;
- (ii) General Agent' s unauthorized delegation of binding authority;
- (iii) General Agent' s failure to follow or adhere to claims handling guidelines of Company; or
- (iv) impairment of General Agent' s resources to perform.

(b) Upon receiving notice of any suspension of authority, General Agent shall have [\*\*] days to cure any underlying cause of such dispute; otherwise, upon the expiration of such [\*\*] days, Company may exercise its unilateral right to suspend the authority of General Agent. Company' s suspension of the authority of General Agent under this Agreement in good faith shall [\*\*].

(c) Company has and retains the right, exercisable in its sole and absolute discretion, to restrict the premium volume of the business produced by General Agent under this Agreement at any time. However, in the event that Company exercises its right under this Section (c) of Article 5.16, the [\*\*] day period for notice under Article 4 Non-competition shall be waived.

#### **Article 6 - Directors and Employees**

Neither General Agent nor Company shall permit any individual representing the other Party or any Agent or Broker to serve on its or any affiliated entity' s board of directors and shall not jointly employ any such individual.

#### **Article 7 - Compensation**

##### 7.1 Commissions.

(a) Commissions, as set forth in each Commission Schedule Addendum attached to and incorporated into this Agreement by reference, shall be payable to General Agent and shall be General Agent' s sole and full compensation for all business placed with Company under this Agreement; provided, however, commissions are payable to General Agent only to the extent premiums on Policies are collected by Company. Compensation is payable in consideration of General Agent' s faithful performance of the duties and obligations set forth in this Agreement and includes payment for unallocated loss adjustment expenses, which shall include General Agent' s internal costs for administering claims, including, but not limited to, employees' salaries and home office expenses.

(b) General Agent shall be solely responsible and solely liable for the payment of any compensation or reimbursement due to any Agent, Broker or claims adjustment contractors resulting from or connected with business placed with Company pursuant to this Agreement. Payment by Company to General Agent of any amounts due in connection with any business accepted by Company pursuant to this Agreement shall satisfy any obligation or liability whatsoever on the part of Company, whether in law or equity, to make such payment to any

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Agent, Broker, claims adjustment contractor or other person or entity. If there is not an Agent or Broker to receive the designated commission on a Policy, General Agent may retain the commission.

7.2 Contingent Commission.

(a) This Agreement allows for payment of a contingent commission between Company and General Agent as set forth on the attached Commission Schedule Addendum.

(b) Notwithstanding any provision in this Agreement to the contrary, in the event that General Agent is in default or has committed a breach of its obligations under this Agreement, no contingent commission shall be paid until such time as General Agent has cured the default or breach.

7.3 Expenses and Return Commissions. General Agent shall be obligated for and shall pay [\*\*], and Company shall not be liable for or obligated to pay [\*\*] incurred by, for, or on behalf of General Agent. General Agent shall be liable for the return of commissions on return premiums at the same rate as the commissions allowed in connection with the coverage for which the return of premiums is being made. General Agent shall not, however, be required to return, as return commissions, monies greater than the total commission payable to General Agent in connection with the coverage for which the return of premium is made.

7.4 Commission Schedule Addendum. More than one Commission Schedule Addendum may be attached to this Agreement, and each Commission Schedule Addendum may be amended by Company and General Agent without otherwise affecting the terms and conditions of this Agreement. All such amendments shall be in writing, executed by the Parties, and specify the effective date thereof.

**Article 8 - Records**

8.1 Records Separation and Retention. General Agent shall keep and maintain records of the business written or transacted for or on behalf of Company pursuant to this Agreement, including underwriting files and claims files, separate and segregated from, and not combined with, any other insurance company records maintained by General Agent. All records on business produced by General Agent under this Agreement shall be retained and maintained by General Agent in good condition for a period at least equal to the minimum period required by Regulations or a period no less than seven years, whichever is longer. The record retention period of a Policy shall begin with the latest of the expiration date of the Policy or the claim settlement date. As regards claim records involving minor claimants, the record retention period shall begin when the minor reaches majority. Company retains the right to control record destruction on business produced by General Agent pursuant to this Agreement, including hardcopy and electronic records. When records are scheduled for destruction by General Agent, all records shall be delivered to Company as requested by Company along with an approved detailed log that fully describes such records. Such records shall be the joint property of Company and General Agent. Upon an order of liquidation of Company, such records shall become the sole property of Company or its estate, and General Agent shall have reasonable access to and the right to copy the records on a timely basis.

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8.2 Maintenance of Policies and Records. General Agent shall provide and maintain all binders, Policies, contracts of insurance, claim files and all necessary books, records, dailies and correspondence with policyholders. General Agent shall be solely responsible for and shall keep accurate records of all Policies assigned to General Agent and, upon Company' s request, shall account to Company for all outstanding and unused policy supplies. In the event canceled or terminated Policies or binders are unavailable, General Agent shall forward or cause to be forwarded properly executed lost policy receipts.

### **Article 9 - Audits and Examinations**

9.1 Availability. General Agent shall make available at all reasonable times and in a usable form for inspection, copy, or audit by Company, Reinsurer, or their designated representatives all records applicable to business produced pursuant to this Agreement, including, but not limited to, underwriting, claims, financial and accounting files. Upon notice, all records shall be made available for inspection at any office of Company in a usable form if insurance department personnel or other governmental authorities request such inspection. Upon request, General Agent shall immediately forward to Company' s independent auditor or statistical agent exact, as written, copies of all applications, binders, daily reports, monthly reporting forms, endorsements, and statistical files, including all other evidence of insurance written, modified or terminated.

9.2 Scheduled Audits. Company and its designated representatives shall be afforded full and complete access to General Agent' s records for the purpose of auditing General Agent with respect to all transactions arising out of or in connection with any business written by General Agent or any Agent or Broker pursuant to this Agreement, including any underwriting, claims, financial or accounting files of General Agent, upon 24 hours notice and during the regular business hours of General Agent. Company shall conduct such audits at least semiannually, and otherwise within 90 days of the close of any 30 day period following the first anniversary of the Effective Date of this Agreement in which Company' s aggregate premium volume increases by 30% or more if General Agent writes more than 20% of Company' s aggregate premium volume and General Agent has itself experienced an increase of 20% or more in its own premium volume produced within the same 30 day period. Copies of such audits shall remain on file with Company for at least the minimum period of time required by Regulations and be available to regulators for review.

Company may conduct examinations more extensively or frequently if issues and matters, in the sole discretion of Company, necessitate such examinations.

9.3 Minimum Scope of Audits. Any audit conducted by Company shall include issues and matters required by Company or Regulations, and at a minimum, shall include a review of the following information or elements:

- (a) General Agent' s claims procedures and claims handling practices;
- (b) timeliness of claim payments, i.e., lag-time between the date a claim is reported and the date it is paid;

- (c) timeliness of General Agent' s reporting of new business to Company;
- (d) timeliness of General Agent' s remittance of monies due Company;
- (e) timeliness of premium and collection for business written for or on behalf of Company;
- (f) reconciliation of General Agent' s policy forms and check and draft inventory; and
- (g) compliance with underwriting guidelines set forth in this Agreement.

9.4 Expenses of Audits and Examinations. All expenses incurred by Company for audits and examinations performed by Company shall be borne by Company, unless the scope of the audit or examination is increased as a result of unusual or unexpected audit or examination findings. If in the opinion of Company, the examination expenses have increased substantially due to a scope expansion, such additional expenses shall be shared by Company and General Agent as mutually agreed. Any expenses incurred by Company or General Agent for audits or examinations conducted by or on behalf of a regulatory agency that specifically relates to the business produced pursuant to this Agreement shall be borne by General Agent.

