ASSURANCEAMERICA CORP
Form 10-K
April 16, 2012

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K

x **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934**
Commission File Number: 0-6334

ASSURANCEAMERICA CORPORATION

NEVADA **(State or Other Jurisdiction of Incorporation or Organization)**	**87-0281240** **(I.R.S. Employer Identification No.)**
5500 Interstate North Pkwy.,	
Suite 600, Atlanta, Georgia **(Address of Principal Executive Offices)**	**30328** **(Zip Code)**

Registrant s telephone number, including area code:

(770) 952-0200

Securities registered under Section 12(b) of the Exchange Act:

None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, par value $0.01 per share

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

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

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 x No ¨

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

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

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x

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

The aggregate market value of the voting and non-voting common equity held by persons other than affiliates of the registrant as of June 30, 2011 was $5,859,178 based on a sale price of $.17 per share.

There were 66,110,531 shares of the registrant s common stock outstanding as of March 30, 2012.

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Forward-Looking Statements

Statements in this report that are not historical fact are forward-looking statements that are subject to certain risks and uncertainties that could cause actual events and results to differ materially from those discussed in this report. In addition, words such as may, will, believe, plan, shou could, seek, expect, anticipate, intend, estimate, goal objective, project, forecast, target and similar words, identify forward The risks and uncertainties include, without limitation, uncertainties related to estimates and assumptions generally; inflation and other changes in economic conditions (including changes in interest rates and financial markets); pricing competition and other initiatives by competitors; ability to obtain regulatory approval for requested rate changes and the timing thereof; legislative and regulatory developments; risks related to the nature of AssuranceAmerica Corporation s business, such as the adequacy of its reserve for loss and loss adjustment expense; claims experience; losses; reliance on key personnel; weather conditions (including the severity and frequency of storms, hurricanes, tornadoes and hail); changes in driving patterns and loss trends; acts of war and terrorist activities; court decisions and trends in litigation and health care and auto repair costs; and other matters described from time to time by AssuranceAmerica Corporation in this report. In addition, you should be aware that generally accepted accounting principles prescribe when a company may reserve for particular risks, including litigation exposures. Accordingly, results for a given reporting period could be significantly affected if and when a reserve is established for a major contingency. Reported results may therefore appear to be volatile in certain accounting periods. AssuranceAmerica Corporation undertakes no duty to update Forward-Looking Statements.

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PART I

Item 1. *BUSINESS*

History

AssuranceAmerica Corporation, a Nevada corporation (the Company), is an insurance holding company that was originally incorporated in 1969 under the laws of the state of Utah. The Company began its current insurance business in 1998 through its subsidiary, TrustWay Insurance Agencies, LLC (TrustWay), a Delaware limited liability company (formerly AssetAmerica Insurance Agencies, LLC). In 1999, the Company formed another subsidiary, AssuranceAmerica Managing General Agency, LLC (MGA), a Delaware limited liability company, that until 2003 provided all of the underwriting, claims and policyholder service functions for the Georgia nonstandard personal automobile program for Gateway Insurance Company of St. Louis, Missouri. In late 2002, the Company formed its subsidiary AssuranceAmerica Insurance Company (AAIC), a property and casualty insurance company and South Carolina corporation that focuses on writing nonstandard automobile business and other specialty products.

In 2006, the Company formed TrustWay T.EA.M., Inc., a Georgia corporation (formerly TrustWay Partners Agencies of Alabama, LLC) a subsidiary of TrustWay Insurance Agencies, LLC. In 2010, the Company formed TrustWay T.E.A.M. Services, LLC a Georgia limited liability professional services Company and subsidiary of TrustWay Insurance Agencies, LLC. During 2011, the Company sold the assets of TrustWay Insurance Agencies, LLC and the stock of TrustWay T.E.A.M., Inc. and interests in TrustWay T.E.A.M. Services, LLC.

Who We Are

We are a holding company which, through our wholly owned insurance company and managing general agency, underwrites and distributes primarily non-standard personal automobile insurance products to individuals. The Company offers non-standard personal automobile insurance that is typically provided to insureds who are unable to obtain standard insurance coverage because of their payment history, driving record, age, vehicle type, or other factors. These policies generally require higher premiums than standard policies for comparable coverage. As of December 31, 2011, we offered products in ten states: Alabama, Arizona, Florida, Georgia, Indiana, Louisiana, Mississippi, South Carolina, Texas and Virginia.

Our Business

We currently have two revenue producing operating subsidiaries, the combination of which we believe is important to generating consistent profitability throughout the insurance cycle: AAIC and MGA. These two subsidiaries constitute what we refer to as our wholesale operations. The wholesale operation sells its insurance products through our 2700 independent insurance agents. AAIC is a property and casualty insurance company domiciled in South Carolina that focuses on writing non-standard automobile business in the states of Alabama, Arizona, Florida, Georgia, Indiana, Louisiana, Mississippi, South Carolina, Texas and Virginia. Additionally, AAIC is licensed to underwrite business in Arkansas, Illinois, Missouri, Pennsylvania, Tennessee and West Virginia. We expect to enter the other states at a later time, provided that the underwriting environment remains positive and the capital and surplus of AAIC supports such growth. AAIC currently has reinsurance contracts with nine reinsurers, eight of which are rated A- or better by A.M. Best and one of which is not formally followed by A.M. Best.

MGA markets AAIC s policies through more than 2,700 appointed independent insurance agencies. MGA provides all of the underwriting, accounting, product management, legal, policyholder administration and claims functions for AAIC. The Company also provides claims services for two unaffiliated carriers in Texas and Florida and one MGA in Florida, which are in run-off. Our own MGA receives commissions and various fees related to insurance transactions that vary according to state insurance laws and regulations.

Our Industry

Personal auto insurance is the largest line of property and casualty insurance in the United States. In 2011, this market was estimated to be $163 billion as reported by the most recent A.M. Best industry data. Personal auto insurance provides coverage to drivers for liability to others for both bodily injury and property damage and for physical damage to an insured s vehicle from collision and other perils. Personal auto insurance is comprised of preferred, standard and non-standard risks. Non-standard insurance is intended for drivers who, due to their driving record, age, vehicle type, payment history or other factors represent a higher than normal risk. As a result, customers that purchase non-standard auto insurance generally pay higher premiums for similar coverage than drivers who qualify for standard or preferred policies. Non-standard personal automobile insurance consumers typically purchase the statutory minimum limits of liability insurance required to register their vehicles.

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Competition

We believe that we primarily compete on the basis of price, the amount of down payment required to bind coverage, and payment terms. However, we also generally compete on the basis of consumer recognition, agency relationships, types of coverage offered, claims handling, financial stability, customer service and geographic availability. Because of the purchasing habits of our customers, the rate of policy retention is poor when compared to the retention rate of standard and preferred policies. Our success, therefore, depends in part on our ability to replace insureds that do not renew their policies.

We currently compete with many national, regional and local insurance underwriters. The insurance underwriting and agency businesses are highly competitive. Many competitors are national in scope, larger, and better capitalized than we are. Some competitors have broad distribution networks of employed agents. Smaller regional insurance companies and local agents also compete vigorously at the local level. We believe our focus on the non-standard automobile market gives us a competitive advantage together with competitive prices, payment terms and emphasis on customer service.

