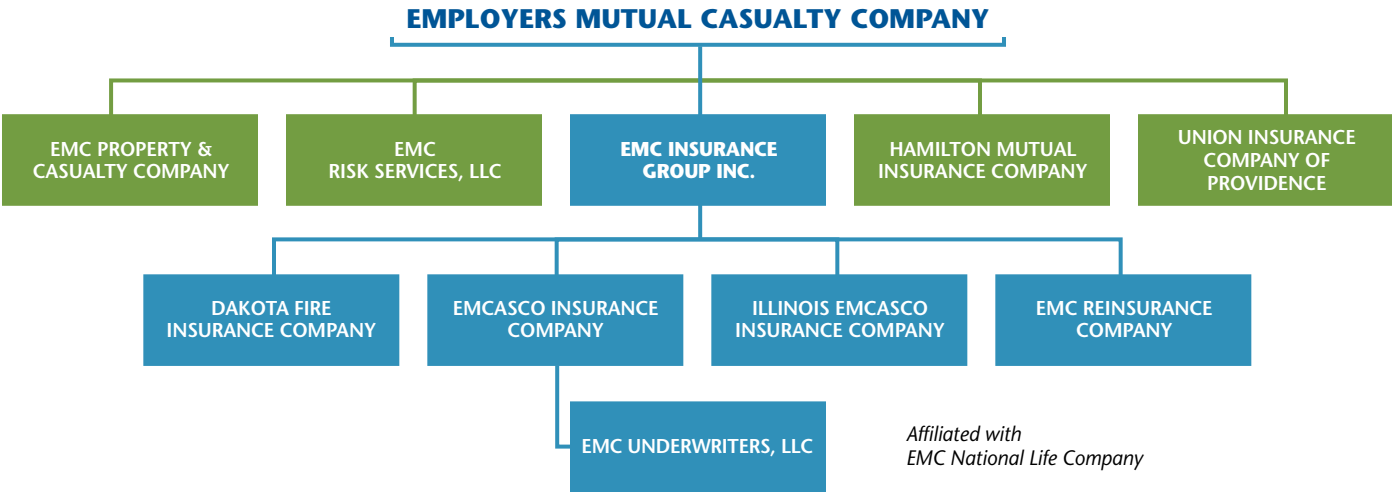


A N N U A L
R E P O R T

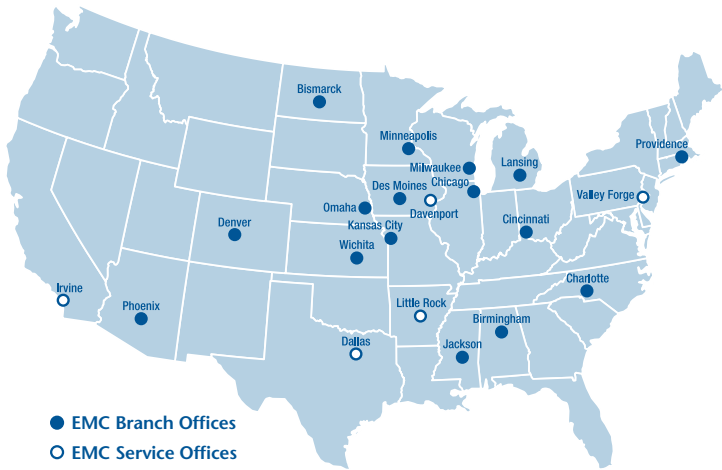
2009

STRONG FOUNDATION

S O L I D R E S U L T S



EMC Offices



EMC Insurance Group Inc. (EMCI) is a publicly held insurance holding company with operations in property and casualty insurance and reinsurance. EMCI was formed in 1974 and became publicly held in 1982. The Company’s common stock trades on the NASDAQ OMX Global Select Market tier of the NASDAQ OMX Stock Market under the symbol EMCI. EMCI is a controlled company in that its parent owns greater than 50 percent of its outstanding stock. As of December 31,

2009, EMCI’s parent company, Employers Mutual Casualty Company, owned 60 percent of EMCI’s outstanding stock and public stockholders owned 40 percent. EMCI has no employees of its own.

Employers Mutual Casualty Company (EMCC) is a mutual insurance company founded in 1911 and is headquartered in Des Moines, Iowa. EMCC employs more than 2,100 people countrywide and markets its products exclusively through a network of independent insurance agents. EMCI and EMCC, together with each entity’s subsidiary and affiliated companies, operate collectively under the trade name EMC Insurance Companies.

EMC Insurance Companies (EMC) focuses on the sale of property and casualty insurance primarily to small and midsize businesses. Products and services are offered through independent insurance agents who are supported by a network of 16 local branch offices. EMC is licensed in all 50 states and the District of Columbia and actively markets insurance products in 41 states; however, the majority of its business is generated in the Midwest.

FINANCIAL HIGHLIGHTS

FOR THE YEAR	(\$ in thousands, except per share data)		
	2009	2008	% CHANGE
Revenues	\$ 432,525	\$ 438,348	(1.3) %
Realized Investment Gains	\$ 17,922	\$ (24,456)	173.3 %
Income (Loss) Before Income Taxes	\$ 62,525	\$ (10,290)	707.6 %
Net Income (Loss)	\$ 45,371	\$ (1,705)	2,761.1 %
PER SHARE			
	2009	2008	% CHANGE
Net Income (Loss)	\$ 3.44	\$ (0.13)	2,746.2 %
Catastrophe and Storm Losses	\$ 1.55	\$ 2.44	(36.5) %
Dividends Paid	\$ 0.72	\$ 0.72	0.0 %
Book Value Per Share	\$ 26.11	\$ 21.32	22.5 %
MARKET PRICE			
	2009	2008	% CHANGE
High	\$ 25.17	\$ 31.65	(20.5) %
Low	\$ 18.01	\$ 16.36	10.1 %
Close on Dec. 31	\$ 21.51	\$ 25.65	(16.1) %
AT YEAR-END			
	2009	2008	% CHANGE
Average Return On Equity (ROE)	14.5%	(0.5)%	3,000.0 %
Total Assets	\$1,165,788	\$1,108,099	5.2 %
Stockholders’ Equity	\$ 342,418	\$ 282,916	21.0 %
Price to Book Value	0.82x	1.20x	(31.7) %
Number of Shares Outstanding	13,114,481	13,267,668	(1.2) %
Number of Registered Stockholders	976	994	(1.8) %
Number of Independent Insurance Agencies	2,110	2,140	(1.4) %

CAUTIONARY STATEMENT: The Private Securities Litigation Reform Act of 1995 provides issuers the opportunity to make cautionary statements regarding forward-looking statements. Accordingly, any forward-looking statement contained in this report is based on management’s current beliefs, assumptions and expectations of the Company’s future performance, taking into account all information currently available to management. These beliefs, assumptions and expectations can change as the result of many possible events or factors, not all of which are known to management. If a change occurs, the Company’s business, financial condition, liquidity, results of operations, plans and objectives may vary materially from those expressed in the forward-looking statements. The risks and uncertainties that may affect the actual results of the Company include, but are not limited to, the following:

- catastrophic events and the occurrence of significant severe weather conditions;
- the adequacy of loss and settlement expense reserves;

- state and federal legislation and regulations;
- changes in the property and casualty insurance industry, interest rates or the performance of financial markets and the general economy;
- rating agency actions;
- “other-than-temporary” investment impairment losses; and
- other risks and uncertainties inherent to the Company’s business, including those discussed under the heading “Risk Factors” in the Company’s Annual Report on Form 10-K.

