MARKEL CORP
Form 10-Q
August 06, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2010**

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: 001-15811

MARKEL CORPORATION

(Exact name of registrant as specified in its charter)

Virginia	**54-1959284**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

4521 Highwoods Parkway, Glen Allen, Virginia 23060-6148

(Address of principal executive offices) (Zip Code)

(804) 747-0136

(Registrant s telephone number, including area code)

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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 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.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

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

Number of shares of the registrant s common stock outstanding at July 30, 2010: 9,770,154

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

	June 30, 2010	December 31, 2009
	(dollars in thousands)	
ASSETS		
Investments, available-for-sale, at estimated fair value:		
Fixed maturities (amortized cost of $5,175,271 in 2010 and $4,961,745 in 2009)	$ 5,427,805	$ 5,112,136
Equity securities (cost of $939,589 in 2010 and $843,841 in 2009)	1,404,314	1,349,829
Short-term investments (estimated fair value approximates cost)	360,869	492,581
Investments in affiliates	0	43,633
Total Investments	7,192,988	6,998,179
Cash and cash equivalents	686,675	850,494
Receivables	332,587	279,879
Reinsurance recoverable on unpaid losses	874,465	886,442
Reinsurance recoverable on paid losses	61,223	65,703
Deferred policy acquisition costs	172,479	156,797
Prepaid reinsurance premiums	72,057	68,307
Goodwill and intangible assets	501,479	502,833
Other assets	430,508	433,262
Total Assets	$ 10,324,461	$ 10,241,896
LIABILITIES AND EQUITY		
Unpaid losses and loss adjustment expenses	$ 5,327,268	$ 5,427,096
Unearned premiums	785,009	717,728
Payables to insurance companies	66,837	46,853
Senior long-term debt and other debt (estimated fair value of $1,075,000 in 2010 and $1,011,000 in 2009)	1,003,576	963,648
Other liabilities	275,328	294,857
Total Liabilities	7,458,018	7,450,182
Commitments and contingencies		
Shareholders equity:		
Common stock	871,887	872,876
Retained earnings	1,553,547	1,514,398
Accumulated other comprehensive income	424,559	387,086
Total Shareholders Equity	2,849,993	2,774,360
Noncontrolling interests	16,450	17,354
Total Equity	2,866,443	2,791,714
Total Liabilities and Equity	$ 10,324,461	$ 10,241,896

See accompanying notes to consolidated financial statements.

MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income and Comprehensive Income (Loss)

	Quarter Ended June 30, 2010	Quarter Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
	(dollars in thousands, except per share data)			
OPERATING REVENUES				
Earned premiums	$ 416,688	$ 455,214	$ 828,823	$ 912,460
Net investment income	64,384	64,070	132,786	132,813
Net realized investment gains (losses):				
Other-than-temporary impairment losses	(3,916)	(11,763)	(5,701)	(67,237)
Other-than-temporary impairment losses recognized in other comprehensive income (loss)	3	3,757	(563)	3,757
Other-than-temporary impairment losses recognized in net income	(3,913)	(8,006)	(6,264)	(63,480)
Net realized investment gains (losses), excluding other-than-temporary impairment losses	1,484	(7,430)	19,578	(7,139)
Net realized investment gains (losses)	(2,429)	(15,436)	13,314	(70,619)
Other revenues	36,771	18,584	77,210	42,955
Total Operating Revenues	515,414	522,432	1,052,133	1,017,609
OPERATING EXPENSES				
Losses and loss adjustment expenses	251,235	286,139	511,405	539,550
Underwriting, acquisition and insurance expenses	179,106	166,394	335,774	348,231
Amortization of intangible assets	3,856	1,434	7,814	2,906
Other expenses	32,969	16,211	68,366	38,760
Total Operating Expenses	467,166	470,178	923,359	929,447
Operating Income	48,248	52,254	128,774	88,162
Interest expense	18,334	11,842	36,293	23,659
Income Before Income Taxes	29,914	40,412	92,481	64,503
Income tax expense	8,997	7,382	28,358	15,037
Net Income	$ 20,917	$ 33,030	$ 64,123	$ 49,466
Less net income attributable to noncontrolling interests	86	232	723	310
Net Income to Shareholders	$ 20,831	$ 32,798	$ 63,400	$ 49,156
OTHER COMPREHENSIVE INCOME (LOSS)				
Change in net unrealized gains on investments, net of taxes:				
Net holding gains (losses) arising during the period	$ (49,927)	$ 121,385	$ 47,514	$ 66,351
Unrealized other-than-temporary impairment losses on fixed maturities arising during the period	170	(3,082)	901	(3,082)
Reclassification adjustments for net gains (losses) included in net income	(3,099)	13,447	(13,639)	48,950