### **Article 10 - General Agent' s Reports**

10.1 Monthly Reports. General Agent shall furnish to Company an accounting on a monthly basis detailing all transactions for or on behalf of Company ("monthly reports"). Such accounting must be received by Company not later than 30 days from the end of the month being accounted for. Monthly reports shall be summarized and detailed by annual statement line of business to enable Company to record the monthly transactions in its statutory annual statement. Company shall have the authority to determine the content of the monthly reports. At a minimum, monthly reports shall include the following information:

- (a) Net Written Premiums, Earned and Unearned Premiums
- (b) Installment Billing Fees collected
- (c) General Agent' s commissions
- (d) paid losses, less loss recoveries and salvage and subrogation
- (e) Loss Adjustment Expenses paid (direct defense, cost containment and other adjusting expenses, shall be reported separately)
- (f) outstanding unearned premium reserves
- (g) outstanding loss reserves
- (h) outstanding LAE reserves (direct defense, cost containment and other adjusting expenses, shall be reported separately)
- (i) outstanding IBNR reserves

10.2 Annual Reports. General Agent shall furnish to Company annual reports, as defined by Company detailing all transactions for or on behalf of Company. Annual reports must be received by Company not later than 30 days from the end of the year being accounted for. Annual reports shall be summarized and detailed by annual statement line of business to enable Company to prepare statutory annual statements. Company shall have the authority to determine the content of annual reports. At a minimum, annual reports shall include year-to-date amounts of all information required for monthly reports as well as the following information:

(a) Segregated by policy year - Net Written Premiums

(b) Segregated by accident year - gross losses paid, salvage and subrogation received and gross Loss Adjustment Expenses paid during the year (direct defense, cost containment and other adjusting expenses, shall be reported separately)

(c) Segregated by accident year - outstanding loss, LAE (direct defense, cost containment and other adjusting expenses, shall be reported separately) and IBNR reserves.

(d) Outstanding unearned premium reserves that are:

- (i) Running one year or less from the date of the Policy;
- (ii) Running more than one year from the date of the Policy; and
- (iii) Advance premiums.

(e) Number of Policies and amounts of Net Written Premiums that are in-force

(f) Claim counts by accident year for:

- (i) Reported claims;
- (ii) Claims closed with payment; and
- (iii) Outstanding claims.

10.3 Data Calls and Indemnity and Hold Harmless. As regards all statistical data calls, whether recurring or special, General Agent shall submit to Company in a timely manner the information and data necessary to allow Company to report General Agent's data in compliance with such data calls. All expenses incurred in connection with such calls shall be the responsibility of General Agent. GENERAL AGENT SHALL INDEMNIFY AND HOLD HARMLESS COMPANY, SINGULARY AND COLLECTIVELY, FROM ANY AND ALL PENALTIES, FINES, COSTS, EXPENSES AND DAMAGES (INCLUDING ATTORNEYS' FEES) OF ANY KIND OR NATURE, THAT MAY BE ASSESSED AGAINST COMPANY BY ANY REGULATORY BODY OR STATISTICAL AGENT AS A RESULT OF ANY DEFICIENCY RELATED TO THE STATISTICAL DATA REPORTED BY GENERAL AGENT FOR BUSINESS WRITTEN PURSUANT TO THIS AGREEMENT.

10.4 Electronic Reports. If General Agent elects to transmit electronically reports required under this Agreement, including, but not limited to, monthly reports, annual reports and claims reports, the time period for transmitting such electronic files to Company shall be consistent with the respective paper report time periods.

10.5 Financial Statement. General Agent shall furnish annually to Company General Agent's audited consolidated financial statements and footnotes that are in accordance with generally accepted accounting principles. The financial statements shall include, but not be limited to, balance sheets for the two most recent years, and income statement and statement of cash flows for the three most recent years. Consolidating schedules, if any, shall also be furnished, as appropriate.

10.6 IRS Form 1099. General Agent shall furnish annually an IRS Form 1099 to any third party, as required by Regulations.

10.7 Other Reports. General Agent shall furnish to Company other reports or information reasonably requested by Company on business written pursuant to this Agreement, including but not limited to, detailed Policy reports and loss run reports.

#### **Article 11 - Establishment of Loss Reserves**

General Agent shall establish, subject to review and adjustment by Company in its absolute discretion, claim and loss reserves with respect to the Policies, including reserves for Loss Adjustment Expenses, incurred but not reported losses, and losses reported but not paid and shall furnish to Company all data supporting estimated IBNR. If required by Regulations, General Agent, on behalf of Company, shall obtain an opinion of a certified actuary, at the sole expense of General Agent, attesting to the adequacy of all losses and Loss Adjustment Expenses incurred and outstanding, including IBNR, on business produced by General Agent pursuant to this Agreement.

#### **Article 12 - Expenses**

12.1 General Agent's Expenses. General Agent shall be responsible for and shall promptly pay all expenses attributable to the producing and servicing of business pursuant to this Agreement, except as specified in Article 12.2 of this Agreement. General Agent's responsibility shall not be altered whether the expense is billed to General Agent or Company. General Agent's expenses include, but are not limited to:

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Any and all expenses described above that are a primary obligation of General Agent and all compensation paid to General Agent under this Agreement shall be deemed to include all expenses of General Agent, including items enumerated above.

12.2 Company's Expenses. Company shall be responsible for and shall promptly pay all expenses attributable to the actions of Company as a result of business produced pursuant to this Agreement. This responsibility shall not be altered whether the expense is billed to Company or General Agent. These expenses include, but are not limited to:

- (a) salaries and all other benefits of all employees of Company;

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- (b) transportation, lodging, and meals of employees of Company;
- (c) losses and Loss Adjustment Expenses incurred at the direction of Company; and
- (d) legal and auditing expense incurred at the direction of Company.

12.3 Data Processing Expenses. Company reserves the right to install data processing or transmission equipment in the office(s) of General Agent and connect into the data processing equipment of General Agent relating to the business written under this Agreement. The responsibility for the expense arising from such action shall be borne solely by Company.

### **Article 13 - Handling of Funds**

13.1 Fiduciary Duty. General Agent shall accept and maintain at all times as a fiduciary for Company all premiums and other funds collected relating to the business written pursuant to this Agreement. General Agent shall not commingle any funds belonging to Company with its corporate accounts, other agency funds, or funds held by General Agent in any other capacity. The privilege of retaining commissions scheduled in the Commission Schedule Addendum to this Agreement shall not be construed as changing the fiduciary capacity or obligations of General Agent.

13.2 Premium Escrow Account. General Agent shall establish and maintain a premium escrow account and shall, upon receipt, deposit in such escrow account all money collected for Company in accordance with the instructions of Company and pursuant to Regulations.

13.3 Claims Adjustment Escrow Account. General Agent, or its claims adjustment contractor approved by Company, may establish and maintain a claims adjustment escrow account and shall transfer sufficient monies from the above premium escrow account to the claims adjustment escrow account to pay losses and Loss Adjustment Expenses in accordance with the instructions of Company and Regulations.

13.4 Signatory Authority, Withdrawal of Funds. General Agency and Company shall maintain signature authority on said premium escrow account and claims adjustment escrow account. General Agent shall act as trustee for Company on said escrow accounts. The financial institution selected by General Agent for such escrow accounts shall be mutually agreed upon by General Agent and Company. General Agent shall have the right to transfer funds held in such escrow accounts to successor financial institutions with the prior written consent of Company. Such financial institutions shall be members of the Federal Reserve System and whose deposits are insured by the Federal Deposit Insurance Corporation or its successor. General Agent shall be entitled to retain any interest earned on funds deposited in such escrow accounts.