Management intends to identify forward-looking statements when using the words “believe”, “expect”, “anticipate”, “estimate”, “project” or similar expressions. Undue reliance should not be placed on these forward-looking statements.

CORPORATE PROFILE



Ronald W. Jean, Bruce G. Kelley and William A. Murray

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STRONG FOUNDATION
SOLID RESULTS

2009 proved to be just that. Operating income for the year was \$2.55 per share, net income was \$3.44 per share and our GAAP combined ratio was 100.2. We closed the year with significant increases in total assets, invested assets, stockholders’ equity, book value and average return on equity—by all accounts, a successful year of solid results built on a strong financial foundation.

Even with these positive results, however, the year was not without its challenges. Fortunately, our strategic plan, based on a long-term approach to business decisions, gave us a framework for overcoming these challenges.

Underwriting Challenges

We entered the year expecting rates to begin to firm due to significant catastrophe and storm losses and the deterioration of the financial markets in 2008. However, for a variety of reasons, including a very mild hurricane season and a general strengthening in the capital base of the industry in 2009, that did not occur. Rates, for the most part, remained very competitive, especially in commercial lines of business. Since approximately 86 percent of the Company’s property and casualty insurance segment premiums written comes from commercial lines of business, the competitive nature of the industry has had a limiting effect on our premium growth.

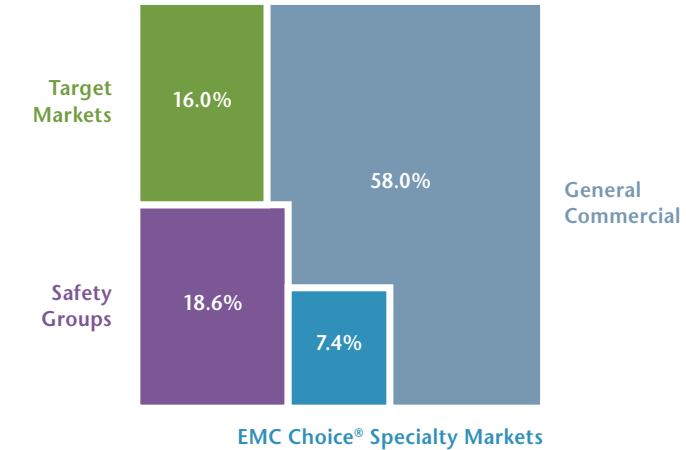
Therefore, our challenge on the underwriting side of the business is to market our products so that during competitive periods we retain our best book of business and find

opportunities to write additional profitable accounts. We continue to meet that challenge by maintaining our branch office system and strengthening our agency relationships.

We currently have 16 branch offices strategically located throughout the United States operating on a largely decentralized basis. Each branch has its own underwriting, claims, risk improvement and marketing departments. This local presence gives the Company a better understanding of the marketing opportunities in each branch territory. Accordingly, each branch is able to react quickly to pricing opportunities that present themselves. This strategy ultimately results in retaining our best accounts and opportunities to review and write new accounts. In 2009, our retention rate of 86 percent again exceeded industry averages. New business increased 13 percent and accounted for 13 percent of our net written premiums.

Our branch structure is important to our strategic plan, but equally important is the development of agency relationships. As part of our ongoing strategic plan, we have stratified our agency force according to production and profitability. Approximately 14 percent of our agency force resides in our top two tiers: Premier and Leading Agents. In 2009, this group produced 47 percent of our written premiums. Our action plan includes the development of comprehensive business plans for many of these agencies, as well as aggressive agency performance evaluations of all our agencies. And, as part of our growth initiative, we appointed an additional 150 new agencies, each with a track record of writing profitable business and each strategically located for expansion. It is our belief that this attention to our agents’ success will result in profitable growth for us as well. We also continued our ongoing efforts to make it easier for our agents to conduct business with us by updating our website and further expanding our technological capabilities.

Commercial Lines Business



EMC Choice® Specialty Markets are designed for specific industries, offering unique coverages tailored to better protect business operations.

Safety Groups are similar accounts that share a specific coverage form and are organized for the promotion of safety and loss control. Premiums and losses are combined for the entire safety group, and an annual dividend is paid for profitable group loss experience.

Target Markets are a specific product marketed by a particular branch office to solicit a certain class of business in a territory. Operations can benefit from enhanced protection with special coverage forms written specifically for the target market.

We continue to expand our business for Safety Groups, Target Markets, EMC Choice® Specialty Markets and EMC Choice® Businessowners, which produced approximately 44 percent of our new business in 2009. These programs currently comprise approximately 42 percent of our

TO OUR STOCKHOLDERS

commercial lines written premium. These niche markets are designed for certain classes of business that need specific coverages and share similar safety and loss control concerns. These programs for schools, municipalities, petroleum marketers, equipment dealers, auto services operations and other specialty groups continue to be a consistent source of profitability for us and provide effective and affordable protection for group members. Personal lines of business comprise approximately 14 percent of the Company's property and casualty segment. Though a small portion of our overall business, these lines do create diversity in premium volume and remain an important part of our business marketing mix.

Our challenge for personal lines is to effectively balance economies of scale with the creation of business opportunities. During an extensive review of the Company's personal lines of business and the branches' potential for profit, we determined that some personal lines marketing strategies needed to be enhanced in select states. Revitalizing personal lines coverage was integral to this growth strategy; hence, we introduced the EMC Choice® Homeowners program, which significantly increased new personal lines premiums in 2009 in the targeted states. The same review identified smaller personal lines marketing programs that offered only limited long-term growth and profit potential, which created a disproportionately high cost of conducting personal lines business in some states. The decision was made to withdraw from those marketing programs that could not benefit from economies of scale and direct our attention to those marketing programs that could.

The Company's reinsurance segment boasted a combined ratio of 87.5 percent in 2009, benefiting from reduced storm and hurricane activity and favorable development on prior accident years' reserves, as well as increased premiums of 3.1 percent. Though this segment was a major profit center in 2009, challenges remain. Our challenge for the reinsurance segment is to increase its premium volume with the intent of further diversifying our overall book of business. We are meeting that challenge by emphasizing international business as a continuing focus of the segment's marketing strategy.

Catastrophe and storm losses were again greater than average, but not nearly as devastating as our 2008 losses. Our challenge is to effectively diversify our risk exposures. We do that by managing our exposures in coastal regions, assessing excessive risk exposures in concentrated regions and diversifying lines of business. An additional challenge is the processing of claims after a catastrophic event. We meet this challenge by distributing the claims processing throughout our branch network. Our claims system allows the branch offices to share data and check the status of all claims so they can assist other branch offices with heavier-than-normal workloads and keep claims moving forward quickly, thereby facilitating the claims process as effectively and timely as possible.

Investment Challenges

Our challenge on the investment side of the business was the continued turmoil in the financial markets during 2009. The financial markets struggled in the first half of 2009, but began to recover in the latter half of the year, which benefited the market value of our investment portfolio. Our total invested assets increased 8.3 percent for the year. Net investment income, however, declined by 1.3 percent

for the year. Our philosophy is to take our risks on the underwriting side of our business rather than the investment side; therefore, 86.1 percent of our \$1.0 billion of invested assets are fixed maturity securities and 98.9 percent of those fixed maturity securities are investment grade. In 2009, the annualized yield on our bond portfolio and cash was 5.27 percent. The total rate of return on our equity portfolio was 21.8 percent.