While there is no established industry-recognized demarcation between non-standard policies and all other personal auto policies, we believe that non-standard auto risks or specialty auto risks generally constitute approximately 15-20% of the overall personal automobile insurance market, with the exact percentage fluctuating according to competitive conditions in the market.

The personal auto insurance industry is cyclical, characterized by periods of price competition and excess capacity followed by periods of high premium rates and shortages of underwriting capacity. When underwriting standards for preferred and standard companies become more restrictive, more insureds seek non-standard coverage and the size of the non-standard market increases.

Our Products

Our non-standard insurance products provide customers with coverage for the minimum required statutory limits for bodily injury and property damage liability arising out of the operation of a personal passenger automobile. We also offer insurance coverage that affords protection for collision and physical damage to the insureds motor vehicles, bodily injury and property damage caused by uninsured motorists, medical payments, towing and labor, and accidental death and dismemberment.

Target Market

The typical purchaser of non-standard personal automobile insurance is highly sensitive to price and payment terms, but generally insensitive to insurer ratings. AAIC is not rated by A.M. Best. Our insureds typically purchase insurance from AAIC or one of its competitors because of a lack of other coverage options and will switch to a standard provider when able. Generally, the resulting customer non-renewals have historically been more than offset by new customers entering our markets.

A significant portion of our policyholder base is comprised of foreign nationals residing in the United States. This market demographic is prominent in the southeast and, as of December 31, 2011, represents approximately 10% of our policies in force.

Wholesale Operations

Our wholesale operations are divided into four primary functional areas: Claims, Underwriting and Customer Service, Product Development and Information Technology.

Claims

AAIC seeks to pay the claims it owes in a fast, fair manner and strives to have the lowest cycle time for non-contested claims (the period of time from the initial claim report to settlement) in the industry. The non-standard personal automobile insurance market experiences a higher level of fraudulent or inflated claims than the standard or preferred market. Our Claims Division takes a hard stance on the claims AAIC does not owe and works to develop a reputation as a carrier that will aggressively fight such inflated or fraudulent claims. In order to accomplish these objectives, the Claims Division seeks the highest caliber associate, paying above prevailing market rates in order to attract and retain experienced professionals in every area of the Claims Division.

All claims are triaged to the appropriate level of experienced claims personnel. Our claims system has the capability to identify numerous facts related to a newly reported claim and triage the claim to the appropriate level of claims employee. The files are automatically assigned by the system to a claims representative once the loss is entered into the claims system. By doing so, cycle time is reduced since the file is immediately assigned to the appropriate level of claims representative 98% of the time. The Claims Division is organized into various units to provide efficient file handling capability.

We make an effort to keep the file pending levels for our adjusters below industry standards to reduce errors. All adjuster authority levels are determined based on the experience of the particular adjuster. We have formalized reserving and audit processes.

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We conduct weekly file reviews and provide direct feedback to the file handler and their supervisor. As part of these reviews we audit for reserving and compliance practices as well. We also have extensive claims reporting which allows us to monitor key aspects of the claims operation.

The Claims Division has a web-based claims system which is instrumental in increasing productivity by streamlining the claims processes, and it provides a competitive advantage by utilizing immediate, real-time data for evaluation purposes and allowing the exchange of information with fraud fighting agencies. The Company maintains a claims office in Tampa, Florida in order to service its customers, help fight fraud and have claims professionals located in the region handling the unique laws and issues relative to bodily injury (BI) and personal injury protection (PIP) coverages.

Underwriting and Customer Service

AssuranceAmerica s strategy is to deliver excellent service to our agents and policyholders, using technology and process efficiencies to achieve a low-cost operating model. The underwriting and customer service function services the needs of our agents and insureds. Many Customer Service representatives are bilingual, providing service to our Spanish-speaking agents and insureds. We emphasize the use of automation wherever possible.

The Company has a phone messaging system that telephones policyholders to remind them of payments due and of pending cancellations. We send agents copies of policyholder notices electronically instead of mailing them and agents can apply payments and process their own policy changes online, reducing the time spent by Customer Service performing these activities. During 2011 the Company developed and implemented an online payment system for our policyholders.

The underwriting team works closely with the claims department in order to address underwriting questions regarding material representations, undisclosed drivers, cancellations and non-renewing of policies. Our underwriting department also utilizes key reporting metrics to improve productivity and the quality of business. Also, the recently developed web-based quoting system has significantly streamlined and improved the issuance of quoted policies.

Product Development

The Product Development function is responsible for designing and pricing products, assisting with new product introduction, monitoring product performance and recommending rate changes. This department uses information from our data warehouse to analyze and monitor each product from the point of sale through termination and claims settlement, if any. We perform a market analysis prior to expanding operations into a new state. As part of the analysis, we produce and review actuarial studies, analyze required coverages, analyze rates and legal and competitive environment studies.

Information Technology

The Information Technology department is responsible for the management and support of the information technology functions of MGA and AAIC. This function is organized in three groups: Application Development, Business Intelligence and Infrastructure Support.

With respect to the Application Development group, our primary application is our policy management system (PTS) which was designed for the non-standard automobile insurance industry. This software application is an end-to-end, enterprise wide, real-time, web-based policy administration system. PTS manages and increases efficiencies among the most critical functions throughout our entire organization.

By utilizing internet technologies, PTS provides a method to manage policies from any location. PTS centralizes information and is designed to reduce workload, errors and costs associated with tracking and managing an insurance policy. It allows for control of user access to the database and opens communication channels through all levels of the organization. PTS is designed to be scalable and is expected to be capable of handling hundreds of thousands of policies. This allows PTS to grow as our business grows. The agreement with the vendor of this software package grants us a perpetual license to the source code and the ability to develop derivatives and advance the product to meet business demands and react to changing market conditions.

The Technology Group has implemented its own proprietary quote and issue application. It provides a clean and easy user interface that executes all business rules and processes to provide a quote, bind and issue of a policy at an independent agent s location. This system allows for the initial premium collection, printing of declarations pages, policies, endorsements and insurance ID cards at the point of sale. The solution rates policies in real time, verifies and interfaces with external information, such as VIN, MVR, CLUE, ADD and credit.

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The Business Intelligence group supports our central data warehouse. Our data warehouse integrates and cleanses data from multiple sources and is the main repository of our Company s historical data. It allows for complex reporting queries to be run without slowing down operational systems. This area also provides the Company with real time business intelligence through a set of processes, architectures, and technologies that transform raw data into actionable reports, gauge driven scorecards, and dashboards.

The Infrastructure Support group supports our voice and data networks, hosts our websites, policy administration system, the accounting system, the claims administration system and the data warehouse. They are also responsible for the VOIP phone system and desktop support.

QTS is the third largest data center provider in the US and provides our core data center services. We are conveying to our customers our commitment to providing seamless, consistent access to our services. This quality data center is designed and constructed to provide mission critical electrical, mechanical and high capacity network systems. This crucial design philosophy is built into our product to minimize service disruption and ensure the highest level of customer service available.

Retail Operations

In 2011, the Company sold the assets of TrustWay retail agencies in Alabama, Florida and Georgia. Previously, the Company operated under the TrustWay brand through a total of 50 independent non-standard automobile insurance agencies located in Florida (31), Alabama (14), and Georgia (5).