All withdrawals from such escrow accounts must be evidenced by detailed accounting which clearly reflects each withdrawal. Funds may be withdrawn from such escrow accounts only for purposes set forth in Article 13.5 below.

13.5 Use of Funds Collected. General Agent shall use any and all premiums and other funds collected by General Agent for and on behalf of Company under this Agreement solely for the following purposes:

- (a) amounts due Company under this Agreement;
- (b) the return of unearned premiums arising due to cancellation or endorsement of Policies;
- (c) General Agent's compensation as set forth in the Commission Schedule Addendum attached to this Agreement;
- (d) losses and Loss Adjustment Expenses;
- (e) money deposited in error; or
- (f) withdrawals of interest belonging to General Agent.

13.6 Payment of Premiums to Company. General Agent assumes responsibility for and shall promptly pay Company, within 30 days after each calendar month end, all premiums collected on Policies issued through General Agent or on General Agent's behalf, subject to any deductions provided for herein. General Agent shall reconcile Net Written Premium, billed and collected and report these reconciliations monthly.

13.7 Omission of Items from Statements. The omission of any item from any monthly statement, account report or any other report shall not affect the responsibility of either Party to account for and pay all amounts due the other Party, nor shall it prejudice the rights of either Party to collect all such amounts due from the other Party.

13.8 Refund of Commissions. General Agent shall refund commissions on Policy cancellations, reductions in premiums or any other return premiums at the same rate at which such commissions were originally retained.

13.9 Disallowance of [\*\*]. Neither General Agent nor Company shall be allowed to [\*\*] under this Agreement with [\*\*] between General Agent and Company. General Agent shall not be allowed to [\*\*] Company under this Agreement [\*\*] General Agent, or any Agent or Broker, [\*\*].

13.10 Assignment of Sums Due. General Agent hereby assigns to Company as security for the obligations of General Agent under this Agreement, but not in payment, all sums due or to become due to General Agent from any policyholder for whom a Policy has been issued by General Agent. Company may demand and collect such sums if General Agent is in default, as defined in Article 20 of this Agreement, and General Agent, Agents or Brokers shall not be entitled to any commissions and other fees on any premiums so collected by Company.

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**Article 14 - Ownership of Books and Records and Miscellaneous Property**

14.1 Records and Expirations. General Agent' s records pertaining to business written pursuant to this Agreement and the use and control of the expirations of Policies shall remain the property of General Agent and be left in General Agent' s undisputed possession, provided General Agent is not in default, as defined in Article 20 of this Agreement. General Agent pledges any and all of its Policy expiration records and its ownership thereof as security for its performance under this Agreement. General Agent agrees and understands that this Agreement, or a copy thereof, may be filed as a financing statement or a financing statement may be required to secure Company' s security interest in the expirations and renewals. If General Agent fails to cure any default within 30 days of Company' s notice thereof to General Agent, ownership of the records, use and control of expirations and the goodwill relating thereto shall be vested in Company. However, if default arises solely from General Agent' s failure to obtain and maintain all required insurance licenses, the ownership of the records, use and control of the expirations and the goodwill relating thereto shall remain the property of General Agent.

14.2 Miscellaneous Property.

(a) Any data processing software or data processing technology or applications, policies, endorsements or forms, or data processing software or data processing technology which produces such applications, policies, endorsements, or forms, or any other supplies furnished to General Agent by Company shall remain the property of Company.

(b) Any data processing software or data processing technology or applications, policies, endorsements or forms, or data processing software or data processing technology which produces such applications, policies, endorsements, or forms, or any other supplies furnished to Company by General Agent shall remain the property of General Agent.

**Article 15 - Advertising**

15.1 Names, Logos, Marks.

(a) Names, Logos and Marks. Except as required by Regulations, General Agent, any Agent or any Broker shall not use the name, logo, trademark or other service marks of Company or any of its affiliates in any advertising, promotional materials or public manner of any nature without specific authorization and prior written approval from Company.

(b) Except as required by Regulations, Company shall not use the name, logo, trademark or other such service marks of General Agent Party or any of its affiliates in any advertising, promotional materials or public manner of any nature without specific authorization and prior written approval from General Agent.

15.2 Advertisements. A copy of any proposed advertisement, promotional materials or such public manner and a description of the intended use shall be forwarded to Company prior to its use. General Agent shall maintain a copy of any and all advertisements and promotional materials containing Company' s name and full details concerning where, when, and how such advertisements or promotional materials were used, and shall furnish Company a copy of all such advertisements, promotional materials and related information. General Agent shall

comply with all legal requirements regarding content, review and approval of advertising and maintenance of records. General Agent shall maintain records of the names and addresses of recipients of any direct mailing or advertising when required by Regulations but shall in all instances record the geographical area in which such mailing or advertising was used.

#### **Article 16 - Changes in Ownership, Control or Management**

16.1 Notice. A Party (“Notifying Party”) shall notify the other Party (“Recipient Party”) in writing as soon as permitted by Regulations of:

- (a) the intended sale or transfer of a majority or controlling interest of the Notifying Party to a third party; or
- (b) the intended merger or consolidation of the Notifying Party with a third party.

16.2 Action by Recipient Party. Upon receipt of such notice, the Recipient Party may:

- (a) consent to the assignment of this Agreement to the successor in interest of Notifying Party;
- (b) enter into a new Agreement with the successor in interest of Notifying Party; or
- (c) terminate this Agreement pursuant to Article 20 of this Agreement.

The Recipient Party shall notify the Notifying Party of its decision regarding any such reported event within 30 days. The failure of Recipient Party to notify Notifying Party of its decision shall not constitute acceptance of the reported event. The Recipient Party’s decision shall not be unreasonably withheld.

16.3 Change in Ownership or Management of General Agent. General Agent shall notify Company in writing within 30 days if there is a change in:

- (a) ownership of 10% or more of the outstanding stock of General Agent;
- (b) any principal officer of General Agent; or
- (c) any director of General Agent.

#### **Article 17 - Indemnity Agreement**

17.1 General Agent. GENERAL AGENT SHALL INDEMNIFY, DEFEND AND HOLD HARMLESS COMPANY, SINGULARLY AND COLLECTIVELY, FROM ANY AND ALL LOSSES, LIABILITIES, ACTIONS, SUITS, DEMANDS, CAUSES OF ACTION, DAMAGES, PENALTIES, FINES, JUDGMENTS AND EXPENSES, INCLUDING ANY AND ALL EXTRA CONTRACTUAL CLAIMS OR LOSSES IN EXCESS OF POLICY LIMITS (ALL SPECIFICALLY INCLUDING BUT NOT LIMITED TO ATTORNEYS’ FEES AND COURT COSTS), (“CLAIMS”) WHICH MAY BE MADE AGAINST COMPANY, SINGULARY OR COLLECTIVELY, AND WHICH ARISE, EITHER DIRECTLY OR INDIRECTLY, OUT OF OR IN CONNECTION WITH:

(a) GENERAL AGENT' S PERFORMANCE OR FAILURE TO PERFORM UNDER THE TERMS OF THIS AGREEMENT;

(b) A VIOLATION OF ANY REGULATION BY GENERAL AGENT, ANY AGENT, OR ANY BROKER OR THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES;

(c) A BREACH BY GENERAL AGENT OF ANY COVENANT, CONDITION, WARRANTY OR REPRESENTATION MADE TO COMPANY;

(d) THE FAILURE BY GENERAL AGENT, ITS DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES TO PROPERLY DISCHARGE DUTIES AND OBLIGATIONS UNDER THIS AGREEMENT OR TO PROPERLY OBSERVE AND COMPLY WITH LIMITATIONS OF AUTHORITIES UNDER THIS AGREEMENT; OR

(e) NEGLIGENCE, WILLFUL MISCONDUCT OR LACK OF GOOD FAITH ON THE PART OF GENERAL AGENT, ANY AGENT, OR ANY BROKER OR THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES, WHETHER OR NOT SUCH CLAIMS ALSO ARISE OUT OF THE COMPARATIVE NEGLIGENCE OR OTHER FAULT OF COMPANY, AND EXCEPTING ONLY WHERE SUCH CLAIMS ARISE OUT OF THE SOLE NEGLIGENCE OR OTHER FAULT OF COMPANY.