Planning for Success

Yes, 2009 was a successful and profitable year, despite a competitive market, numerous storms and continued volatility in the financial markets. However, we do not strategize for a single successful year, we strategize for a profitable future. We build our success on a strong foundation of financial security, and the result is the creation of solid results and stockholder value—today and tomorrow.

Thank you for your continued interest in EMC Insurance Group Inc.

Bruce G. Kelley

Bruce G. Kelley
J.D., CPCU, CLU
President
& Chief Executive Officer

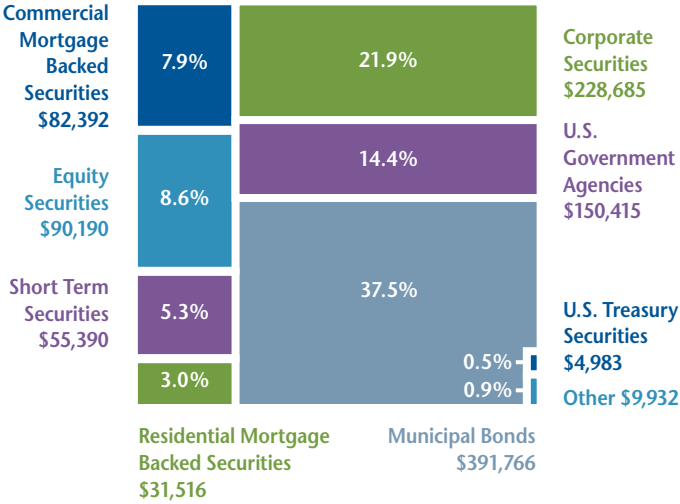
William A. Murray

William A. Murray
CIC, AU
Executive Vice President
& Chief Operating Officer

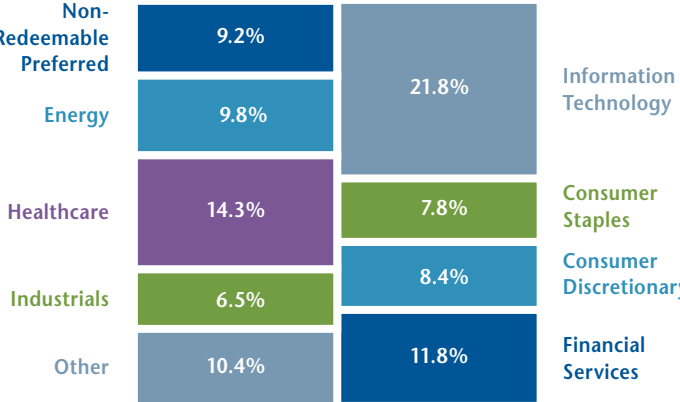
Ronald W. Jean

Ronald W. Jean
FCAS, MAAA
Executive Vice President
for Corporate Development

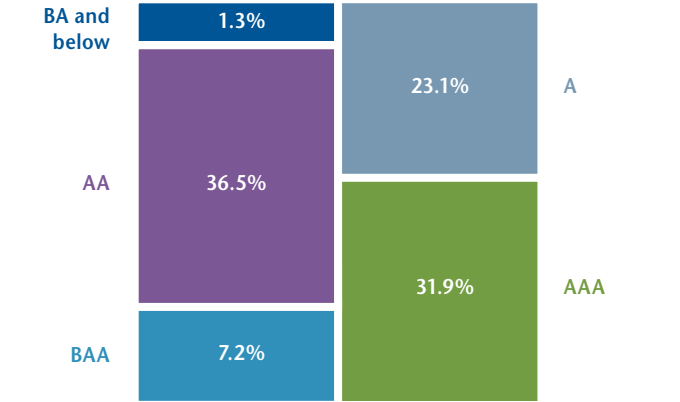
Total Investment Portfolio (\$ in thousands)



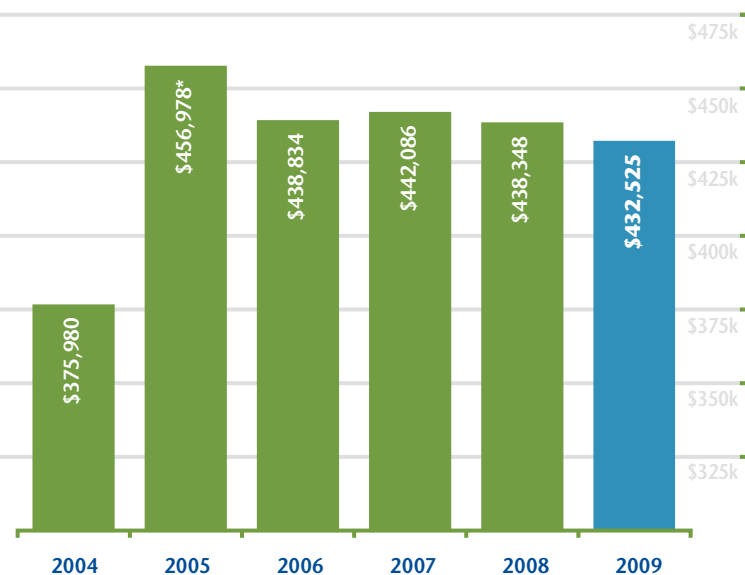
Equity Portfolio



Bond Quality

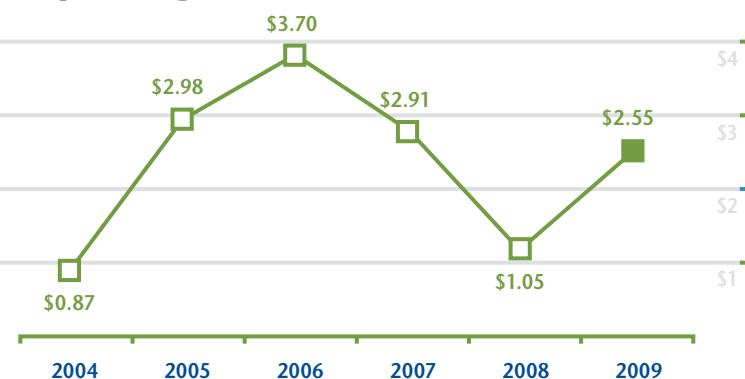


Revenues (\$ in thousands)

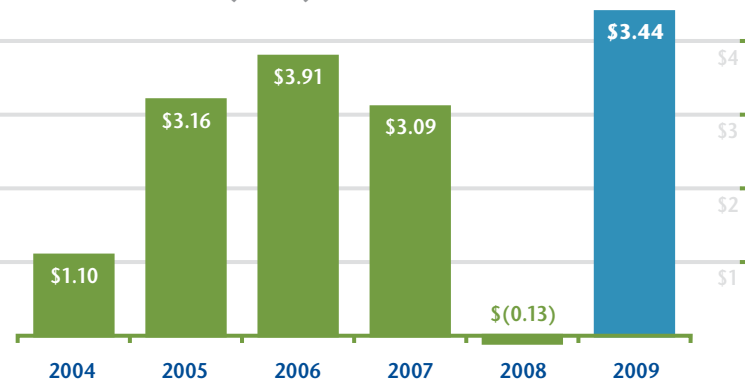


* Change in pool participation effective 1/1/2005

Operating Income Per Share



Net Income (Loss) Per Share



Total Revenues

Total revenues for the year were \$432.5 million, a decline of 2.0 percent, which is attributed to a 1.4 percent decline in premiums earned and a 1.3 percent decline in net investment income.