Reinsurance

In the normal course of business, AAIC seeks to reduce its overall risk levels by obtaining quota share reinsurance. Reinsurance contracts do not relieve AAIC from its obligations to policyholders in the event that a reinsurer is unable to make its payments to AAIC. The Company periodically reviews the financial condition of its reinsurers to minimize its exposure to losses from reinsurer insolvencies. AAIC cedes gross written premium to nine reinsurers, eight of which are rated A- or better by A.M. Best and one of which is not formally followed by A.M. Best.

Liability for Property-Casualty Losses and Loss Adjustment Expenses

The Company s consolidated financial statements include its estimated liability for unpaid losses and loss adjustment expenses (LAE). Our objective is to determine that the total reserves (i.e., case reserves and incurred but not reported reserves, or (IBNR) are adequate to cover all loss costs, while sustaining minimal variation from the time reserves are initially established until losses are fully developed. The liabilities for losses and LAE are determined using actuarial and statistical procedures and represent undiscounted estimates of the ultimate net cost of all unpaid losses and LAE incurred through December 31 of each year. These estimates are subject to the effect of future trends on claims settlement, among other factors. These estimates are reviewed monthly as new information becomes known and we are able to observe actual loss development. Adjustments, if any, relating to accidents that occurred in prior years are reflected in the current results of operations and are referred to as development of the prior year estimates. A detailed discussion of our loss reserving practices can be found in the Critical Accounting Policies of the Management s Discussion and Analysis of Financial Condition and Results of Operations in this Annual Report on Form 10-K. The accompanying tables present information concerning our property-casualty losses and LAE.

Reserves

AAIC establishes reserves for its estimated liability for unpaid losses and loss adjustment expenses on an individual case basis for all reported incidents. The reserve includes amounts for anticipated future claim development and losses incurred but not reported (based upon actuarial analysis of historical data). Our claims system is designed to set up a statistical reserve when a feature is opened. These reserve amounts are set by age of claim for each coverage and each state. The claims department conducts file audits, monthly reserve reconciliation and periodic reviews of every pending file. Additionally, the reserves for loss and loss adjustment expenses are reviewed independently each quarter by a consulting independent actuarial firm.

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The following table provides a reconciliation of beginning and ending estimated liability balances for the years ended December 31, 2011, 2010 and 2009:

RECONCILIATION OF NET RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES

(thousands)	**2011**	**2010**	**2009**
Balance at January 1	$ 33,311	$ 41,973	$ 42,581
Less reinsurance recoverables on unpaid losses	23,410	29,710	29,747
Net balance at January 1	9,901	12,263	12,834
Incurred related to:			
Current year	26,959	22,864	26,002
Prior years	4,081	2,158	(754)
Total incurred	31,040	25,022	25,248
Paid related to:			
Current year	(15,965)	(15,587)	(16,195)
Prior years	(10,428)	(11,797)	(9,624)
Total paid	(26,393)	(27,384)	(25,819)
Net balance at December 31	14,548	9,901	12,263
Plus reinsurance recoverable on unpaid losses	27,550	23,410	29,710
Balance at December 31	$ 42,098	$ 33,311	$ 41,973

Total development consists of net changes in estimates made by our external actuary for prior accident year reserves, based on quarterly scheduled reviews, the settlement of claims for more or less than reserved, the emergence of unrecorded claims at rates different than reserved, and changes in reserve estimates by claim representatives. Our net reserves developed unfavorably in 2011 resulting from higher than expected costs on auto liability claims to what was originally estimated. The unfavorable development in 2010 resulted from an increase in the number of reported claims and higher than expected costs to settle claims for prior accident years. We have not entered into any loss reserve portfolio transfers or similar transactions having a material effect on earnings or reserves.

The following loss triangle table represents the development of balance sheet liabilities for losses and LAE from the beginning of the Company s insurance operations in 2003 through 2011. The third line of the table shows the Company s estimated liability for unpaid losses and LAE recorded at the balance sheet date for each of the indicated years, after adjustment for the effect of reinsurance. This liability represents the Company s estimated amount of losses and LAE for claims that were unpaid at the balance sheet date, including IBNR.

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ANALYSIS OF LOSS AND LOSS ADJUSTMENT EXPENSES DEVELOPMENT

(thousands)

	2003	2004	2005	2006	2007	2008	2009	2010	2011
GROSS LIABILITY FOR UNPAID LOSSES AND LAE(1)	$ 4,499	$ 10,656	$ 15,110	$ 24,904	$ 33,661	$ 42,581	$ 41,973	$ 33,311	$ 42,098
REINSURANCE RECOVERABLE ON UNPAID LOSSES	3,149	7,459	10,577	17,433	23,250	29,747	29,710	23,410	27,550
LIABILITY FOR UNPAID LOSSES AND LAE NET	$ 1,350	$ 3,197	$ 4,533	$ 7,471	$ 10,411	$ 12,834	$ 12,263	$ 9,901	$ 14,548
NET PAID (CUMULATIVE) AS OF:									
One year later	796	2,040	2,940	4,576	8,248	9,624	11,797	10,428	0
Two years later	967	2,393	3,744	6,605	10,650	11,819	14,258	0	0
Three years later	992	2,580	4,373	7,217	11,353	12,495	0	0	0
Four years later	1,015	2,686	4,533	7,366	11,569	0	0	0	0
Five years later	1,031	2,715	4,583	7,423	0	0	0	0	0
Six years later	1,031	2,722	4,586	0	0	0	0	0	0
Seven years later	1,032	2,723	0	0	0	0	0	0	0
Eight years later	1,032	0	0	0	0	0	0	0	0
Nine years later	0	0	0	0	0	0	0	0	0
Ten years later	0	0	0	0	0	0	0	0	0
NET LIABILITY RE-ESTIMATED AS OF:									
One year later	1,171	2,783	4,691	7,394	11,164	12,080	14,421	13,982	0
Two years later	1,062	2,823	4,615	7,694	11,437	12,474	15,460	0	0
Three years later	1,045	2,794	4,374	7,373	11,566	12,785	0	0	0
Four years later	1,051	2,785	4,573	7,406	11,635	0	0	0	0
Five years later	1,172	2,730	4,592	7,450	0	0	0	0	0
Six years later	1,031	2,739	4,610	0	0	0	0	0	0
Seven years later	1,032	2,742	0	0	0	0	0	0	0
Eight years later	1,032	0	0	0	0	0	0	0	0
Nine years later	0	0	0	0	0	0	0	0	0
Ten years later	0	0	0	0	0	0	0	0	0
NET CUMULATIVE	$ 318	$ 455	$ (77)	$ 21	$ (1,224)	$ 49	$ (3,197)	(4,081)	0
FAVORABLE/ (UNFAVORABLE) PERCENTAGE(2)	23.6%	14.2%	(1.7)%	0.3%	(11.8)%	0.4%	(26.1)%	(41.2)%	0

(1) Represents loss and LAE reserves, without regard to reinsurance recoverable on unpaid losses at the balance sheet date.
(2) Net Cumulative Development as a percentage of Liability for Unpaid Losses and LAE Net.