Change in net unrealized gains on investments, net of taxes	(52,856)	131,750	34,776	112,219
Change in currency translation adjustments, net of taxes	(2,259)	6,938	1,960	7,819
Change in net actuarial pension loss, net of taxes	336	383	686	679
Total Other Comprehensive Income (Loss)	(54,779)	139,071	37,422	120,717
Comprehensive Income (Loss)	$ (33,862)	$ 172,101	$ 101,545	$ 170,183
Less comprehensive income attributable to noncontrolling interests	41	232	909	310
Comprehensive Income (Loss) to Shareholders	$ (33,903)	$ 171,869	$ 100,636	$ 169,873
NET INCOME PER SHARE				
Basic	$ 2.13	$ 3.34	$ 6.47	$ 5.01
Diluted	$ 2.12	$ 3.34	$ 6.46	$ 5.00

See accompanying notes to consolidated financial statements.

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MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Equity

	Six Months Ended June 30, 2010	2009
	(dollars in thousands)	
COMMON STOCK		
Balance at beginning of period	$ 872,876	$ 869,744
Issuance of common stock	6,664	0
Purchase of noncontrolling interest	(8,345)	0
Restricted stock units expensed	692	1,375
Other	0	503
Balance at end of period	$ 871,887	$ 871,622
RETAINED EARNINGS		
Balance at beginning of period	$ 1,514,398	$ 1,297,901
Net income to shareholders	63,400	49,156
Cumulative effect of adoption of FASB ASC 320-10, net of taxes	0	15,300
Repurchases of common stock	(24,251)	0
Balance at end of period	$ 1,553,547	$ 1,362,357
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)		
Net unrealized holding gains on investments, net of taxes:		
Balance at beginning of period	$ 433,241	$ 58,652
Change in net unrealized holding gains on investments, net of taxes	32,286	115,301
Balance at end of period	465,527	173,953
Unrealized other-than-temporary impairment losses on fixed maturities, net of taxes:		
Balance at beginning of period	(15,452)	0
Cumulative effect of adoption of FASB ASC 320-10, net of taxes	0	(15,300)
Change in unrealized other-than-temporary impairment losses on fixed maturities, net of taxes	2,490	(3,082)
Balance at end of period	(12,962)	(18,382)
Cumulative translation adjustments, net of taxes:		
Balance at beginning of period	3,772	(15,416)
Change in currency translation adjustments, net of taxes	2,011	7,819
Balance at end of period	5,783	(7,597)
Net actuarial pension loss, net of taxes:		
Balance at beginning of period	(34,475)	(30,207)
Change in net actuarial pension loss, net of taxes	686	679
Balance at end of period	(33,789)	(29,528)
Balance at end of period	$ 424,559	$ 118,446
SHAREHOLDERS EQUITY AT END OF PERIOD	$ 2,849,993	$ 2,352,425
NONCONTROLLING INTERESTS		

Balance at beginning of period	$ 17,354	$ 261
Net income	723	310
Purchase of noncontrolling interest	(1,557)	0
Other	(70)	59
Balance at end of period	$ 16,450	$ 630
TOTAL EQUITY AT END OF PERIOD	$ 2,866,443	$ 2,353,055

See accompanying notes to consolidated financial statements.