Operating Income

Operating income for the year was \$33.7 million, or \$2.55 per share. This is significantly greater than the 2008 operating income of \$14.2 million, or \$1.05 per share. Operating income was impacted by a significant reduction in catastrophe and storm losses as compared to the record storm losses in 2008, an increase in the amount of favorable development experienced on prior years' reserves and a 4.1 percent decline in premium rate levels implemented in 2008.

Net Income

The Company reported net income of \$45.4 million, or \$3.44 per share. This is significantly greater than the 2008 net loss of \$1.7 million, or \$0.13 per share. The 2009 improvement in net income is attributed to a record amount of catastrophe and storm losses in 2008, a record amount of "other-than-temporary" investment impairment losses recognized in 2008 as a result of the financial crisis, a \$22.5 million realized investment gain recognized in 2009 from the sale of the Company's holdings of Verisk Analytics, Inc. common stock and an improved underwriting performance by the Company's reinsurance subsidiary in 2009.

Catastrophe and Storm Losses

Catastrophe and storm losses totaled \$31.5 million, or \$1.55 per share, and contributed 8.2 points to the combined ratio in 2009, mostly due to a high frequency of storms in the Midwest; however, many of the 2009 storms were not large enough to trigger reinsurance recoveries. Catastrophe and storm losses for the period between 2000 and 2007 averaged 6.5 points of the combined ratio. Catastrophe and storm losses for 2008 accounted for 13.5 points—the most devastating storm season in the Company's history.

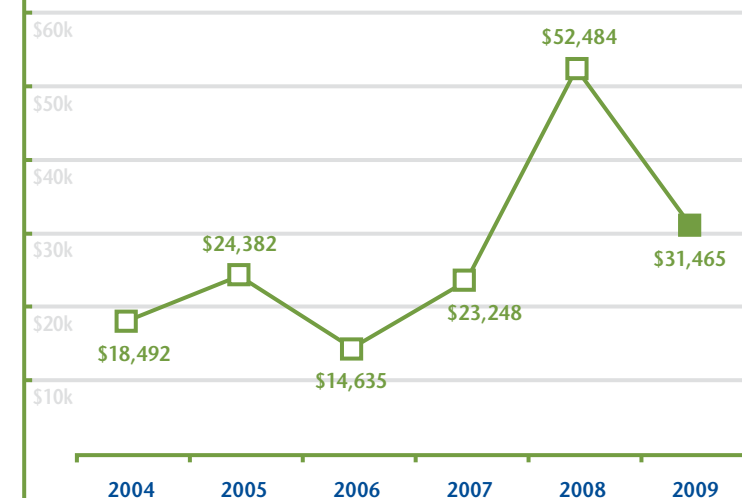
Net Premiums Written

Net premiums written for the year totaled \$388.7 million, an increase of 0.5 percent. In the property and casualty insurance segment, net premiums written remained flat for the year (0.1 percent decrease), reflecting a 2.0 percent decrease in the commercial lines of business and a 12.1 percent increase in the personal lines of business. In the reinsurance segment, net premiums written increased 3.1 percent primarily due to a moderate increase in rate levels and the addition of a few new accounts.

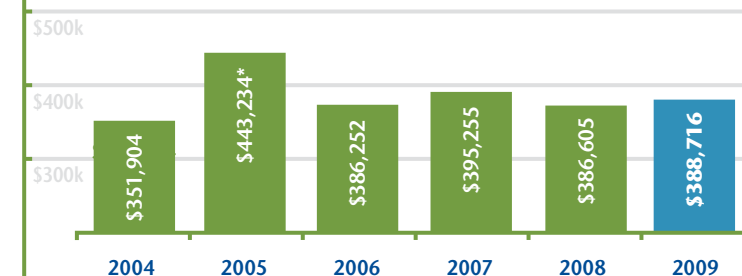
Investment Income

Net investment income was \$47.8 million in 2009, a decline of 1.3 percent from 2008. Net investment income for 2009 was negatively impacted by a high level of call activity on the Company's U.S. government agency securities during 2009 as a result of the declining interest rate environment, a decline in yield on short-term investments and the elimination of dividends on the perpetual preferred stocks of Freddie Mac and Fannie Mae held by the Company.

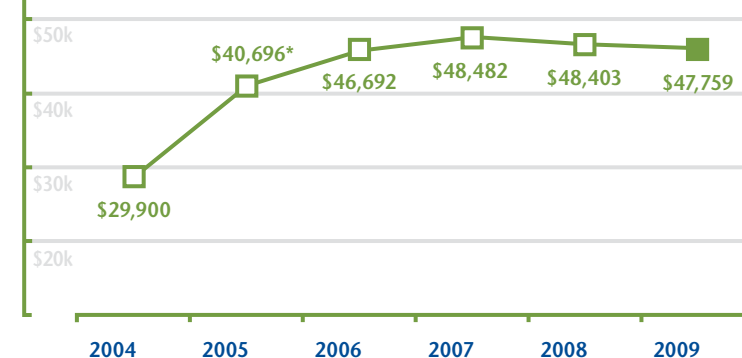
Catastrophe and Storm Losses (\$ in thousands)



Net Written Premiums (\$ in thousands)



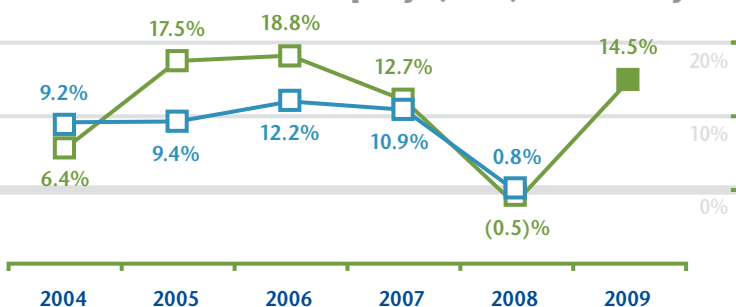
Investment Income (\$ in thousands)



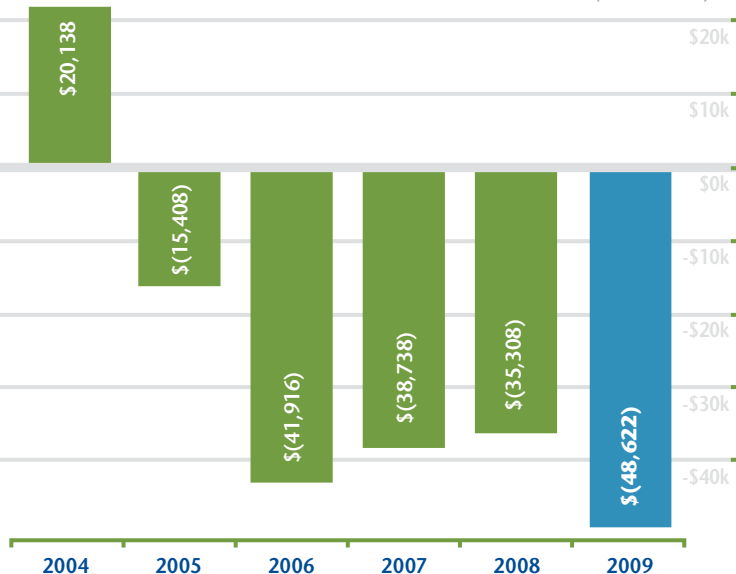
* Change in pool participation effective 1/1/2005