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The section of the table (labeled Paid (Cumulative) as of) shows the cumulative amount paid with respect to the previously recorded liability as of the end of each succeeding year. The lower portion of the table (labeled Liability Re-estimated as of) shows the re-estimated amount of the previously recorded liability based on experience as of the end of each succeeding year. The re-estimated amount is the sum of the paid amounts above and the outstanding reserve for occurrences prior to the reserve date. The estimate is increased or decreased as more information about the claims becomes known for individual years. For example, at December 31, 2010, we estimated our net unpaid losses to be $9.9 million. During 2011, these reserves developed unfavorably by $4.1 million, bringing the re-estimated net unpaid losses to $14.0 million, as shown at the bottom of the table.

The Analysis of Loss and Loss Adjustment Expenses Development table is constructed from Schedule P, Part-1, from the Company s Statutory Annual Statements as filed with the various state insurance departments.

The Company did change its reinsurance terms for the state of Florida, whereby we ceded 50% of the Florida business for nine months of the year. There were no other recent material changes in mix of business, unusually large losses or gains, hedging or effects of currency fluctuations in its estimated loss reserves.

The Company did not have any differences between U.S. Generally Accepted Accounting Principles (GAAP) and statutory basis property-casualty reserves for claims and loss adjustment expenses. Further, the claim reserves have not been discounted on a GAAP basis.

State Insurance Licenses

AAIC and MGA operate under licenses issued by various insurance authorities. Certain employees must be licensed as insurance adjusters in any state where they perform a function requiring licensure. These licenses may be of perpetual duration or renewable periodically, provided the holder continues to meet applicable regulatory requirements. The licenses govern the kinds of insurance that may be written in the issuing state and the other services that may be provided. Such licenses are normally issued only after the filing of an appropriate application and the satisfaction of prescribed criteria. All licenses that are material to our businesses are in good standing.

Supervision and Regulation

Insurance companies are generally subject to regulation and supervision by insurance departments of the jurisdiction in which they are domiciled or licensed to transact business. The nature and extent of such regulation and supervision varies from jurisdiction to jurisdiction. Generally, an insurance company is subject to a higher degree of regulation and supervision in its state of domicile. State insurance departments have broad administrative power relating to licensing insurers and agents, regulating premium charges and policy forms, establishing reserve requirements, prescribing statutory accounting methods, the form and content of statutory financial reports, and regulating the type and amount of investments permitted. Rate regulation varies from file and use to prior approval to mandated rates.

State insurance departments are charged with the responsibility of ensuring that insurance companies maintain adequate capital and surplus and comply with a variety of operational standards. Insurance companies are generally required to file detailed annual and other reports with the insurance department of each jurisdiction in which they conduct business. State insurance departments are authorized to make periodic and other examinations of insurers financial condition and operations to monitor the financial stability of the insurers, to ensure adherence to statutory accounting principles, and compliance with state insurance laws and regulations.

Insurance holding company laws enacted in many jurisdictions grant to insurance authorities the power to regulate acquisitions of insurers and certain other transactions and require periodic disclosure of certain information. These laws impose prior approval requirements for transactions between regulated insurers and their affiliates and generally regulate dividends and other distributions, including management fees, loans, and cash advances, between regulated insurers and their affiliates.

Under state insolvency and guaranty laws, regulated insurers can be assessed or required to contribute to state guaranty funds to cover policyholder losses resulting from the insolvency of other insurers. Insurers are also required by many states, as a condition of doing business in the state, to provide coverage to certain risks which are not insurable in the voluntary market. These assigned risk plans generally specify the types of insurance and the level of coverage which must be offered to such involuntary risks, as well as the allowable premium. Many states also have involuntary market plans which hire a limited number of servicing carriers to provide insurance to involuntary risks. These plans, through assessments, pass underwriting and administrative expenses on to insurers that write voluntary coverages in those states.

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Insurance companies are generally required by insurance regulators to maintain sufficient surplus to support their writings. Although, the ratio of writings to surplus that the regulators will allow is a function of a number of factors, including the type of business being written, the adequacy of the insurer s reserves, the quality of the insurer s assets and the identity of the regulator, the annual net premiums that an insurer may write are generally limited in relation to the insurer s total policyholders surplus. Thus, the amount of an insurer s surplus may, in certain cases, limit its ability to grow its business. The National Association of Insurance Commissioners (NAIC) also has developed a risk-based capital (RBC) program to enable regulators to carry out appropriate and timely regulatory actions relating to insurers that show signs of weak or deteriorating financial condition. The RBC program consists of a series of dynamic surplus related formulas which contain a variety of factors that are applied to financial balances based on a degree of certain risks, such as asset, credit and underwriting risks.

Many states have laws and regulations that limit an insurer s ability to exit a market. For example, certain states limit an automobile insurer s ability to cancel or non-renew policies. Furthermore, certain states prohibit an insurer from withdrawing one or more lines of business from the state, except pursuant to a plan that is approved by the state insurance department. The state insurance department may disapprove a plan that may lead to market disruption. Laws and regulations that limit cancellation or non-renewal of policies and that subject program withdrawals to prior approval requirements may restrict an insurer s ability to exit unprofitable markets.

Regulation of insurance constantly changes as real or perceived issues and developments arise. Some changes may be due to economic developments, such as changes in investment laws made to recognize new investment vehicles. Other changes result from such general pressures as consumer resistance to price increases and concerns relating to insurer rating, underwriting practices and solvency. In recent years, legislation and voter initiatives have been introduced, and in some areas adopted, which deal with use of non-public consumer information, use of financial responsibility and credit information in underwriting, insurance rate development, rate determination and the ability of insurers to cancel or non-renew insurance policies, reflecting concerns about consumer privacy, coverage, availability, prices and alleged discriminatory pricing. In addition, during 2010, the federal government established the Federal Insurance Office in order to monitor the financial condition of insurers. The U.S. Congress and certain federal agencies will continue to investigate the current condition of the insurance industry.

In some states, the automobile insurance industry has been under pressure in past years from regulators, legislators or special interest groups to reduce, freeze, or set rates to a level that is not necessarily related to underlying costs. This kind of activity has affected adversely, and in the future may affect adversely, the profitability and growth of the automobile insurance business in those jurisdictions and may limit the ability to increase rates to compensate for increases in costs. Adverse legislative and regulatory activity limiting the ability to price automobile insurance adequately or affecting the insurance operations adversely in other ways may occur in the future. The impact of these regulatory changes on us cannot be predicted.

Statutory Accounting Principles

The Company s results are reported in accordance with GAAP, which differ in certain respects from amounts reported under statutory accounting principles (SAP) prescribed by insurance regulatory authorities. Primarily, under GAAP:

1. Commissions, premium taxes and other variable costs incurred in connection with writing new and renewal business are capitalized and amortized on a pro rata basis over the period in which the related premiums are earned, rather than expensed as incurred, as required by SAP.

2. Certain assets are included in the consolidated balance sheet, but are non-admitted and charged directly against statutory surplus under SAP. These assets consist primarily of premium receivables and reinsurance recoverables that are outstanding over 90 days, federal deferred tax assets in excess of statutory limitations, furniture, equipment, application computer software, leasehold improvements and prepaid expenses.