17.2 Company. COMPANY SHALL INDEMNIFY, DEFEND AND HOLD HARMLESS GENERAL AGENT FROM ANY AND ALL LOSSES, LIABILITIES, ACTIONS, SUITS, DEMANDS, CAUSES OF ACTION, DAMAGES, PENALTIES, FINES, JUDGMENTS AND EXPENSES, INCLUDING ANY AND ALL EXTRA CONTRACTUAL CLAIMS OR LOSSES IN EXCESS OF POLICY LIMITS (ALL SPECIFICALLY INCLUDING BUT NOT LIMITED TO ATTORNEYS' FEES AND COURT COSTS), ("CLAIMS") WHICH MAY BE MADE AGAINST GENERAL AGENT AND WHICH ARISE, EITHER DIRECTLY OR INDIRECTLY, OUT OF OR IN CONNECTION WITH:

(a) COMPANY' S PERFORMANCE OR FAILURE TO PERFORM UNDER THE TERMS OF THIS AGREEMENT;

(b) A VIOLATION OF ANY REGULATION BY COMPANY;

(c) A BREACH BY COMPANY OF ANY COVENANT, CONDITION, WARRANTY OR REPRESENTATION MADE TO GENERAL AGENT;

(d) THE FAILURE BY COMPANY, ITS DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES TO PROPERLY DISCHARGE DUTIES AND OBLIGATIONS UNDER THIS AGREEMENT; OR

(e) NEGLIGENCE, WILLFUL MISCONDUCT OR LACK OF GOOD FAITH ON THE PART OF COMPANY OR ITS DIRECTORS, OFFICERS, EMPLOYEES, OR REPRESENTATIVES, WHETHER OR NOT SUCH CLAIMS ALSO ARISE OUT OF THE COMPARATIVE NEGLIGENCE OR OTHER FAULT OF GENERAL AGENT, AND EXCEPTING ONLY WHERE SUCH CLAIMS ARISE OUT OF THE SOLE NEGLIGENCE OR OTHER FAULT OF GENERAL AGENT.

### **Article 18 - Errors and Omissions Insurance, Surety Bond**

18.1 Errors and Omissions Insurance. General Agent shall maintain an errors and omissions insurance policy naming Company as an additional insured issued by an insurance carrier approved by Company with policy limits no less than [\*\*] dollars and a deductible no greater than [\*\*] dollars. A copy of such errors and omissions policy shall be forwarded to Company for its records within 30 days of its issue or renewal.

18.2 Surety Bond. General Agent shall maintain a surety bond in a form acceptable to Company and an amount not less than (i) \$[\*\*] or (ii) [\*\*]% of nationwide annual premium for business written pursuant to this Agreement, whichever is greater, but in no event more than \$[\*\*], issued by an insurance carrier approved by Company. A copy of the surety bond shall be forwarded to Company for its records within 30 days of its issue or renewal.

### **Article 19 - Arbitration**

If irreconcilable differences of opinion arise as to the interpretation of this Agreement which are not satisfactorily resolved through mediation, the differences shall be submitted to arbitration. One arbitrator shall be chosen by Company, one shall be chosen by General Agent, and an umpire shall be chosen within 30 days by the two arbitrators. The arbitrators and umpire shall be disinterested officers or former officers of property and casualty insurance companies or managing general agencies. The arbitrators shall be relieved from all judicial formalities and may abstain from following the strict rules of law. This Agreement shall be interpreted as an honorable engagement. The decision of the arbitrators and umpire shall be final and binding upon both Parties, and judgment upon the final decision may be entered in any court of competent jurisdiction. Each Party shall bear the expense of its own arbitrator and shall jointly and equally bear the other expenses of the umpire and of the arbitration. Any arbitration shall take place in Dallas, Texas, unless otherwise mutually agreed. If either Party fails to name its arbitrator within 30 days after receiving the written request by registered mail, return receipt requested, of the other Party to do so, the latter shall name both arbitrators, who shall select an umpire as stipulated herein. The Parties hereby agree this Article shall not apply to or govern Article 21, Article 5.3, Article 22.1, or any action by Company required by Regulations to be subject to the ultimate control of Company.

### **Article 20 - Termination**

20.1 Mutual Agreement or Notice. This Agreement may be terminated by mutual agreement at any time, or by either Party giving the other Party written notice at least 180 days prior to such termination. Any draft authority of General Agent shall terminate upon the effective date of termination unless provided otherwise in writing by Company. Upon the request of Company, General Agent shall send or cause to be sent to all insureds timely notice of nonrenewal or cancellation of Policies in accordance with applicable law.

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20.2 Automatic Termination. This Agreement shall automatically and immediately terminate with the providing of [\*\*] days written notice in the event of:

(a) the cancellation or termination of the Quota Share Reinsurance Agreement or Excess of Loss Reinsurance Agreement reinsuring the business under this Agreement; provided, however, notice provisions pertaining to the cancellation or termination of the Quota Share Reinsurance Agreement or Excess of Loss Reinsurance Agreement as set forth in such Quota Share Reinsurance Agreement or Excess of Loss Reinsurance Agreement shall apply notwithstanding the [\*\*] days written notice provided herein. Company shall immediately forward to General Agent any notice of termination or cancellation regarding the Quota Share Reinsurance Agreement or Excess of Loss Reinsurance Agreement received by Company from the Quota Share Reinsurer or Excess of Loss Reinsurer.

(b) the insolvency or bankruptcy of General Agent or an assignment by General Agent for the benefit of creditors; or

(c) the insolvency or bankruptcy of Company; or an order of liquidation of Company by a state insurance department or court of competent jurisdiction. In the event this Agreement is terminated as a result of this subsection, the records of Company's business maintained by General Agent shall, notwithstanding any provisions to the contrary, become the sole property of Company or its estate and General Agent shall have reasonable access to and the right to copy such records on a timely basis.

20.3 Termination by Company. Company may terminate this Agreement for cause upon providing General Agent 10 days written notice in the event of the occurrence of one or more of the following events:

(a) the expiration or termination of any licenses or certificates of authority held by General Agent necessary for General Agent to perform its obligations under this Agreement;

(b) the transfer or sale of the majority of the stock or a substantial portion of the assets of General Agent or its controlling party or parent, unless such transfer or sale is made with the express written consent of Company;

(c) the commission of any fraud, gross negligence or willful misconduct by General Agent, which includes, but is not limited to, willful violation of instructions or willful violation of any covenant of this Agreement or any Regulation applicable to General Agent;

(d) General Agent ceases all business operations; or

(e) General Agent violates any provision of this Agreement, provided, however, that General Agent shall be allowed [\*\*] days to cure such violation. For purposes of this provision, routine differences in the accounting methods of General Agent and Company, which are minor in amount, shall not be grounds for termination of this Agreement.