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MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Six Months Ended June 30, 2010	2009
	(dollars in thousands)	
OPERATING ACTIVITIES		
Net income	$ 64,123	$ 49,466
Adjustments to reconcile net income to net cash provided by operating activities	(557)	65,818
Net Cash Provided By Operating Activities	63,566	115,284
INVESTING ACTIVITIES		
Proceeds from sales of fixed maturities and equity securities	186,435	42,823
Proceeds from maturities, calls and prepayments of fixed maturities	206,214	166,117
Cost of fixed maturities and equity securities purchased	(679,387)	(107,718)
Net change in short-term investments	125,397	(246,899)
Acquisitions, net of cash acquired	(35,317)	(2,481)
Other	(12,643)	19,936
Net Cash Used By Investing Activities	(209,301)	(128,222)
FINANCING ACTIVITIES		
Additions to senior long-term debt and other debt	30,697	156,373
Repayments of senior long-term debt and other debt	(1,549)	(102,242)
Repurchases of common stock	(24,251)	0
Purchase of noncontrolling interest	(3,001)	0
Other	(11,294)	59
Net Cash Provided (Used) By Financing Activities	(9,398)	54,190
Effect of foreign currency rate changes on cash and cash equivalents	(8,686)	9,049
Increase (decrease) in cash and cash equivalents	(163,819)	50,301
Cash and cash equivalents at beginning of period	850,494	640,379
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 686,675	$ 690,680

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

Markel Corporation markets and underwrites specialty insurance products and programs to a variety of niche markets.

The consolidated balance sheet as of June 30, 2010, the related consolidated statements of income and comprehensive income (loss) for the quarters and six months ended June 30, 2010 and 2009, and the consolidated statements of changes in equity and cash flows for the six months ended June 30, 2010 and 2009 are unaudited. In the opinion of management, all adjustments necessary for fair presentation of such consolidated financial statements have been included. Such adjustments consist only of normal, recurring items. Interim results are not necessarily indicative of results of operations for the entire year. The consolidated balance sheet as of December 31, 2009 was derived from Markel Corporation s audited annual consolidated financial statements.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include the accounts of Markel Corporation and all subsidiaries (the Company). All significant intercompany balances and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to the current presentation.

Prior to the fourth quarter of 2009, the Company accounted for its two non-insurance subsidiaries as investments in affiliates under the equity method of accounting. The Company had determined that the differences between the equity method of accounting and consolidation accounting for these two entities were immaterial to the consolidated financial statements. During the fourth quarter of 2009, the Company acquired two additional businesses that operate outside of the specialty insurance marketplace and, as a result, the Company consolidated the two entities that had previously been accounted for as investments in affiliates. This change had no impact on the Company s net income to shareholders for the quarter and six months ended June 30, 2009. The Company consolidates the results of its non-insurance subsidiaries on a one-month lag.

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results may differ from the estimates and assumptions used in preparing the consolidated financial statements.

The consolidated financial statements and notes are presented as permitted by Form 10-Q and do not contain certain information included in the Company s annual consolidated financial statements and notes. Readers are urged to review the Company s 2009 Annual Report on Form 10-K for a more complete description of the Company s business and accounting policies.

2. Net Income per Share

a) Net income per share was determined by dividing net income to shareholders by the applicable weighted average shares outstanding.

	Quarter Ended June 30,		Six Months Ended June 30,	
(in thousands, except per share amounts)	2010	2009	2010	2009
Net income to shareholders	$ 20,831	$ 32,798	$ 63,400	$ 49,156
Basic common shares outstanding	9,794	9,815	9,803	9,814
Dilutive potential common shares	13	10	11	10
Diluted shares outstanding	9,807	9,825	9,814	9,824
Basic net income per share	$ 2.13	$ 3.34	$ 6.47	$ 5.01
Diluted net income per share	$ 2.12	$ 3.34	$ 6.46	$ 5.00

b) The Markel Corporation Omnibus Incentive Plan (Omnibus Incentive Plan) provides for grants or awards of cash, restricted stock, restricted stock units, performance grants and other stock-based awards to employees and directors. The Omnibus Incentive Plan is administered by the Compensation Committee of the Company s Board of Directors (Compensation Committee) and will terminate on March 5, 2013. In May 2010, the Compensation Committee awarded 26,410 restricted stock units to certain associates and executive officers. The restricted stock units had a grant-date fair value of $9.5 million. Each restricted stock unit will ultimately allow the recipient to receive one share of the Company s common stock. The restricted stock units are designed to assist the Company in retaining the services of key employees. Twenty percent of the restricted stock units vest after one year, and the balance after five years, with pro rata vesting in case of death, disability or retirement. Shares will be issued in respect of the initial twenty percent of the restricted stock units promptly after vesting. The remaining shares will be issued only following termination of employment, except that issuance of a portion of the shares may occur earlier if designated share price targets are attained. Violation of non-competition agreements contained in the award agreement may result in cancellation of the award, even after vesting.