3. Amounts related to ceded reinsurance, such as prepaid reinsurance premiums and reinsurance recoverables, are shown gross, rather than netted against unearned premium reserves and loss and loss adjustment expense reserves, respectively, as required by SAP.

4. Fixed-maturity securities, which are classified as available-for-sale, are reported at current market values, rather than at amortized cost, or the lower of amortized cost or market, depending on the credit quality of the specific security, as required by SAP. Equity securities are reported at quoted market values, which may differ from the NAIC market values as required by SAP. The amortization of the cost of the other long-term investment for tax credits are amortized through income tax expense rather than through investment income as required by SAP.

5. Both current and deferred taxes are recognized in the income statement for GAAP, while deferred taxes are posted directly to surplus for SAP.

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Investments

The Company employs a conservative approach to investment and capital management intended to ensure that there is sufficient capital to support all of the insurance premium that can be profitably written. The Company s portfolio is invested primarily in investment-grade fixed-income securities.

Employees

As of December 31, 2011, we had 148 employees, of which 147 are full-time and 1 was part-time, whom we refer to as associates .

Item 2. ***PROPERTIES***

AssuranceAmerica Corporation leases office space for its corporate headquarters located at RiverEdge One, 5500 Interstate North Parkway, Atlanta, Georgia 30328. Effective October 1, 2009 the Company signed an amendment to extend its lease until 2019 under more favorable lease terms. AssuranceAmerica Managing General Agency, LLC., leases a claims office in the state of Florida. During 2011, the Company sold its TrustWay retail operations and the leases associated with the sale are no longer commitments for the Company. However, the Company is still obligated for the lease commitment on three discontinued retail offices in Alabama under short term commercial leases. The Company believes that its existing facilities in the various states are adequate for the Company s current requirements and operations. Rent expense for long-term leases with predetermined minimum rental escalations is recognized on a straight-line basis, and the difference between the recognized rental expense and amounts payable under the leases, or deferred rent, is included in other liabilities.

Item 3. ***LEGAL PROCEEDINGS***

The Company is not a party to any pending legal proceedings other than routine litigation that is incidental to its business.

Item 4. ***RESERVED***

N/A

EXECUTIVE OFFICERS OF THE REGISTRANT

Incorporated by reference from information with respect to executive officers of the AssuranceAmerica Corporation and its subsidiaries set forth in Item 10 in Part III of this Form 10-K.

PART II

Item 5. ***MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES***

The Company Common Stock is quoted on the Over-the-Counter Bulletin Board (OTC-BB) under the symbol ASAM.PK . There is currently a very limited trading market for the Company Common Stock. The following sets forth, for the respective periods indicated, the high and low bid prices of the Company Common Stock in the over-the-counter market, as reported and summarized by the OTC-BB. Such prices are based on inter-dealer bid and asked prices, without retail mark-up, mark-down, commissions or adjustments, and may not represent actual transactions.

Bid Prices

Quarter Ended	High	Low
2011 Fiscal Year:		
March 31, 2011	$ 0.30	$ 0.17
June 30, 2011	$ 0.20	$ 0.17
September 30, 2011	$ 0.17	$ 0.16
December 31, 2011	$ 0.28	$ 0.16
2010 Fiscal Year:		
March 31, 2010	$ 0.35	$ 0.16
June 30, 2010	$ 0.35	$ 0.18
September 30, 2010	$ 0.46	$ 0.18
December 31, 2010	$ 0.40	$ 0.11

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The Company has never declared or paid cash dividends on the Company s common stock and currently intends to retain any future earnings for the operation and expansion of its business. Any determination to pay cash dividends on the Company s common stock will be at the discretion of the Board of Directors of the Company and will be dependent on the Company s financial condition, results of operations, contractual restrictions, capital requirements, business prospects and such other factors as the Company s Board of Directors deems relevant. Additionally, the payment of dividends or distributions from AAIC to the Company is restricted by the insurance laws and regulations of South Carolina (see Note 15 of the Consolidated Financial Statements).

At March 30, 2012, there were approximately 768 holders of record of the Company Common Stock.

Item 6. ***SELECTED FINANCIAL DATA***

N/A

Item 7. ***MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS***

Restatement

During 2011, the company s management discovered an error in its stated accounts receivables. The error arose as a result of the process used to record transactions to the accounting system for insufficient funds on policy payments from insureds. This process, which in certain instances required manual adjustments to the accounts receivable system for insufficient funds transactions, resulted in a duplicate booking of certain transactions to the accounting systems in years 2007 through 2010. The process for recording and reconciling insufficient funds transactions was changed in 2011. Additionally, the company s management strengthened its internal controls as a result of this error.

As a result, the Company s accounts receivable were overstated by $1.8 million as of December 31, 2010. The effect of the overstatement is a cumulative charge to earnings, after giving effect to taxes, of $1.2 million over the four-year period from 2007 through and including 2010. Of this aggregate charge to earnings after giving effect to taxes, $254,623 related to fiscal year 2007; $397,818 related to fiscal year 2008; $269,634 related to fiscal year 2009; and $312,583 related to fiscal year 2010.

Based on the foregoing, on April 2, 2012, the Company s Board of Directors, after consultation with the Company s management, concluded that the Company s financial statements for the fiscal years 2009 and 2010, the interim periods contained therein, and the quarterly statements for the first three quarters of 2011 must be restated to the extent of the overstatements listed above. See Note 3 within the Consolidated Financial Statements for further information.

Results of Continuing Operations

The Company reported a net after-tax loss on continuing operations of $9.0 million for the year ended December 31, 2011 compared to earnings of $2.7 million for the year ended December 31, 2010. The Company reported basic and fully diluted losses per common share from continuing operations of $0.136 for the year ended December 31, 2011 compared to earnings of $0.042 for the same period in 2010. The pre-tax loss from continuing operations was $6.5 million for the period ended December 31, 2011 compared to pre-tax earnings of $4.7 million for the same period in 2010.

The pre-tax loss from continuing operations for the year ended December 31, 2011 compared to the same period last year, resulted primarily from lower earnings in the wholesale operation (AAIC and MGA) in 2011 and a $3.5 million gain on extinguishment of debt recognized in 2010. Total revenue declined by $6.9 million or 11% from the prior year. This reduction reflects both the challenging economic environment as well as actions taken by the Company to address underwriting results. The loss and loss adjustment expenses increased $6.0 million compared to the prior year. This increase included $4.1 million of adverse loss development from prior accident years, primarily 2009 and 2010.

Results of Discontinued Operations

The Company sold its TrustWay retail agencies in 2011. The TrustWay business is reported as discontinued operations in the Consolidated Financial Statements and 2010 results for this business was reclassified as discontinued operations for comparative purposes. The Company reported a net after-tax loss from discontinued operations of $2.6 million for the year ended December 31, 2011, compared to a net after-tax loss of $2.2 million for the year ended December 31, 2010. The Company reported basic and fully diluted losses per common share from discontinued operations of $0.040 for the year ended December 31, 2011, compared to losses of $0.033 in the same period in 2010. The pre-tax loss from discontinued operations was $2.7 million for the year ended December 31, 2011 and $3.2 million for 2010, respectively.