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20.4 Termination by General Agent. General Agent may terminate this Agreement for cause upon providing Company [\*\*] days written notice in the event of the occurrence of one or more of the following events:

(a) the commission of any fraud, gross negligence or willful misconduct by Company, which includes, but is not limited to, willful violation of instructions or willful violation of any covenant of this Agreement or any Regulation applicable to Company;

(b) Company ceases all its underwriting operations;

(c) Company's consolidated capital and surplus is reduced during any year by an amount greater than [\*\*]% of the amount of the consolidated capital and surplus of Company as reported in annual statutory financial statements for the year immediately preceding;

(d) Company's A.M. Best's rating is reduced to less than [\*\*], and such rating is not restored within a stated period of time as agreed to by the Parties;

(e) the expiration or termination of any licenses or certificates of authority held by Company necessary for Company to perform its obligations under this Agreement;

(f) The transfer or sale of the majority of the stock or a substantial portion of assets of Company (on a consolidated basis), unless such transfer or sale is made with the express written consent of General Agent; or

(g) Company's violation of any material provision of this Agreement, provided however that Company shall be allowed [\*\*] days to cure such violation. For purposes of this provision, routine differences in the accounting methods of General Agent and Company, which are minor in amount, shall not be grounds for termination of this Agreement.

20.5 Return of Property. Upon notice of termination of this Agreement, General Agent shall immediately deliver, or cause to be delivered, to Company all property of Company, including, but not limited to, Policies, manuals, forms, unused drafts and all materials relative to the handling of claims and servicing of Policies, all computerized and data processing records, and the physical and logical equipment, or unlimited access thereto, required for the processing of those records and data. If General Agent fails to deliver such property within [\*\*] days after the termination date and Company takes action to obtain said property, General Agent shall bear any and all reasonable expenses which Company may expend or cause to be expended in obtaining such property. IN THE EVENT THAT POLICIES CANNOT BE ACCOUNTED FOR BY GENERAL AGENT OR HAVE BEEN DESTROYED, LOST OR MISLAID, GENERAL AGENT AGREES TO PROTECT, FOREVER DEFEND, AND HOLD HARMLESS COMPANY, SINGULARLY AND COLLECTIVELY, AGAINST ALL PERSONS AND CLAIMS WHATSOEVER ARISING FROM OR RELATED TO SAID POLICIES.

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20.6 Cessation of Binding Authority. From or after the effective date of the termination of this Agreement, General Agent shall have no authority to issue any binder, Policy, or contract of insurance, nor any endorsement or amendment thereof without prior written consent of Company.

20.7 Limitation of Damages. Either Party exercising its right to terminate this Agreement shall not give rise to any right, claim, or cause of action in the other Party for any loss of prospective profits, commissions, earnings, income, or for any other damage to the business or personal interests of the Parties arising therefrom.

20.8 Suspension of Authority upon Default. The rights to solicit and place new business, or to renew, or to modify any existing business shall be suspended immediately in the event of default by General Agent. The term default with respect to General Agent means, in the opinion of Company, any material breach by General Agent or material failure by General Agent to comply with the terms and conditions of this Agreement and includes, but is not limited to, the following:

- (a) material failure to adjust all claims arising from all business written pursuant to this Agreement;
- (b) material failure to adhere to the underwriting guidelines approved by the Company;
- (c) failure to remit balances due as provided for in this Agreement;
- (d) failure to maintain licenses or certificates required by Regulations; or
- (e) material failure to comply with any applicable Regulations.

In the event that Company determines that General Agent is in default, Company, in its sole discretion, may immediately suspend any and all of General Agent's authority to act as a managing general agent of Company. Any such suspension shall be effective upon written notification to General Agent. General Agent shall have 30 days to cure any such violation. Within 10 days of its initial notification to General Agent of the violation, Company shall notify General Agent of the nature of the default in reasonable detail.

20.9 Termination for Fraud or Breach. In the event of termination of this Agreement due to fraud or breach of conditions, any indebtedness of General Agent to Company and all premiums in the possession of General Agent, or for the collection of which General Agent is responsible, shall, notwithstanding any provisions of this Agreement to the contrary, become immediately due and payable to Company. The failure of Company or General Agent to declare promptly a default or breach of any of the terms and conditions of this Agreement shall not be construed as a waiver of any of said terms and conditions, nor estop either Party from thereafter demanding full and complete compliance with such terms and conditions or of this Agreement.

20.10 Run-off of business upon Termination. If this Agreement is terminated for any reason, Company shall have the option to assume, upon the effective date of termination, General Agent's responsibility to administer the "run-off" of the business in-force, and to bear all costs of "run-off" and cease to pay compensation to General Agent. However, if this Agreement is

terminated and Company elects to allow General Agent to continue to administer the “run-off” of the business in force, the provisions of this Agreement shall continue to apply to all unfinished business to the end that all obligations and liabilities incurred by each Party as a result of this Agreement shall be fully performed and discharged. In such event, General Agent shall continue to administer, at its sole expense, the “run-off” of the in-force business to normal expiration in accordance with Article 5, Article 7, Article 8, Article 9, Article 10, Article 12, Article 13, Article 16, Article 17, Article 20, Article 21 and Article 24 of this Agreement, which shall survive the termination of this Agreement. In addition, provided General Agent is not in default of any of its obligations under this Agreement, Company shall continue to pay commissions to General Agent during the “run-off” period according to the Commission Schedule Addendum until all Policies written under this Agreement have expired and all losses on such Policies have been fully settled. The term “run-off” as used herein shall mean, but not be limited to, confirming coverage under Policies, adjusting all claims, administering Policies and any required renewals thereof and endorsements thereto, providing reports to Company as required by this Agreement, paying premiums to Company and return premiums to policyholders, collecting all sums due, including return commissions from Agents and Brokers, and such other activities as required of General Agent under this Agreement.

### **Article 21 – Claims Handling**

21.1 **Authority of Company.** Company shall retain the ultimate, final authority over disputes concerning claims settlement and setting of loss reserves.

21.2 **Authority of General Agent.** General Agent shall have the authority to handle and settle claims arising from business placed with Company under this Agreement in accordance with established procedures approved by Company and Regulations. Any settlement authority granted to General Agent may be terminated for cause upon Company’ s written notice to General Agent or upon termination of this Agreement. Company may suspend such settlement authority during the pendency of any dispute regarding the cause for termination of this Agreement. The authority of General Agent to settle a claim shall not exceed [\*\*]% of Company’ s (singularly) policyholder surplus as of December 31 of the last completed calendar year; or \$[\*\*], whichever is greater. General Agent shall not have the authority to waive any policy condition or commit Company to any cost, expense or liability that is not covered under Policies, unless Company approves in writing such losses in excess of the policy limits or extra-contractual obligations. General Agent shall have the authority to incur Loss Adjustment Expenses on behalf of Company that are directly connected with the settlement of losses or recovery of losses by way of salvage or subrogation in accordance with established procedures approved by Company. Any indirect Loss Adjustment Expenses incurred by General Agent must be specifically identified and authorized in writing by Company in order for General Agent to be reimbursed for such expenses.

21.3 **Notice of Lawsuits and Complaints** General Agent shall promptly report to Company any and all lawsuits and complaints known to General Agent, Agent or Broker and shall be responsible for such reporting and investigation of any lawsuit or complaint that, in the opinion of Company, is connected with this Agreement. General Agent shall cooperate fully with

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Company during the investigation of any lawsuit or complaint connected with this Agreement. General Agent may, subject to the written approval of Company, appoint appropriate claims adjustment firms or attorneys to handle investigations and settlements relating to such lawsuits or complaints. Company, in its sole discretion, may withdraw such approval upon written notice to General Agent.