YEAR IN REVIEW

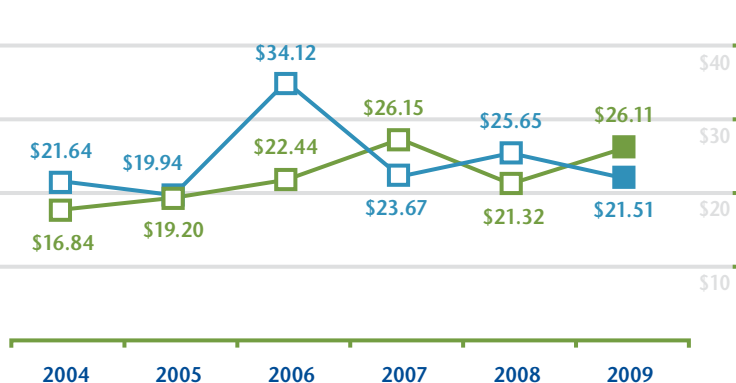
■ GAAP Return on Equity (ROE) – EMCI
■ GAAP Return on Equity (ROE) – Industry



Reserve Development – (Favorable) Adverse
(\$ in thousands)



■ Book Value Per Share
■ Stock Price Per Share



Net Realized Investment Gains

Net realized investment gains totaled \$17.9 million in 2009. This amount reflects a \$22.5 million realized gain on the sale of Verisk Analytics, Inc. common stock and \$10.1 million of “other-than-temporary” investment impairment losses recognized on 34 equity securities and three fixed maturity securities.

Reserve Development

The Company experienced \$48.6 million of favorable reserve development in 2009, compared to \$35.3 million in 2008. The amount for 2009 includes \$4.2 million (\$0.21 per share after tax) of favorable reserve development that occurred in the fourth quarter in the reinsurance subsidiary as a result of a reduction in the bulk IBNR reserve and the winding down of the MAERP Reinsurance Association (formerly known as Mutual Atomic Energy Reinsurance Pool). Also included is \$3.5 million (\$0.17 per share after tax) of favorable development on prior years’ catastrophe and storm loss reserves. In 2008, favorable development on prior years’ catastrophe and storm loss reserves totaled \$1.7 million (\$0.08 per share after tax).

Book Value Per Share

Book value as of December 31, 2009, was \$26.11 per share, an increase of 22.5 percent from \$21.32 per share at December 31, 2008. This significant increase is attributed to improved underwriting results, an increase in the amount of favorable development experienced on prior years’ reserves and a significant increase in the market value of the Company’s investment portfolio in 2009.

Sale of Verisk Analytics, Inc. Holdings

The Company sold 100 percent of its investment in Verisk Analytics, Inc. common stock in connection with that company’s IPO on October 7, 2009. As a result of this sale, the Company recorded an after-tax realized investment gain of \$14.6 million, or \$1.11 per share. The decision to sell these shares was made primarily to reduce the potential volatility of the Company’s equity portfolio; however, there were also some tax considerations involved in the decision.

BOARD OF DIRECTORS CHANGES

Steven A. Crane was elected a Director in 2009. Mr. Crane is an independent corporate governance consultant with over 30 years of experience in the property and casualty insurance business. Mr. Crane was Chief Executive Officer of AlphaStar Insurance Group Limited from 1999 to 2004. Prior to that, he served as Chief Executive Officer of Gryphon Holdings Inc. and G.L. Hodson & Son. Prior to those positions, Mr. Crane was Chief Financial Officer of Corroon & Black Corporation and Orion Capital Corporation. Mr. Crane is also a member of the Board of Directors of First Security Benefit Life Insurance and Annuity Company of New York, WNC Holding Corp. and Green Bullion Financial Services, LLC.

David J. Fisher retired in 2009 after 24 years as an EMC Insurance Group Inc. Board member. Mr. Fisher has been Chairman of the Board and Chief Executive Officer of Onthank Company, a Des Moines-based wholesale distributor of floor, window, wall covering and countertop products, since 1978 and has been employed by that firm since 1962. Mr. Fisher was instrumental in leading our Board through the challenges of implementing the processes and procedures necessary to comply with the reporting requirements of the Sarbanes Oxley Act of 2002.

EMC INSURANCE COMPANIES OPERATIONS

The financial strength of the Company, EMC Insurance Group Inc. (EMCI), is, in part, a result of the financial strength of its parent organization, Employers Mutual Casualty Company (EMCC), which owns more than 50 percent of EMCI stock. EMCI, EMCC and their affiliate and subsidiary companies offer the same insurance products and services. All companies share the same management, employees, facilities and business functions, such as marketing, claims, risk improvement and underwriting. Collectively, the organization uses the trade name EMC Insurance Companies (EMC).

The following pages of this report summarize the 2009 accomplishments of the EMC Insurance Companies organization. Because EMCI’s business is directly linked to EMC, this information is relevant to EMCI stockholders.

EMC Insurance Group Inc.’s mission is to create stockholder value through customer satisfaction and employee commitment to excellence, and directly complements the mission of the parent organization, EMC Insurance Companies.

The mission of EMC Insurance Companies is to grow profitably through partnership with independent insurance agents and to enhance the ability of our partners to deliver quality financial protection to the people and businesses we mutually serve.



**STABLE AND SECURE, EMC STANDS TOUGH
AGAINST ALL OF LIFE'S CHALLENGES.
OUR LONG-STANDING RELATIONSHIPS,
QUALITY PRODUCTS AND SUPERIOR SERVICE
KEEP OUR FOUNDATION STRONG.**

LAYING THE GROUNDWORK FOR SOLID RESULTS

Ninety-nine years ago, EMC Insurance Companies was organized to provide workers' compensation insurance to Iowa businesses. Our founders foresaw that commercial insurance would be the best kind of business on which to base the company—they couldn't have been more right. Today, more than 85 percent of EMC's business is in commercial lines for businesses big and small, counties, cities, schools and more.

From the Ground Up: Group Programs

EMC is known for insurance coverage for special niche markets; in fact, 36 percent of our total commercial book is made up of group business. We offer these products for certain classes of business that need specific coverages and share similar safety and loss control concerns. EMC provides insurance protection for schools, fire departments, municipal utilities and water districts, counties and municipalities, petroleum marketers and other specialty groups.

About 20 percent of our new business in 2009 came from group programs—a solid niche market for EMC that continues to grow. We build on this growth by expanding into other branch territories, extending and revising the coverages, and improving the group-specific loss control services available exclusively from EMC. In 2009, group programs increased 2.7 percent in written premium over 2008, exceeding our overall corporate growth objective.

Building on the Base: EMC Choice® Products

EMC made the strategic decision to expand into broader small and midsize business coverage, developing the EMC Choice family of products in 2005. Enhanced in 2008, the EMC Choice Businessowners products offer competitively priced coverages for more than 340 classes of business, from retail and convenience stores to offices, and from motels to self-storage facilities.

Knowing that different businesses have different risks and distinctive needs, EMC developed an auto services program in 2009 as part of the EMC Choice family. Our EMC Choice specialty market programs are designed for specific industries with coverages that suit their business operations. In 2009, EMC Choice specialty markets grew 7.9 percent over the prior year, contributing significantly to EMC's new business growth.

Currently, about 20 percent of EMC's total commercial business is comprised of EMC Choice business. Net written premium for businessowners accounts increased 7.6 percent over the prior year, exceeding our overall corporate growth goal. EMC Choice products contributed about one-fourth of the new commercial lines business written in 2009.

A New Framework: Personal Lines

More than five years ago, EMC began a careful analysis of the company's personal lines business and its potential for profit. Executive management determined the company needed to stimulate marketing efforts in select states and withdraw from personal lines business in others. Revitalizing personal lines coverage was integral to this growth strategy; as a result, the EMC Choice® Homeowners program was introduced in 2008. Once again, our long-range strategic decisions are paying off today, with a more than 50 percent increase in new personal lines premiums in those select states compared to 2008.