The $2.7 million pre-tax loss from discontinued operations for the year ended December 31, 2011 includes a loss on disposal of $1.3 million from the sale of TrustWay retail agency operations. The pre-tax loss from discontinued operations also includes $1.4 million of discontinued operating losses for the year ended December 31, 2011 compared to a $3.2 million pre-tax loss for the same period last year. The prior year pre-tax loss reflects a discontinued operating loss of $1.7 million and a goodwill impairment of $1.5 million related to the TrustWay agency operations. See Note 9 of the Consolidated Financial Statements for further information.

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Revenues

Premiums

Gross premiums written (GPW) for the year ended December 31, 2011 were $89.5 million, a decline of 11% compared to the same period in 2010. The decline in premium was driven by a reduction in new business policies as well as a product mix shift from 12 month policies to 6 month policies. The reduction in new business is due to the challenging economic environment as well as actions taken by the Company to improve profitability in underperforming market segments. These actions include rate increases, implementation of tighter underwriting guidelines and restrictions on new business in high fraud areas in the state of Florida. Additionally, the Company stopped writing new business policies in the states of Texas, Mississippi and Louisiana in November, 2011. Average policy premium for six month policies increased for new and renewal policies written during the last six months of the year by 15.4% and 5.4%, respectively, compared to the same period in 2010, reflecting the impact of the rate increases taken earlier in the year.

Policies in-force of 68,663 as of December 31, 2011 decreased 16.7% from policies in-force at December 31, 2010.

The Company ceded approximately 65% or $58.1 million of its direct premiums written to its reinsurers in 2011 compared to 67% or $67.8 million in 2010. The reduction is the result of lower direct premium volume produced and lower ceded premium for the state of Florida, which was ceded for only nine months during 2011.

Premiums written refers to the total amount of premiums billed to the policyholder less the amount of premiums returned, generally as a result of cancellations, during a given period. Premiums written become premiums earned as the policy ages. Barring premium rate changes, if an insurance company writes the same gross premiums written (GPW) each year, premiums written and premiums earned will be equal and the unearned premium reserve will remain constant. During periods of growth in GPW, the unearned premium reserve will increase, causing premiums earned to be less than premiums written. Conversely, during periods of decline in GPW, the unearned premium reserve will decrease, causing premiums earned to be greater than premiums written. The Company s net premiums earned, after deducting reinsurance, remained flat at $33.4 million for the year ended December 31, 2011.

Commission and Fee Income

Our MGA operations receive managing general agent commissions for agency, underwriting, policy administration, and claims adjusting services performed on behalf of insurers. Commission income for the year ended December 31, 2011 was $12.2 million compared to $14.8 million in 2010. The decrease in commission income was driven by the reduction in premium volume and a lower ceding commission rate. AAIC pays the MGA commission on premium, which AAIC retains and this amount is subsequently eliminated upon consolidation.

The MGA operations also receive finance and other fees associated with premium installment plans. Managing general agent fees of $10.5 million for the year ended December 31, 2011 were $0.5 million lower than the prior year, resulting from the reduction of in-force policies.

Gain on extinguishment of debt

On December 30, 2010, AAIC issued a dividend in-kind to its parent Company of all the 5,000 of the AssuranceAmerica Capital Trust s floating rate capital securities, with a liquidation amount of $1,000 per capital security (the Capital Securities) in the amount of $1,001,089 and the Company extinguished the floating rate junior subordinated debentures of the Company (the Debentures) of $4,988,513, which resulted in a gain of $3,509,845 after the unamortized issuance cost.

Net Investment Income and Investment Gains

Our investment portfolio is highly liquid and consists substantially of readily marketable, investment-grade debt securities. Net investment income is primarily comprised of interest and dividends earned on these securities and related investment expenses. Net investment income and gains were $0.4 million for the year ended December 31, 2011 and $0.7 million for the same period last year. The lower investment performance was mainly due to interest income received on the trust preferred debt in the prior year, which was extinguished in December of 2010, offset by higher realized gains on equity securities sold in 2011.

Expenses

Insurance Loss and Loss Adjustment Expenses

Insurance losses and loss adjustment expenses include payments made to settle claims, estimates for future claim payments and changes in those estimates for current and prior periods, as well as loss adjustment expenses incurred in connection with settling

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claims. Insurance losses and loss adjustment expenses are influenced by many factors, such as claims frequency and severity trends, the impact of changes in estimates for prior accident years, and increases in the cost of medical treatment and automobile repairs. The anticipated impact of inflation is considered when we establish our premium rates and set loss reserves. During 2011, our outside actuarial firm performed quarterly analyses of accident year results to update reserve requirements. The estimate of ultimate loss and loss adjustment expenses is evaluated by accident quarter and by major coverage group (e.g., bodily injury, physical damage). The quarterly analyses are gross of reinsurance and then reinsurance terms are applied to calculate indicated net reserves.

We have historically used reinsurance to manage our exposure to losses and loss adjustment expenses by ceding a portion of our gross losses and loss adjustment expenses to reinsurers. We remain obligated for amounts covered by reinsurance in the event that the reinsurers do not meet their obligations under the reinsurance agreements due to, for example, disputes with the reinsurer or the reinsurer s insolvency.

Effective May 15, 2011, the Company entered into a twelve month catastrophe agreement with Shelter Mutual Insurance Company (SMIC). SMIC shall be liable for private passenger automobile physical damage coverage with respect to each loss occurrence, for the ultimate net loss over and above an initial ultimate net loss of $400,000 each event such as a storm or flood, subject to a limit of liability to the reinsurer of $1,600,000 each event, and further subject to a limit of liability to SMIC of $3,200,000 with respects to all events commencing during the term of this contract.

Effective April 1, 2011, the Company entered into a new quota share agreement with Greenlight Reinsurance Ltd. (Greenlight) for premium written in the state of Florida for the period of April 1, 2011 to March 31, 2012. The Company ceded 50% of premiums and losses for bodily injury liability, physical damage and other automobile liability coverages to Greenlight. The Company will receive a 19% ceding commission on ceded premiums earned if the loss and loss adjustment expense ratio as a percentage of earned premium is 75.5% or greater. If the loss ratio is less than 75.5%, but not less than 71.5% then the ceding commission shall be 19.0%, plus one half of the difference in percentage points between 75.5% and the actual loss ratio. If the loss ratio is 71.5% or less, then the ceding commission rate will be 21.0%. The Company receives a provisional commission rate of 20% in advance, which is subject to adjustment once the final loss ratio is known.

Effective January 1, 2011, the Company entered into a new quota share agreement with Swiss Reinsurance America Corporation for business written in 2011 for all states other than Florida. The Company ceded premium and losses equal to 75% of the bodily injury liability coverage and 82.5% of physical damage and other automobile liability coverages. The agreement includes a loss corridor of 75.0%-79.0%, whereby the Company retains the amount by which losses and loss adjustment expenses incurred exceed 75% of collected net premiums earned, subject to a maximum additional retention equal to 4% of collected net premiums earned. The Company retains the amount by which losses and loss adjustment expense incurred, after the application of the loss corridor, exceeds 120% of collected net premiums earned.