21.4 Compliance with Regulations. General Agent shall comply with all Regulations in carrying out the claims handling responsibilities under this Agreement, including Special Investigation Unit (SIU) regulations and all required related regulatory reporting. General Agent shall notify Company of changes in Regulations regarding claims handling and shall assure compliance thereto.

21.5 Checks and Drafts. Payment of losses shall be made on checks or drafts in the name of the specific Policy issuing Company. General Agent shall be responsible for the safekeeping of all checks and drafts used for settling claims and shall:

- (a) mark, retain and account for all voided checks and drafts of Company;
- (b) immediately notify Company of any irregularities, theft, disappearance, or destruction of checks and drafts; and
- (c) ensure that all checks and drafts are sequentially numbered and issued in numerical order.

21.6 Coverage Issues. General Agent may refer any coverage question, denial of liability, or Policy limit demand to Company for final determination by Company concerning such issues. General Agent shall notify and provide a copy of any applicable claim file to Company within 30 days of determination that a claim has:

- (a) the potential to exceed the authority limit set forth in Article 21.2 of this Agreement;
- (b) a coverage dispute, or any unusual circumstances or large loss possibilities or any issues that would be required to be reported to Reinsurers under the Affiliated Reinsurance Agreements, Quota Share Reinsurance Agreement, or Excess of Loss Reinsurance Agreement;
- (c) a demand in excess of Policy limits;
- (d) allegations of bad faith, violations of any deceptive trade practice acts, or any other Regulation;
- (e) resulted in a legal action being instituted against General Agent, an Agent, a Broker or Company;
- (f) arisen from or caused a complaint to be filed with any regulatory authority;
- (g) arisen from or caused an inquiry from any regulatory authority, including, but not limited to, any insurance department, with respect to any loss, even if the inquiry does not arise from a complaint;

- (h) a significant coverage dispute that may be denied;
- (j) been open for more than six months or involves an allegation of extra contractual damages;
- (j) a minor claimant, unless it is certain that the amount of the loss related to a minor is less than \$[\*\*]; or
- (k) been closed by payment of an amount established by Company.

General Agent shall, if requested by Company, send a copy of each and every claim to Company within 24 hours of General Agent's receipt of such claim as described in Article 21.2 of this Agreement. To the extent possible, such transmission of claims shall be by electronic means, overnight mail or facsimile to Company at 1-972-788-6609 or such other telephone number as Company may specify.

21.7. Claims Reporting Requirement. General Agent will advise Company promptly of all losses in excess of \$[\*\*] or involving specific circumstances listed below and all material subsequent developments pertaining thereto. General Agent will also advise Company of all Employers Liability losses. As respects bodily injuries to persons, such notices will include, but not be confined to, claims arising out of any bodily injuries causing:

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These cases are to be reported regardless of liability. The General Agent shall also notify the Company of any actual or alleged bad faith claims.

## **Article 22 - Reinsurance**

22.1 Agreements. A portion or all of the business as described in the Schedule of Business Addendum shall be reinsured under certain (a) Affiliated Reinsurance Agreements between Company and Republic Underwriters Insurance Company; (b) Excess of Loss Reinsurance Agreements between Republic Reinsurance Company and Excess of Loss Reinsurers; or (c) Quota Share Reinsurance Agreements between Republic Underwriters Insurance Company and Quota Share Reinsurers, all as may be entered into, renewed, amended or terminated from time to time.

22.2 Commission Schedule. The Commission Schedule may be based upon certain terms and conditions of the Quota Share Reinsurance Agreements and Excess of Loss Reinsurance Agreements.

22.3 General Agent's Authority. General Agent shall not have the authority to collect any payment from a Reinsurer or to commit Company to any claim settlement with a Reinsurer, without Company's express written consent. General Agent shall have no authority to cede, arrange, facilitate or bind Company with regard to reinsurance. Binding authority for all reinsurance agreements shall rest with Company.

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### **Article 23 - Prohibited Acts**

In addition to limitation and prohibitions of General Agent's authority under this Agreement as provided for herein above, it is understood and agreed that General Agent shall have no authority to:

- (a) bind reinsurance or retrocessions on behalf of Company;
- (b) commit Company to participate in insurance or reinsurance syndicates;
- (c) appoint any insurance producer or broker on behalf of Company, except in accordance with the provisions of subsection 5.6 of this Agreement;
- (d) appoint any sub-managing general agents; or
- (e) collect any payment from a Reinsurer or commit Company to any claim settlement with a Reinsurer without the prior written approval of Company. In the event such prior written approval is received, a report detailing such payment or settlement must be promptly forwarded to Company.

### **Article 24 - Miscellaneous**

24.1 **Performance**. The obligations and undertaking of each of the Parties to this Agreement shall be performable in Omaha, Nebraska and Dallas, Texas, as applicable. General Agent agrees to pay to Company at Company's administrative office in Dallas, Texas all sums of money which may become payable to Company under this Agreement.

24.2 **Entire Agreement**. This Agreement with attached addenda constitutes the entire Agreement between the Parties. This Agreement supersedes all previous agency agreements, if any, whether written or oral, between Company and General Agent.

24.3 **Amendments**. No amendments to or modifications of this Agreement or its addenda shall be valid unless made in writing and executed by Company and General Agent in the form of an amendment to this Agreement or its addenda and specifying the effective date thereof.

24.4 **Assignment**. General Agent shall not directly or indirectly assign its rights and obligations under this Agreement in whole or in part without the prior written approval of Company.

24.5 **Plural Forms and Gender**. Wherever from the context it appears appropriate, each term stated in either the singular or plural shall include the singular and plural and any term stated in the masculine, the feminine or the neuter gender, shall include the masculine, the feminine and neuter gender.

24.6 Headings. All captions and article headings are intended to be for purposes of reference only and do not affect the substance of the articles to which they refer.

24.7 Future Acts. Each Party hereto agrees to perform any further acts and execute and deliver further documents that may be reasonably necessary to carry out the provisions of this Agreement.

24.8 Illegal or Unenforceable Provisions. In the event any provision, or portion thereof, of this Agreement is held to be illegal, invalid or unenforceable by any court of competent jurisdiction, the validity and enforceability of the remaining provisions, or portions thereof, shall not be affected by the severance herefrom of the illegal, invalid or unenforceable provision.

24.9 Notices. Notices required or permitted to be given under this Agreement shall be in writing and shall be deemed given when deposited in the United States Postal Service by certified mail, return receipt requested, to the Party' s last known address or such other address provided by the Party.

24.10 Counterparts. This Agreement may be executed in multiple counterparts, each of which and together shall constitute an original document.

This Agreement is executed and effective the 1st day of July, 2006.

[Signature Page Follows]

Managing General Agency Agreement  
Effective July 1, 2006

Southern Insurance Company

By: /s/ John E. Fulton Attest: /s/ Chris Daley

Its: Vice President

Southern Vanguard Insurance Company

By: /s/ John E. Fulton Attest: /s/ Chris Daley

Its: Vice President

Republic Underwriters Insurance Company

By: /s/ John E. Fulton Attest: /s/ Chris Daley

Its: Vice President

Republic Fire and Casualty Insurance Company

By: /s/ John E. Fulton Attest: /s/ Chris Daley

Its: Vice President

FirstComp Underwriters Group, Inc.