3. Reinsurance

The following tables summarize the effect of reinsurance on premiums written and earned.

	Quarter Ended June 30,			
(dollars in thousands)	2010		2009	
	Written	Earned	Written	Earned
Direct	$ 448,302	$ 415,553	$ 446,515	$ 452,277
Assumed	68,052	57,599	59,160	55,161
Ceded	(62,125)	(56,464)	(49,482)	(52,224)
Net premiums	$ 454,229	$ 416,688	$ 456,193	$ 455,214

	Six Months Ended June 30,			
(dollars in thousands)	2010		2009	
	Written	Earned	Written	Earned
Direct	$ 857,693	$ 820,023	$ 853,733	$ 915,169
Assumed	148,845	109,397	138,778	106,035
Ceded	(105,807)	(100,597)	(98,263)	(108,744)

Net premiums	$ 900,731	$ 828,823	$ 894,248	$ 912,460

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Incurred losses and loss adjustment expenses were net of reinsurance recoverables (ceded incurred losses and loss adjustment expenses) of $55.9 million and $0.7 million, respectively, for the quarters ended June 30, 2010 and 2009 and $63.8 million and $16.8 million, respectively, for the six months ended June 30, 2010 and 2009. Both periods of 2010 included $43.2 million of estimated reinsurance recoverables related to the Deepwater Horizon drilling rig explosion.

4. Investments

a) The following tables summarize the Company s available-for-sale investments.

(dollars in thousands)	June 30, 2010 Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Unrealized Other-Than-Temporary Impairment Losses	Estimated Fair Value
Fixed maturities:					
U.S. Treasury securities and obligations of U.S. government agencies	$ 338,365	$ 25,695	$ 0	$ 0	$ 364,060
Obligations of states, municipalities and political subdivisions	2,176,010	84,534	(4,189)	0	2,256,355
Foreign governments	464,870	28,128	(386)	0	492,612
Residential mortgage-backed securities	418,743	34,873	(653)	(11,778)	441,185
Asset-backed securities	22,544	908	0	0	23,452
Public utilities	115,394	8,209	0	0	123,603
Convertible bonds	16,687	0	0	0	16,687
All other corporate bonds	1,622,658	96,853	(2,185)	(7,475)	1,709,851
Total fixed maturities	5,175,271	279,200	(7,413)	(19,253)	5,427,805
Equity securities:					
Insurance companies, banks and trusts	381,072	261,790	(5,842)	0	637,020
Industrial, consumer and all other	558,517	212,175	(3,398)	0	767,294
Total equity securities	939,589	473,965	(9,240)	0	1,404,314
Short-term investments	360,848	21	0	0	360,869
Investments, available-for-sale	$ 6,475,708	$ 753,186	$ (16,653)	$ (19,253)	$ 7,192,988

(dollars in thousands)	December 31, 2009 Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Unrealized Other-Than-Temporary Impairment Losses	Estimated Fair Value
Fixed maturities:					
U.S. Treasury securities and obligations of U.S. government agencies	$ 358,360	$ 18,053	$ (91)	$ 0	$ 376,322
Obligations of states, municipalities and political subdivisions	2,068,714	65,824	(8,798)	0	2,125,740
Foreign governments	410,435	14,912	(2,335)	0	423,012
Residential mortgage-backed securities	419,707	24,223	(1,534)	(12,342)	430,054
Asset-backed securities	27,052	244	(1,001)	0	26,295
Public utilities	136,302	7,317	0	0	143,619
Convertible bonds	30,750	0	0	0	30,750
All other corporate bonds	1,510,425	70,285	(13,942)	(10,424)	1,556,344
Total fixed maturities	4,961,745	200,858	(27,701)	(22,766)	5,112,136
Equity securities:					
Insurance companies, banks and trusts	338,369	243,669	(3,521)	0	578,517
Industrial, consumer and all other	505,472	266,165	(325)	0	771,312
Total equity securities	843,841	509,834	(3,846)	0	1,349,829
Short-term investments	492,563	20	(2)	0	492,581

Investments, available-for-sale	$ 6,298,149	$ 710,712	$ (31,549)	$ (22,766)	$ 6,954,546

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b) The following tables summarize gross unrealized investment losses by the length of time that securities have continuously been in an unrealized loss position.