LAYING THE GROUNDWORK



**A Structure That Works:
Local Branch Offices**

From the beginning, EMC made the choice to serve agents and policyholders through local branch offices, and we stand by that decision. Today, we have a network of 21 branch and service offices located throughout the country. Our branch office network gives us the advantage of being close to our customers and the agility to respond to the area’s market needs and business climate. The employees in our local offices are able to respond quickly to their customers’ underwriting, claims, marketing and loss control servicing needs.

Six branch offices have profitable growth and development projects underway. Based on their existing strengths and books of business, these branches are building on identified areas of opportunity for growth in their territories.

**Structural Flexibility:
Regional Expansion**

We are flexible within our branch office network and can adapt as needed to optimize our growth potential. For example, to better serve our agents, we established the western marketing region in 2008 to coordinate efforts of the Bismarck, Denver and Phoenix Branch offices with large, multistate agency groups. The branch office management teams of this region meet frequently to develop and execute plans to facilitate business in the western United States.

EMC is developing more new business in Idaho, Oregon, Utah, Northern California and Nevada. This expansion into the northwest United States is easily accomplished through our branch office structure. To assist with this expansion, we recently realigned branch office marketing territories with marketing representatives located in Montana, Idaho and Oregon.

**Successful Partners:
Independent Agents**

EMC Insurance Companies is represented through local independent insurance agents and is committed to the independent agency system. We believe independent agents bring a superior level of personalized service to insurance customers. To demonstrate our commitment to independent agents, EMC supports the Trusted Choice® consumer brand initiative.



Because our company’s success is directly tied to the success of our agents, our branch offices conduct joint planning with many of their Premier and Leading Partner agencies, which represent the company’s most successful agencies. Although those agencies represent about 14 percent of EMC’s agency force, they produced over 38 percent of the company’s new business volume in 2009. A new initiative that began in 2009 to build on our agency relations emphasizes the importance of using key marketing best practices, not only to attract top-quality business from our best agencies, but to identify and develop business from under-performing agencies with profitable growth potential.

EMC continues to seek out and appoint only top-quality agents with a track record of writing profitable business and the ability to place a substantial amount of business with EMC. More than 150 new agencies joined EMC Insurance Companies in 2009. Many of these appointments were made by the branch offices in the western region that are working to expand within their territories.



Agents Prefer Super-Regionals Like EMC

A 2009 survey of insurance agents across the country showed agents prefer to work with super-regional carriers in nearly every attribute: pricing, service to the customer, service to the agent and marketing support.

EMC has the advantage of being a super-regional carrier that has the desired reach, capacity and financial strength. We’re a near-national company that is stable and large enough to meet our agents’ product needs, yet small enough to provide face-to-face customer service.

EMC Insurance Companies has been on the near-national property/casualty carrier list every year since it was first published by the Insurance Journal in 2007.

Sources: “Taking Care of Business” Insurance Journal, July 6, 2009;
“How Independent Agents View Carriers: The Super Regionals” Insurance Journal, July 20, 2009

Stability in the Marketplace

We are a reliable and stable company in the markets we serve, with remarkable longevity. Most of our branch offices were established before 1970.

1911	Des Moines	1962	Kansas City
1934	Wichita	1966	Jackson
1937	Chicago	1968	Providence
1939	Omaha	1973	Bismarck
1940	Lansing	1975	Charlotte
1942	Minneapolis	1981	Denver
1956	Milwaukee	1982	Birmingham
1958	Phoenix	1997	Cincinnati



**BUILT ON STRENGTH AND SUCCESS, EMC PROVIDES
COMPREHENSIVE PROTECTION, SUPERIOR SERVICE
AND FINANCIAL SECURITY TO POLICYHOLDERS,
AGENTS AND EMPLOYEES WHO HAVE COME TO
COUNT ON EMC® NOW AND FOR THE FUTURE.**

BUILDING THE FUTURE ON A STRONG FOUNDATION

Policyholders, agents and employees want a company they can count on, and EMC delivers. *Count on EMC®* defines the level of service and satisfaction our customers can expect from our company. In addition to providing the insurance products our customers need, we continually strive to improve safety, service claims as quickly and fairly as possible, and make our online services a true benefit for agents and policyholders. *Count on EMC.* It's our promise. It represents the way we do business, and it's the foundation on which we've built our company.

Expanding Capabilities: Technology Advancements

EMC has established itself as a leader in shaping online technology for the insurance industry. Not only are we at the forefront of the real-time/download revolution, but we constantly add new online services and enhance existing services for our agents and policyholders. Our innovative technology is helping build a strong future by making it easier for our customers to do business with us in almost every way.

Design and Function: emcins.com

"We use our agency website to market the resources of Van Wyk Corporation, but we depend on our carriers' sites to help us service that business. The new EMC website will be of tremendous value in responding to our customers' needs."

Go to emcins.com and you'll see what I mean:

- *The clean look of the homepage makes it simple to quickly locate the information you need*
- *The choice of soothing colors makes this site easy on your eyes*
- *Go from page to page and you'll soon realize how effortlessly you can navigate through the new site*

From design to functionality, EMC has done an outstanding job of streamlining every aspect of the website, which streamlines our agency's ability to serve our EMC policyholders."

– MAX VAN WYK
Chief Executive Officer
Van Wyk Corporation
Grand Rapids, Michigan

New Website and Same Great Tools for Agents

Near the end of 2009, we revamped our website, emcins.com, introducing vibrant colors and incorporating more appealing, user-friendly features. The new site pulls together online capabilities, provides easy navigation and delivers a wealth of information. Customers and agents alike have complimented our new website; we encourage you to take a look at emcins.com.

More Online Services for Agents

Agent Access, a secure area of emcins.com, offers a streamlined process designed for agents to get quick and easy quotes for new business. The option of

BUILDING FOR THE FUTURE



Ease and Efficiency: emcins.com

“I can tell you, as insurance websites go, yours is one of the nicest I have ever had the pleasure to work with. You’ve definitely got a winner here. From an administrative point of view, it is awesome. Very easy to figure out, even when I logged in the first time. Everything was very logical, clearly accessible, and it made sense!”

– ROSANNA I. KRENN
Web Portal & Online Administration
Henderson Brothers, Inc.
Pittsburgh, Pennsylvania

“What impresses us most about the new EMC site is its maneuverability. It’s easy for us to get to the information we need: marketing manuals, policy snapshots complete with endorsements and forms, and loss control information.”

– AMY W. SMITH
CPCU, CIC, AU
Vice President
Ross & Yerger Insurance, Inc.
Jackson, Mississippi

adding umbrella coverage when quoting a businessowners policy online was added in 2009. Three new lines of business (property, general liability and inland marine) are being added to commercial online quote in 2010. Then, agents will be able to quote a complete commercial package online that can include property, general liability, inland marine, businessowners, business auto, business umbrella and workers’ compensation.* Agents can complete and submit applications electronically, plus create professional client proposals including agency contact information.

In 2009, EMC gave agents the ability to report business auto claims online, just as they can for personal auto, motorcycle, dwelling and homeowners claims. It’s a convenient, cost-effective option through Agent Access. To submit a claim, agents need only basic information, which is transferred directly to EMC’s claim system.