By: /s/ Greg Donsbach Attest: /s/ Chris Daley

Its:

Vice President



Schedule of Business Addendum No. A-1

to

Managing General Agency Agreement

This Schedule of Business Addendum No. A-1 ( this "Schedule" ) is entered into by and between Southern Insurance Company, an insurance company domiciled in the State Texas, Southern Vanguard Insurance Company, an insurance company domiciled in the State of Texas, Republic Underwriters Insurance Company, an insurance company domiciled in the State of Texas, and Republic Fire and Casualty Insurance Company, an insurance company domiciled in the State of Oklahoma (singularly and collectively referred to herein as "Company") and FirstComp Underwriters Group, Inc., a Nebraska Corporation with administrative offices in Omaha, Nebraska (referred to herein as "General Agent") and is attached to and incorporated into the Managing General Agency Agreement (the "Agreement") between Company and General Agent, as of the Effective Date of the Agreement.

Company and General Agent hereby agree as follows:

1. General Agent shall have the authority to accept on forms approved by Company any policy, endorsement, binder, certificate, proposal for insurance or other documents which bind Company ("Policy") for the classes or lines of insurance stated hereunder subject to the limitations and conditions set forth herein and in the reinsurance agreements referenced in Article 22 of the Agreement ("Authorized Business"). General Agent acknowledges and agrees that it is fully aware of the terms and conditions of such reinsurance agreements, including, but not limited to, the original Policy limits, territories, and Policy terms, and it shall comply with all such reinsurance terms and conditions.

2. "Workers' Compensation" Business

Company has authorized General Agent to write the following lines of insurance ("Authorized Business") and such lines shall be referred to as "Workers' Compensation" business:

<u>Class/Line</u>	<u>Limits Up To</u>
Workers' Compensation	Statutory
Employer' s Liability	\$[**]

For the above, Policy terms shall not exceed [\*\*] months.

3. Territory Limitations. Territories in which Authorized Business may be written are as follows and other states as may be amended by General Agent during the term hereof with the written consent of Company:

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[\*\*] CERTAIN INFORMATION ON THIS PAGE HAS BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION. CONFIDENTIAL TREATMENT HAS BEEN REQUESTED WITH RESPECT TO THE OMITTED PORTIONS.

Schedule of Business Addendum A-1

4. Special Acceptances and Referrals. General Agent shall be authorized to write classes of operations for the above lines of insurance under this Agreement provided that General Agent complies with the written underwriting guidelines approved by Company. General Agent may submit referrals for special acceptance to Company in accordance with the referral submission requirements for those risks that do not meet all of the underwriting guidelines approved by Company, including but not limited to, policies with annual premiums in excess of \$[\*\*] or classes of operations not specifically listed as approved classes of operations to be written.

5. Premium Volume. General Agent shall be limited to writing a maximum aggregate premium volume of \$[\*\*] in all territories shown above in any 12 month period, such period to run consecutively from the effective date of this Schedule and the Agreement unless provided otherwise in writing by Company. Such annual premium maximum shall be based on mutually agreed upon premium plan by state.

6. Rates, Rules and Forms. All rates, rules and forms used by General Agent to produce Authorized Business under the Agreement are to be submitted by General Agent for Company' s written approval prior to General Agent' s use. Such rates, rules and forms, as mutually agreed upon by General Agent and Company, shall be filed by Company with the proper regulatory agency, as required. Upon completion of filing and receipt of approval from the applicable regulatory agency or according to approval granted by Regulations, Company shall notify General Agent of the effective date of such filing. General Agent acknowledges and agrees that it is fully aware of all of the terms and conditions of the approved rates, rules and forms, and it shall comply with all such terms and conditions that are within the control of General Agent, including, but not limited to, Policy cancellation provisions, otherwise, it shall bear all risks for non-compliance.

7. Policy Cancellation Provision. As per approved and filed policy forms referenced in Section 6 of this Schedule.

7. Termination. In the event the Agreement is terminated, the termination provisions set forth in Article 20 - Termination of the Agreement shall apply to this Schedule.

8. All other terms and provisions of the Agreement and this Schedule of Business Addendum remain otherwise unchanged.

This Schedule of Business Addendum is executed and effective this 1st day of July, 2006.

[Signature Page Follows]

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Schedule of Business Addendum A-1

A-1-2

Southern Insurance Company

By: /s/ John E. Fulton Attest: /s/ Chris Daley

Its: Vice President

Southern Vanguard Insurance Company

By: /s/ John E. Fulton Attest: /s/ Chris Daley

Its: Vice President

Republic Underwriters Insurance Company

By: /s/ John E. Fulton Attest: /s/ Chris Daley

Its: Vice President

Republic Fire and Casualty Insurance Company

By: /s/ John E. Fulton Attest: /s/ Chris Daley

Its: Vice President

FirstComp Underwriters Group, Inc.

By: /s/ Greg Donsbach Attest: /s/ Chris Daley

Its: Vice President

Schedule of Business Addendum No. A-1

**Schedule of Commission Addendum B-1**  
**To**  
**Managing General Agency Agreement**

This Commission Schedule Addendum No. B-1 ( this "Commission Schedule") is entered into by and between Southern Insurance Company, an insurance company domiciled in the State Texas, Southern Vanguard Insurance Company, an insurance company domiciled in the State of Texas, Republic Underwriters Insurance Company, an insurance company domiciled in the State of Texas, and Republic Fire and Casualty Insurance Company, an insurance company domiciled in the State of Oklahoma (singularly and collectively referred to herein as "Company") and FirstComp Underwriters Group, Inc., a Nebraska Corporation with administrative offices in Omaha, Nebraska (referred to herein as "General Agent") and is attached to and incorporated into the Managing General Agency Agreement (the "Agreement") between Company and General Agent, as of the Effective Date of the Agreement.

Company and General Agent hereby agree as follows:

1. Reinsurance Agreements. This Commission Schedule is based upon the Quota Share Reinsurance Agreements and Excess of Loss Reinsurance Agreements described in Article 22 of the Agreement.
2. Commissions. Beginning with all Policies issued on or after the 1st day of July, 2006, under the Agreement, General Agent will be allowed commissions and other fees as hereinafter provided.
3. Provisional Commissions; Adjusted Commissions.

(a) Provisional Commissions allowed General Agent shall be adjusted periodically in accordance with the provisions set forth herein. Policies written during the first underwriting year of the Agreement will be allocated to the first adjustment period, which shall be from the effective date of this Commission Schedule through June 30, 2007, and Policies written during each subsequent 12 month period thereafter shall be allocated to a separate adjustment period for that underwriting year. If the Agreement or this Commission Schedule is terminated, the final adjustment period shall be from the beginning of the then current adjustment period through the effective date of termination.

(b) The Provisional Commission Rate shall be [\*\*]% of Net Written Premium; provided, however such Provisional Commission Rate shall be adjusted as hereinafter provided and such adjusted commission rate shall be the Adjusted Commission Rate.

(c) The Adjusted Commission Rate shall be calculated as follows and applied to Premiums Earned for the applicable adjustment period to determine the Adjusted Commissions:

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(i) If the ratio of Losses Incurred to Premiums Earned is [\*\*]% or less, the Adjusted Commission Rate for the applicable adjustment period shall be the Provisional Commission Rate plus [\*\*]% of Premiums Earned. Such amount shall be the maximum commission allowed the General Agent for Adjusted Commission.

(ii) If the ratio of Losses Incurred to Premiums Earned is more than [\*\*]%, but not greater than [\*\*]%, the Adjusted Commission Rate for the applicable adjustment period shall be the Provisional Commission Rate, plus [\*\*]% of the difference in percentage points between [\*\*]% and the actual ratio of Losses Incurred to Premiums Earned.