As a result of the reinsurance agreements, the Company is currently ceding to its reinsurers approximately 67% in 2011 and 72% in 2010 of its direct loss and loss adjustment expenses incurred. The Company ceded approximately 65% of its direct premiums written to its reinsurers during 2011 compared to 67% in 2010.

After making deductions for the effect of reinsurance, losses and loss adjustment expenses were $31.0 million for the year ended December 31, 2011, compared to $25.0 million for the same period in 2010. The amount represents actual payments made and changes in estimated future payments to be made to or on behalf of AAIC s policyholders, including the expenses associated with settling claims. As a percentage of earned premiums, the loss ratio for the year ended December 31, 2011 was 92.9% and 75.0% for the same period in 2010. The year-over-year increase in loss cost includes $4.1 million of adverse loss development on claims from accident years 2009 and 2010 and $1.5 million of reserves established for the loss corridor provision in the 2011 reinsurance treaty.

The $4.1 million of adverse development is attributed to higher than expected cost for bodily injury claims as well as additional cost exposure for Florida no-fault coverage (PIP). The Company has implemented both rate and underwriting actions to improve loss results for the bodily injury coverage. The adverse development on PIP coverage in Florida is related to recent Florida district court decisions, ruling that an insurer may not limit payment for PIP medical services to the permissive fee schedule of the Florida PIP statute unless there is specific language in the policy contract indicating use of the fee schedule. This is not expected to be a recurring issue as the Company added language to its policy contract effective January 1, 2011. As of December 31, 2011 the Company reserved for the estimated amount of remaining exposure.

Operating Expenses

Selling, general and administrative expenses were $30.9 million for the year ended December 31, 2011 and $32.3 million for the same period of 2010. The decrease of $1.4 million in 2011 expenses relates to a $1.7 million decrease in selling expenses due to lower premium volume in the wholesale division and a $1.5 million goodwill impairment loss reflected in the prior year, partially offset by increases in personnel costs of $0.6 million, boards and bureau assessments of $0.6 million and $0.4 million in other administrative costs. Depreciation and amortization expenses increased $223 thousand related to investment in a proprietary web-based quoting and policy issuance platform. Interest expense was $344 thousand lower than the prior year, primarily due to the extinguishment of the trust preferred debt in late 2010.

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Income Tax Expense

The net income tax expense for the year ended December 31, 2011 from continuing and discontinued operations was $2.4 million compared to $0.9 million for the prior year. The increase in the tax expense during the year relates to a valuation allowance of $4.9 million on the Company s deferred tax assets. The valuation allowance was established based on the more likely than not threshold for the Company s net deferred income tax asset as of December 31, 2011. The Company s ability to realize deferred tax assets depends on the ability to generate sufficient taxable income within the carryforward period provided for in the tax law. The Company considered the following possible sources of taxable income when assessing the possible realization of deferred tax assets: future reversals of existing taxable temporary differences; future taxable income exclusive of reversing temporary differences and carryforwards; taxable income in prior carryback years; and tax planning strategies.

Financial Condition

As of December 31, 2011, the Company had investments and cash of $16.6 million, compared to $21.5 million at December 31, 2010. The Company s investment strategy is to be investing in bonds with short durations in order to meet its insurance obligations. As of December 31, 2011, the Company had $8.1 million in cash and short-term investments, which included $0.3 million of cash restricted to provide security for certain reinsurance reserve obligations. The Company s long term investments of $7.9 million are spread among direct obligations of the U.S. Treasury as well as those securities unconditionally guaranteed as to the payment of principal and interest by the United States government or any agency thereof and in corporate bonds. The Company changed its investment strategy during the year and sold all of its remaining equity securities in order to mitigate its exposure to a volatile equity market environment and reinvested the funds received in bonds. The other long term investments of $0.6 million represent low income housing tax credits, which will be used to offset the Company s future tax liabilities.

The Company s investment activities are made in accordance with the Company s investment policy. The objectives of the investment policy are to obtain favorable after-tax returns on investments through a diversified portfolio of fixed income securities. The Company s investment criteria and practices reflect the short-term duration of its contractual obligations with policyholders. Tax considerations include federal and state income tax as well as premium tax abatement and credit opportunities offered to insurance companies in the states where AAIC writes policies.

As of December 31, 2011, the Company s assets included two promissory notes secured by real estate mortgages, in the amount of $2.5 million and $1.5 million, respectively. The two notes were subsequently assigned by the Company as a capital contribution to its subsidiary AssuranceAmerica Insurance Company. The assigned promissory notes are secured by mortgages and real estate deeds owned by Guy Millner the Chairman of the Company and a related party. See Note 6 of the Consolidated Financial Statements for further details regarding the notes.

Receivable from insureds as of December 31, 2011, decreased $5.7 million to $25.1 million compared to $30.8 million as of December 31, 2010. The balance represents amounts due from AAIC s insureds and the majority of the decrease is directly attributable to the decline in AAIC s premium writings during 2011. The Company s policy is to write off uncollected receivable balances within 60 days of cancellation or expiration, and the Company does not consider an allowance for doubtful accounts to be necessary.

Reinsurance recoverable as of December 31, 2011, increased $2.7 million to $36.7 million compared to $34.0 million as of December 31, 2010. The increase is directly related to an increase in ceded loss reserves. AAIC maintains quota-share reinsurance treaties whereby it ceded approximately 65% of premiums and 67% of losses in 2011. The $36.7 million represents the reinsurers portion of losses and loss adjustment expenses, both paid and unpaid.

Prepaid reinsurance premiums as of December 31, 2011, decreased $4.2 million to $19.5 million compared to $23.6 million as of December 31, 2010. The decrease results from AAIC s decline in premium during the year of 2011 and represents premiums ceded to its reinsurers which have not been fully earned.

Other receivables as of December 31, 2011 increased $0.9 million to $1.6 million when compared to December 31, 2010. The increase mainly relates to $0.2 million note receivable due from the purchaser of the TrustWay Alabama agencies, $0.3 million due from the purchaser of the TrustWay Florida agencies and $0.4 million increase for balances related to the managing general agency agreements.

Assets of discontinued operations decreased $8.1 million to $0.2 million as of December 31, 2011 from the balance of $8.3 million as of December 31, 2010. This decrease is mainly related to the sale of the TrustWay agency assets disposed of during 2011. See Note 9 of the Consolidated Financial Statements for further information.

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Prepaid income taxes decreased $107 thousand as of December 31, 2011, when compared to the balance at December 31, 2010. Deferred tax assets decreased $2.4 million as of December 31, 2011 compared to the balance as of December 31, 2010. A valuation allowance of $4,851,743 was established based on the more likely than not threshold for the Company s net deferred income tax asset as of December 31, 2011. See Note 10 of the Consolidated Financial Statements.

Accounts payable and accrued expenses as of December 31, 2011, increased $0.6 million to $7.3 million from the balance of $6.7 million as of December 31, 2010. The increase is due to $1.6 million of unclaimed property, offset by a decrease of $0.3 million in lower premium tax accruals, $0.5 million in general and administrative expense accruals, and amounts due to agents of $0.2 million.

Unearned premium decreased $6.1 million to $28.1 million as of December 31, 2011 from $34.2 million as of December 31, 2010, and represents premiums written but not earned. This decrease is directly attributable to the decline in AAIC s premium writings during 2011.