More Online Convenience for Policyholders

Our website features all the online capabilities for policyholders on the homepage for quick access. Personal lines customers can easily log in to Policyholder Access, where they can securely view policy information, pay bills, find their agent’s contact information, print duplicate auto ID cards and more. Policyholders can also report home, personal auto, motorcycle and dwelling claims online any time,* or they have the option of calling a toll-free number, their agent or an EMC branch office.

*Availability varies by state and agency

Our Technology Wins Awards

EMC Insurance Companies received two technology awards from industry groups during the year. The 2009 Interface Partner Award was given to EMC in recognition of the company’s leadership, innovations and commitment to providing insurance agents with download, real-time inquiry and real-time rating. “The continued commitment of EMC and other forward-thinking carriers keeps our industry advancing,” said Doug Johnston, vice president, Partner Relations & Product Innovations, at Applied Systems. “We recognize the company’s dedication to interface partnerships with its agencies, and for overall benefit to the industry.”

The 2009 Real Time Breakthrough Award was presented to EMC by Applied Systems, citing the company’s use of technology to step outside the status quo, while going above and beyond in providing ASCnet (Applied’s user group) members with improved workflows.

A Blueprint for Safety: Loss Control Services

EMC offers our commercial policyholders valuable loss control services, usually free of charge, and has done so for more than 80 years. We spend nearly twice as much on these services than most of our competitors, proving our commitment to our customers and their safety. To provide local, face-to-face assistance, we employ highly trained loss control representatives in each branch office, backed by experts in the Home Office. We also give business customers access to a wealth of loss control information, resources and tools through our website. Each year, we find new ways to meet the needs of our policyholders by building on our strong foundation of loss control services.

Online Safety Training

Introduced in 2009, EMC’s online training modules cover a variety of topics such as preventing slips and falls, forklift basics and defensive driving. The self-directed modules are delivered in short segments and can be viewed on demand, allowing employers to train workers when it’s most convenient. EMC provides unlimited use of these training modules at no cost to our commercial policyholders. Plus, employers can use the online training management system to easily register workers, assign modules and track completion. EMC’s online training modules are increasing in popularity—online visits nearly doubled in the fourth quarter compared to the first quarter of 2009.

Online Resources and Tools

The safety tools and resources section on emcins.com offers safety signs and posters, disaster planning tools, safe driver awards, ergonomic tools and more to businesses and organizations. EMC adds information and resources to the site as needed. For example, when the H1N1 flu virus began spreading across the country, EMC posted a special H1N1 resource page that included official website links, informational guides and documents, and flu prevention signage.

H1N1 Resources Impress EMC Agency

Even the absence of one employee at the Esten and Richard Insurance Agency in Woonsocket, R.I., can make a big difference, so the spread of the H1N1 virus was a concern for Agency Manager Barbara Kirby. After seeing a message about H1N1 flu resources on EMC’s website, she jumped at the chance to read more. “EMC is the only insurance company that I have seen be so proactive in this area,” she said. “I was quite impressed with the wealth of information available all in one spot.”



EPA Recognizes EMC’s Services for Schools

The U.S. Environmental Protection Agency’s Schools Chemical Cleanout Campaign (SC3) honored EMC Insurance Companies in 2009 for the company’s dedication and efforts to protect students and teachers.

“By engaging in SC3 projects and promoting responsible chemical management in K-12 schools, EMC has demonstrated its commitment to create safer environments in which students can learn and develop into the leaders of tomorrow. EMC’s example is also helping to make responsible chemical management attainable in every school across the nation.”

– MATT HALE
Director, Office of Resource Conservation and Recovery
U.S. Environmental Protection Agency

Industry Services

EMC insures thousands of schools and local governments across the country, so we developed a special video presentation for those industries to explain the variety of services we offer. *Keeping Schools Safe* focuses on how to improve safety for buildings, food service, bus drivers and passengers, and students and staff, while *Keeping Local Governments Safe* covers areas such as facility, worker and public safety.

EMC continually develops loss control services and provides helpful loss control tips for specific industries. For example, our two chemical management awareness programs for schools provide chemical management awareness training for school staff, on-site assessments and assistance with Environmental Protection Agency (EPA) compliance. To date, the programs have reached more than 380 schools, identified over 338,000 pounds of materials for removal and trained more than 3,400 school staff.*

Our Fundamental Purpose:
Claim Services

EMC’s claim services rest on a solid reserving philosophy and clearly defined and consistent claim practices. Local claim representatives and adjusters at each branch strive to handle every claim as fairly and quickly as possible, regardless of the type or size.

Accuracy in Estimating Reserves

EMC developed a new data analysis program in 2009. This program quickly sorts and summarizes data extracted from EMC’s claim reporting system by specific categories and lines of business, allowing claim managers to view the data in multiple ways. This new system significantly speeds up claims analysis and brings more accuracy to claim reserving.

*Data through Feb. 1, 2010

As a property/casualty insurance company, our ability to properly estimate losses is imperative. EMC’s claims staff has a proven and commendable record of making accurate estimates of ultimate losses within a relatively short time after major events. The following chart shows estimated losses carried on company books six months after the event as a percent of the actual losses.

EMC was close in estimating reserves for the five major storm events that occurred over the past five years. For each event, the estimated losses carried on the company books six months after the event are within four percentage points (plus or minus) of being 100 percent accurate. For example, six months after Hurricane Rita, EMC had set aside enough in reserves to cover 98.5 percent of the total EMC losses from the hurricane.

MAJOR STORM EVENT	6-MONTH ESTIMATE % VARIANCE FROM ACTUAL LOSS
Hurricane Rita (2005)	-1.5%
Hurricane Katrina (2005)	-1.6%
Greensburg, Kansas Tornado (2007)	+3.3%
Hurricane Ike (2008)	-3.9%
Parkersburg, Iowa Tornado (2008)	+4.0%

Shared Claim Processing

EMC makes the best use of our claims staff and uses our claim reporting system to its highest potential. When widespread storms generated a large numbers of claims, we met the challenge by distributing the claims processing throughout our branch network. Our claim reporting system allows the branch offices to share data and check the status of all claims so they can assist other branch offices with heavier-than-normal workloads and keep claims moving forward quickly. This is one significant reason EMC can stand behind its claim philosophy, so policyholders receive payment of covered claims in the most timely manner possible.

Kansas School Learns Meaning of Count on EMC®

Excerpt from a Nov. 23, 2009, letter received by EMC Insurance Companies

“I want everyone at EMC to know how much I appreciate the work you did to help us recover from the school fire on March 10, 2007, and the work leading to the construction of Nemaha Valley Elementary and Middle School. Our students are now in the beautiful new building and are enjoying the surroundings.

Through the entire time period, I found every person I worked with at EMC very professional and helpful. What could have been a complex maze of insurance laws and regulations was made understandable for us by the EMC staff. While any organization who has suffered such a significant loss hopes for easy answers, I came to appreciate that EMC was providing everything possible under our policy.

I have gained a new appreciation for the insurance business after going through this claim. Thanks for your work on behalf of Nemaha Valley Schools.”

– BRIAN HARRIS
Superintendent of Schools
Nemaha Valley Schools
Seneca, Kansas



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**EMCI Board's designated
financial expert*

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Kelley, Robert L. Howe, Richard W. Hoffmann (Corporate Secretary)*

2009

FINANCIAL INFORMATION



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SELECTED FINANCIAL DATA.