	June 30, 2010					
	Less than 12 months		12 months or longer		Total	
(dollars in thousands)	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses
Fixed maturities:						
U.S. Treasury securities and obligations of U.S. government agencies	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Obligations of states, municipalities and political subdivisions	136,370	(1,300)	88,083	(2,889)	224,453	(4,189)
Foreign governments	5,978	(358)	4,224	(28)	10,202	(386)
Residential mortgage-backed securities	7,099	(9,935)	15,262	(2,496)	22,361	(12,431)
Asset-backed securities	0	0	0	0	0	0
All other corporate bonds	69,601	(8,302)	26,835	(1,358)	96,436	(9,660)
Total fixed maturities	219,048	(19,895)	134,404	(6,771)	353,452	(26,666)
Equity securities:						
Insurance companies, banks and trusts	74,368	(3,198)	21,602	(2,644)	95,970	(5,842)
Industrial, consumer and all other	72,852	(3,398)	0	0	72,852	(3,398)
Total equity securities	147,220	(6,596)	21,602	(2,644)	168,822	(9,240)
Short-term investments	0	0	0	0	0	0
Total	$ 366,268	$ (26,491)	$ 156,006	$ (9,415)	$ 522,274	$ (35,906)

At June 30, 2010, the Company held 99 securities with a total estimated fair value of $522.3 million and gross unrealized losses of $35.9 million. Of these 99 securities, 46 securities had been in a continuous unrealized loss position for greater than one year and had a total estimated fair value of $156.0 million and gross unrealized losses of $9.4 million. Of these securities, 45 securities were fixed maturities where the Company expects to receive all interest and principal payments when contractually due and one was an equity security. The Company does not intend to sell or believe it will be required to sell these fixed maturities before recovery of their amortized cost. The equity security had a fair value of 89% of its cost basis at June 30, 2010.

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	December 31, 2009					
	Less than 12 months		12 months or longer		Total	
(dollars in thousands)	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses
Fixed maturities:						
U.S. Treasury securities and obligations of U.S. government agencies	$ 23,798	$ (91)	$ 0	$ 0	$ 23,798	$ (91)
Obligations of states, municipalities and political subdivisions	214,792	(2,388)	148,570	(6,410)	363,362	(8,798)
Foreign governments	92,166	(2,335)	0	0	92,166	(2,335)
Residential mortgage-backed securities	33,223	(12,748)	11,162	(1,128)	44,385	(13,876)
Asset-backed securities	0	0	10,607	(1,001)	10,607	(1,001)
All other corporate bonds	217,072	(18,890)	143,057	(5,476)	360,129	(24,366)
Total fixed maturities	581,051	(36,452)	313,396	(14,015)	894,447	(50,467)
Equity securities:						
Insurance companies, banks and trusts	45,917	(3,521)	0	0	45,917	(3,521)
Industrial, consumer and all other	10,943	(325)	0	0	10,943	(325)
Total equity securities	56,860	(3,846)	0	0	56,860	(3,846)
Short-term investments	4,298	(2)	0	0	4,298	(2)
Total	$ 642,209	$ (40,300)	$ 313,396	$ (14,015)	$ 955,605	$ (54,315)

At December 31, 2009, the Company held 190 securities with a total estimated fair value of $955.6 million and gross unrealized losses of $54.3 million. Of these 190 securities, 78 securities had been in a continuous unrealized loss position for greater than one year and had a total estimated fair value of $313.4 million and gross unrealized losses of $14.0 million. All 78 securities were fixed maturities.

The Company completes a detailed analysis each quarter to assess whether the decline in the fair value of any investment below its cost basis is deemed other-than-temporary. All securities with unrealized losses are reviewed. The Company considers many factors in completing its quarterly review of securities with unrealized losses for other-than-temporary impairment, including the length of time and the extent to which fair value has been below cost and the financial condition and near-term prospects of the issuer. For equity securities, the ability and intent to hold the security for a period of time sufficient to allow for anticipated recovery is considered. For fixed maturities, the Company considers whether it intends to sell the security or if it is more likely than not that it will be required to sell the security before recovery, the implied yield-to-maturity, the credit quality of the issuer and the ability to recover all amounts outstanding when contractually due.