(iii) If the ratio of Losses Incurred to Premiums Earned is greater than [\*\*]%, but not greater than [\*\*]%, the Adjusted Commission Rate for the applicable adjustment period shall be the Provisional Commission Rate, less [\*\*]% of the difference in percentage points between [\*\*]% and the actual ratio of Losses Incurred to Premiums Earned.

(iv) If the ratio of Losses Incurred to Premiums Earned is [\*\*]% or greater, the Adjusted Commission Rate for the applicable adjustment period shall be the Provisional Commission Rate less [\*\*]% of Premiums Earned. Such amount shall be the minimum commission allowed the General Agent for Adjusted Commission.

(d) Within [\*\*] days following the close of each quarter, General Agent shall provide a letter of credit or some other form of collateral acceptable to Company equal to [\*\*]% of Premiums Earned to secure the amounts due in the event the loss ratio for an adjustment period is greater than [\*\*]%.

(e) If the ratio of Losses Incurred to Premiums Earned for any adjustment period is greater than [\*\*]%, the difference in percentage points between the actual ratio of Losses Incurred to Premiums Earned and [\*\*]% shall be multiplied by Premiums Earned for such adjustment period and the product shall be carried forward to the next adjustment period as a debit to Losses Incurred.

(f) If the ratio of Losses Incurred to Premiums Earned for any adjustment period is less than [\*\*]%, the difference in percentage points between [\*\*]% and the actual ratio of Losses Incurred to Premiums Earned shall be multiplied by Premiums Earned for such adjustment period and the product shall be carried forward to the next adjustment period as credit to Losses Incurred.

(g) Debits or Credits calculated pursuant to Sections 3(e) and 3(f) above shall continue to apply to all commission adjustment calculations under the Agreement until all losses subject to such calculations have been fully settled.

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Schedule of Commission Addendum B-1

(h) Company shall calculate and report the Adjusted Commissions on Premiums Earned for the first adjustment period within 30 days following [\*\*] months after the inception of this Commission Schedule and shall continue to update the adjusted commission calculation within 30 days after the end of each 12 month period thereafter until all losses subject hereto have been fully settled. Commission adjustment calculations shall be made for each new adjustment period that follows the first adjustment period and calculations for each new adjustment period shall be made consistent with the calculations made for the first adjustment period. Annual calculations for each adjustment period shall be based on cumulative transactions under the Agreement and this Commission Schedule from the beginning of the adjustment period under consideration through the effective date of adjustment, including, as respects Losses Incurred, any debit or credit from the preceding adjustment period. Such annual calculations for each adjustment period shall be calculated separately as described above. The aggregate difference between the Adjusted Commissions owed and the commissions previously allowed by Company for all adjustment periods shall be remitted in accordance with the following deferral schedule by the owing Party to the other Party within 30 days following receipt of Company' s report. Adjusted Commissions owed as a result of the first calculation for each adjustment period will be deferred at a rate of [\*\*]%. The deferred Adjusted Commissions shall be paid to General Agent or used to set off sums owed by General Agent, as applicable, for the subsequent adjustment period. Adjusted Commissions owed as a result of subsequent calculations for an adjustment period following the first calculation will not be deferred.

(i) As used in this Commission Schedule, "Losses Incurred" means losses and Loss Adjustment Expenses paid as of the effective date of calculation of the Adjusted Commission Rate, plus the reserves for losses and Loss Adjustment Expenses outstanding as of such date, minus amounts due from Excess of Loss Reinsurance (whether or not recoverable), plus the debit or minus the credit, if any, from the preceding adjustment period, and shall include a provision for incurred but not reported reserves (IBNR) as calculated by Company' s actuary and agreed upon by General Agent. If mutual agreement cannot be reached, an independent actuary will be retained, whose cost will be equally shared between the parties. All losses and related Loss Adjustment Expenses under Policies with effective or renewal dates during an adjustment period shall be charged to that adjustment period, regardless of the date said losses actually occur.

(j) As used in this Commission Schedule, "Premiums Earned" means Net Written Premium for Policies with effective or renewal dates during the adjustment period, less the unearned portion thereof, and less the amounts incurred by Company for Excess of Loss Reinsurance as of the effective date of calculation of the Adjusted Commission Rate, and shall include only Net Written Premium reported by General Agent and collected by Company. Premiums Earned shall not include any Installment Billing Fees, allowed or not allowed under the Agreement. For purposes of the calculation of Adjusted Commissions for an adjustment period, Premiums Earned for such adjustment period shall be reduced by the premiums paid for Excess of Loss Reinsurance covering such adjustment period.

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Schedule of Commission Addendum B-1

(k) Company shall have no obligation to pay General Agent any additional commissions calculated to be owed, if any, under the Agreement until all balances owed by General Agent to Company for premiums or otherwise have been collected by Company.

(l) General Agent shall pay applicable premium taxes, fees and assessments to Company each month on premiums whether collected or not, as set forth by any applicable state insurance department or pursuant to Regulations effective now or in the future. General Agent will pay estimated premium tax at [\*\*]% of Net Written Premium, which may be adjusted from time to time. The estimated premium tax rates shall be adjusted annually to an actual rate. If such adjustment is less than [\*\*]% then Company shall remit such amount to General Agent. If such adjustment is greater than [\*\*]% then General Agent shall remit such amount to Company.

4. Other Administrative Fees. General Agent shall be entitled to retain an administrative fee equal to 100% of all Installment Billing Fees reported to Company and collected by General Agent, subject to periodic adjustments and deductions for applicable premium taxes on the subject fees as described in this Commission Schedule.

5. Termination. In the event the Agreement is terminated, the termination provisions set forth in Article 20 - Termination of the Agreement shall apply to this Commission Schedule.

All other terms and provisions of the Agreement and this Commission Schedule remain otherwise unchanged.

This Commission Schedule is executed and effective this 1st day of July, 2006.

Southern Insurance Company

By: /s/ John E. Fulton Attest: /s/ Chris Daley  
Its: Vice President

Southern Vanguard Insurance Company

By: /s/ John E. Fulton Attest: /s/ Chris Daley  
Its: Vice President

Republic Underwriters Insurance Company

By: /s/ John E. Fulton Attest: /s/ Chris Daley  
Its: Vice President

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Schedule of Commission Addendum B-1

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Republic Fire and Casualty Insurance Company

By: /s/ John E. Fulton

Its: Vice President

Attest: /s/ Chris Daley

FirstComp Underwriters Group, Inc.

By: /s/ Greg Donsbach

Its: Vice President

Attest: /s/ Chris Daley

Schedule of Commission Addendum B-1

B-1-5



**CERTIFICATION**

I, Parker W. Rush, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Republic Companies Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) [Reserved]
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2006

/s/ PARKER W. RUSH

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**Parker W. Rush**  
**President and Chief Executive Officer**

**CERTIFICATION**

I, Martin B. Cummings, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Republic Companies Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) [Reserved]
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2006

/s/ MARTIN B. CUMMINGS

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**Martin B. Cummings**  
**Chief Financial Officer**

**CERTIFICATIONS PURSUANT TO SECTION 906 OF THE**  
**SARBANES-OXLEY ACT OF 2002**

I, Parker W. Rush, President and Chief Executive Officer of Republic Companies Group, Inc. (the “Company”), do hereby certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), that:

(1) the Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2006 (the “Report”), which this certification accompanies, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ PARKER W. RUSH

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**Parker W. Rush**

**President and Chief Executive Officer**

August 14, 2006

I, Martin B. Cummings, Chief Financial Officer of Republic Companies Group, Inc. (the “Company”), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), that:

(1) the Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2006 (the “Report”), which this certification accompanies, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ MARTIN B. CUMMINGS

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**Martin B. Cummings**

**Chief Financial Officer**

August 14, 2006