Unpaid losses and loss adjustment expenses increased $8.8 million to $42.1 million as of December 31, 2011 from $33.3 million at December 31, 2010. This amount represents management s estimates of future amounts needed to pay claims and related expenses. The increase is primarily related to reserve strengthening and adjustments to the actuarial estimate for prior accident years related to the bodily injury and personal injury protection coverages.

Reinsurance payable as of December 31, 2011 decreased $8.9 million to $20.5 million, compared to $29.4 million on December 31, 2010. The amount represents premiums owed to the Company s reinsurers. AAIC maintains nine reinsurance treaties with its reinsurers and is currently ceding approximately 65% of premiums written. The decrease is mainly due to the decrease in premiums written during the year.

Provisional commission reserves represent the difference between the minimum ceding commission and the provisional amount paid by the reinsurers. These balances as of December 31, 2011 decreased $0.8 million to $2.5 million, compared to the balance on December 31, 2010 of $3.3 million. The decrease is related to the reduction in ceded written premium in 2011 and a reduction in the commission rate.

The Company s revolving line of credit of $1.5 million was fully paid during 2011. The line was not renewed by the Company.

Notes payable due to a related party increased by $1,557,911. The increase represents two notes payable issued in the amount of $2.5 million and $1.5 million to Mr. Millner, the Chairman of the Company, in consideration of providing the secured notes to AssuranceAmerica Corporation, (for assignment by the Company as a capital contribution to its subsidiary AssuranceAmerica Insurance Company). As additional consideration, the Company also issued a Warrant Agreement giving the Chairman the right to purchase 11,629,000 shares of the common stock of the Company for $0.01 per share. At December 31, 2011, the recorded balance of the notes is $1,557,911, net of $2,442,089 discount related to the issuance of the warrants. The discount will be amortized over the life of the notes as a yield adjustment. See Note 11 of the Consolidated Financial Statements for further information.

Notes and interest payable as of December 31, 2011 decreased $58 thousand due to principal payments on a note with a third party.

Liquidity and Capital Resources

Net cash used by operating activities for the year ended December 31, 2011 was $7.0 million. The decrease in operating cash was primarily due to a change in payment terms for reinsurance commissions (paid on collected premium versus paid on written premium) impacting cash flow in 2011 by $3.4 million, the return of $1.6 million held as restricted on behalf of the reinsurer and payment of provisional commissions of $1.8 million.

Investing activities provided cash for the year ended December 31, 2011 of $7.9 million. The increase primarily consists of $4.5 million related to the sale of the TrustWay insurance agencies, $2.8 million net proceeds from the sale of bonds and equity securities, and $1.5 million transfer of cash from restricted funds held for reinsurers, offset by $0.9 million of purchases of property and equipment related to the wholesale division.

Financing activities for the year ended December 31, 2011, used cash of $1.5 million, primarily due to the $1.5 million payment of the line of credit.

On June 30, 2010, the Company entered into a First Amendment Agreement (First Amendment) to the Loan Agreement between the Company and Wells Fargo Bank, N.A. (as successor in interest by merger to Wachovia Bank, N.A.) (Lender). The First Amendment amends the Loan

Agreement, dated July 17, 2009, between the Company and the Lender (Loan Agreement).

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The First Amendment extended the maturity date for the credit facility to July 16, 2011. However, the lender extended the agreement through September 30, 2011. The facility was fully paid in July 2011 and upon expiration, the facility was not renewed. The proceeds of the facility was used for funding certain permitted acquisitions, funding short-term loans to the Company s wholly owned subsidiary, AAIC, or for working capital or general corporate needs in the ordinary course of business. The credit facility was secured by a pledge of the Company s ownership interests in two of the Company s subsidiaries, TrustWay and MGA, and was guaranteed by the same entities.

On December 30, 2010, AAIC issued a dividend in-kind to the Company of all the capital securities issued by AssuranceAmerica Capital Trust in the amount of $1,001,089 and the Company extinguished the related junior subordinated debentures of $4,988,513, which resulted in a gain of $3,509,845. On March 10, 2009, AAIC purchased all of the capital securities issued by the trust at a discounted price of $1,000,000 from the non-affiliated holder of those securities. The discount was accreted to interest income over the remaining life of the capital securities using the interest method. The purchase resulted in an increase in AAIC s investment portfolio for redeemable preferred stock in the amount of $1,001,089.

To support Company growth, the Company maintains a highly liquid investment portfolio and closely manages capital requirements. AAIC is required by the state of South Carolina to maintain minimum statutory capital and surplus of $3.0 million. As of December 31, 2011, AAIC s statutory capital and surplus was $11.4 million.

Off-Balance Sheet Arrangements

The Company does have off balance sheet leasing arrangements. For further information, please refer to Note 16 in the Consolidated Financial Statements.

CRITICAL ACCOUNTING POLICIES

Loss and LAE Reserves

The Company is required to make certain estimates and assumptions when preparing its financial statements and accompanying notes in accordance with GAAP. One area which requires estimations and assumptions is the establishment of loss and LAE reserves. Loss and LAE reserves are established to reflect the estimated costs of paying claims and claims expenses under insurance policies we have issued. These reserves are an approximation of amounts necessary to settle all outstanding claims, including known claims and claims that have been incurred but not reported (IBNR) as of the financial statement date.

Loss and LAE reserves are determined using actuarial and statistical procedures and represent undiscounted estimates of the ultimate net cost of all unpaid losses and LAE incurred through December 31 of each year. When establishing loss and LAE reserves, the Company considers its historical loss experience and current trends or assumptions, particularly those relating to the following factors:

- Claims settlement and payment practices;
- Industry averages and average paid losses by state and other geographical regions;
- Coverage limits and deductibles;
- Inflation and changes in automobile repair costs, medical costs and industry averages; and
- Legal and regulatory trends affecting claims settlements and average legal defense costs by state and other geographical regions.

The Company considers its historical loss experience and the factors set forth above at a state, product and line of business level to estimate its loss and LAE reserves. The Company reviews its loss and LAE reserves by line of business on a monthly basis as new information becomes known and it is able to observe actual loss development. Our statistical average reserves are reviewed throughout the year. If emerging issues relating to a product or state necessitate a change in our scheduled reviews of a particular coverage of the business, we identify and measure variances and make adjustments if necessary. For example, we track medical and auto repair costs and may adjust statistical averages if trends were emerging.

At December 31, 2011 and 2010, we had $14.5 million and $9.9 million of net loss and LAE reserves, respectively, which included $5.1 million and $5.2 million of case reserves and $9.4 million and $4.7 million of IBNR reserves, respectively. The Company s case reserves were flat year-over-year and IBNR reserves increased $4.7 million. This increase in IBNR reserves is related to reserve strengthening and adjustments to the actuarial estimate for prior accident years related to the bodily injury and personal injury protection coverages.

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GROSS RESERVES BY LINE OF BUSINESS

The following table presents the gross reserves by line of business as of December 31, 2011 and December 31, 2010:

	2011	2010
Personal Auto Liability	$ 39,969,262	$ 31,638,391
Personal Auto Physical Damage	2,129,001	1,672,676
Total Gross Reserves-Unpaid Losses and LAE		