For equity securities, a decline in fair value that is considered to be other-than-temporary is recognized in net income based on the fair value of the security at the time of assessment, resulting in a new cost basis for the security. For fixed maturities where the Company intends to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost, a decline in fair value that is considered to be other-than-temporary is recognized in net income based on the fair value of the security

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at the time of assessment, resulting in a new cost basis for the security. If the decline in fair value of a fixed maturity below its amortized cost is considered to be other-than-temporary based upon other considerations, the Company compares the estimated present value of the cash flows expected to be collected to the amortized cost of the security. The extent to which the estimated present value of the cash flows expected to be collected is less than the amortized cost of the security represents the credit-related portion of the other-than-temporary impairment, which is recognized in net income, resulting in a new cost basis for the security. Any remaining decline in fair value represents the non-credit portion of the other-than-temporary impairment, which is recognized in other comprehensive income (loss). The discount rate used to calculate the estimated present value of the cash flows expected to be collected is the effective interest rate implicit for the security at the date of purchase.

When assessing whether it intends to sell a fixed maturity or if it is likely to be required to sell a fixed maturity before recovery of its amortized cost, the Company evaluates facts and circumstances including, but not limited to, decisions to reposition the investment portfolio, potential sales of investments to meet cash flow needs and potential sales of investments to capitalize on favorable pricing. Additional information on the methodology and significant inputs, by security type, that the Company used to determine the amount of credit loss recognized on fixed maturities with declines in fair value below amortized cost that were considered to be other-than-temporary is provided below.

Residential mortgage-backed securities. For U.S. mortgage-backed securities, credit impairment is assessed by estimating future cash flows from the underlying mortgage loans and interest payments. The cash flow estimate incorporates actual cash flows from the mortgage-backed securities through the current period and then projects the remaining cash flows using a number of assumptions, including prepayment rates, default rates, recovery rates on foreclosed properties and loss severity assumptions. Management develops specific assumptions using market data and internal estimates, as well as estimates from rating agencies and other third party sources. Default rates are estimated by considering current underlying mortgage loan performance and expectations of future performance. Estimates of future cash flows are discounted to present value. If the present value of expected cash flows is less than the amortized cost, the Company recognizes the estimated credit loss in net income.

Corporate bonds. For corporate bonds, credit impairment is assessed by evaluating the underlying issuer. As part of this assessment, the Company analyzes various factors, including the following:

- fundamentals of the issuer, including current and projected earnings, current liquidity position and ability to raise capital;
- fundamentals of the industry in which the issuer operates;
- expectations of defaults and recovery rates;
- changes in ratings by the rating agencies;
- other relevant market considerations; and
- receipt of interest payments

Default probabilities and recovery rates from rating agencies are key factors used in calculating the credit loss. Additional research of the industry and issuer is completed to determine if there is any current information that may affect the fixed maturity or its issuer in a negative manner and require an adjustment to the cash flow assumptions.

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c) The amortized cost and estimated fair value of fixed maturities at June 30, 2010 are shown below by contractual maturity and investment type.

(dollars in thousands)	Amortized Cost	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government agencies:		
Due in one year or less	$ 49,226	$ 50,035
Due after one year through five years	168,755	183,807
Due after five years through ten years	116,366	125,973
Due after ten years	4,018	4,245
Total	338,365	364,060
Obligations of states, municipalities and political subdivisions:		
Due in one year or less	0	0
Due after one year through five years	59,847	61,910
Due after five years through ten years	658,717	689,762
Due after ten years	1,457,446	1,504,683
Total	2,176,010	2,256,355
Foreign governments:		
Due in one year or less	7,634	7,716
Due after one year through five years	172,131	180,668
Due after five years through ten years	285,105	304,228
Due after ten years	0	0
Total	464,870	492,612
Residential mortgage-backed securities:		
Due in one year or less	1,484	1,507
Due after one year through five years	10,312	10,758
Due after five years through ten years	38,282	39,487
Due after ten years	368,665	389,433
Total	418,743	441,185