	Year ended December 31,										
	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
	(\$ in thousands, except per share amounts)										
INCOME STATEMENT DATA											
Insurance premiums											
earned	\$ 384,011	\$ 389,318	\$ 393,059	\$ 391,615	\$ 415,625	\$ 345,478	\$ 330,623	\$ 297,043	\$ 265,280	\$ 231,459	\$ 211,098
Investment income, net	47,759	48,403	48,482	46,692	40,696	29,900	29,702	32,778	30,970	29,006	25,761
Realized investment											
gains (losses)	17,922	(24,456)	3,724	4,252	3,834	4,379	1,170	(3,159)	800	1,558	277
Other income	756	627	545	527	657	602	862	866	774	1,473	2,194
Total revenues	450,448	413,892	445,810	443,086	460,812	380,359	362,357	327,528	297,824	263,496	239,330
Losses and expenses	387,923	424,182	386,891	366,721	400,702	364,788	334,375	305,636	303,366	262,431	245,321
Income (loss) before											
income tax expense (benefit) ...	62,525	(10,290)	58,919	76,365	60,110	15,571	27,982	21,892	(5,542)	1,065	(5,991)
Income tax expense (benefit)	17,154	(8,585)	16,441	22,818	17,101	2,386	7,633	5,790	(3,436)	(1,264)	(5,187)
Net income (loss)	<u>\$ 45,371</u>	<u>\$ (1,705)</u>	<u>\$ 42,478</u>	<u>\$ 53,547</u>	<u>\$ 43,009</u>	<u>\$ 13,185</u>	<u>\$ 20,349</u>	<u>\$ 16,102</u>	<u>\$ (2,106)</u>	<u>\$ 2,329</u>	<u>\$ (804)</u>
Net income (loss)											
per common share											
- basic and diluted:	<u>\$ 3.44</u>	<u>\$ (0.13)</u>	<u>\$ 3.09</u>	<u>\$ 3.91</u>	<u>\$ 3.16</u>	<u>\$ 1.10</u>	<u>\$ 1.78</u>	<u>\$ 1.42</u>	<u>\$ (0.19)</u>	<u>\$ 0.21</u>	<u>\$ (0.07)</u>
Premiums earned by segment:											
Property and casualty											
insurance	\$ 308,079	\$ 315,598	\$ 320,836	\$ 318,416	\$ 321,165	\$ 250,034	\$ 241,237	\$ 225,013	\$ 203,393	\$ 184,986	\$ 167,265
Reinsurance	75,932	73,720	72,223	73,199	94,460	95,444	89,386	72,030	61,887	46,473	43,833
Total	<u>\$ 384,011</u>	<u>\$ 389,318</u>	<u>\$ 393,059</u>	<u>\$ 391,615</u>	<u>\$ 415,625</u>	<u>\$ 345,478</u>	<u>\$ 330,623</u>	<u>\$ 297,043</u>	<u>\$ 265,280</u>	<u>\$ 231,459</u>	<u>\$ 211,098</u>
BALANCE SHEET DATA											
Total assets	<u>\$ 1,165,788</u>	<u>\$ 1,108,099</u>	<u>\$ 1,202,713</u>	<u>\$ 1,206,159</u>	<u>\$ 1,113,682</u>	<u>\$ 934,816</u>	<u>\$ 905,571</u>	<u>\$ 674,864</u>	<u>\$ 671,565</u>	<u>\$ 587,676</u>	<u>\$ 542,395</u>
Stockholders' equity	<u>\$ 342,418</u>	<u>\$ 282,916</u>	<u>\$ 360,352</u>	<u>\$ 308,294</u>	<u>\$ 261,883</u>	<u>\$ 228,473</u>	<u>\$ 180,751</u>	<u>\$ 157,768</u>	<u>\$ 140,458</u>	<u>\$ 148,393</u>	<u>\$ 141,916</u>

	Year ended December 31,										
	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
	(\$ in thousands, except per share amounts)										
OTHER DATA											
Average return on equity	14.5%	(0.5)%	12.7%	18.8%	17.5%	6.4%	12.0%	10.8%	(1.5)%	1.6%	(0.5)%
Book value per share	\$ 26.11	\$ 21.32	\$ 26.15	\$ 22.44	\$ 19.20	\$ 16.84	\$ 15.72	\$ 13.84	\$ 12.40	\$ 13.14	\$ 12.60
Dividends paid per share	\$ 0.72	\$ 0.72	\$ 0.69	\$ 0.65	\$ 0.61	\$ 0.60	\$ 0.60	\$ 0.60	\$ 0.60	\$ 0.60	\$ 0.60
Property and casualty insurance subsidiaries aggregate pool percentage	30.0%	30.0%	30.0%	30.0%	30.0%	23.5%	23.5%	23.5%	23.5%	23.5%	23.5%
Reinsurance subsidiary quota share percentage	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Closing stock price	\$ 21.51	\$ 25.65	\$ 23.67	\$ 34.12	\$ 19.94	\$ 21.64	\$ 21.14	\$ 17.87	\$ 17.15	\$ 11.75	\$ 9.13
Net investment yield (pre-tax)	4.87%	5.00%	5.02%	5.02%	4.97%	4.33%	4.81%	5.92%	6.31%	6.47%	5.96%
Cash dividends to closing stock price	3.3%	2.8%	2.9%	1.9%	3.1%	2.8%	2.8%	3.4%	3.5%	5.1%	6.6%
Common shares outstanding	13,114	13,268	13,778	13,742	13,643	13,569	11,501	11,399	11,330	11,294	11,265
Statutory trade combined ratio ...	100.3%	109.1%	96.8%	92.8%	94.7%	104.2%	99.8%	101.3%	112.4%	113.5%	115.2%

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The term "Company" is used below interchangeably to describe EMC Insurance Group Inc. (Parent Company only) and EMC Insurance Group Inc. and its subsidiaries. The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements included under Part II, Item 8 of this Form 10-K.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides issuers the opportunity to make cautionary statements regarding forward-looking statements. Accordingly, any forward-looking statement contained in this report is based on management's current beliefs, assumptions and expectations of the Company's future performance, taking all information currently available into account. These beliefs, assumptions and expectations can change as the result of many possible events or factors, not all of which are known to management. If a change occurs, the Company's business, financial condition, liquidity, results of operations, plans and objectives may vary materially from those expressed in the forward-looking statements. The risks and uncertainties that may affect the actual results of the Company include, but are not limited to, the following:

- catastrophic events and the occurrence of significant severe weather conditions;
- the adequacy of loss and settlement expense reserves;
- state and federal legislation and regulations;
- changes in the property and casualty insurance industry, interest rates or the performance of financial markets and the general economy;
- rating agency actions;
- "other-than-temporary" investment impairment losses; and
- other risks and uncertainties inherent to the Company's business, including those discussed under the heading "Risk Factors" in Part I, Item 1A, of this Form 10-K.

Management intends to identify forward-looking statements when using the words "believe", "expect", "anticipate", "estimate", "project" or similar expressions. Undue reliance should not be placed on these forward-looking statements.

COMPANY OVERVIEW

The Company, a 60 percent owned subsidiary of Employers Mutual Casualty Company (Employers Mutual), is an insurance holding company with operations in property and casualty insurance and reinsurance.

Property and casualty insurance operations are conducted through three subsidiaries and represent the most significant segment of the Company's business, totaling approximately 80 percent of consolidated premiums earned in 2009. The Company's three property and casualty insurance subsidiaries and two subsidiaries and an affiliate of Employers Mutual are parties to reinsurance pooling agreements with Employers Mutual (collectively the "pooling agreement"). Under the terms of the pooling agreement, each company cedes to Employers Mutual all of its insurance business, with the exception of any voluntary reinsurance business assumed from nonaffiliated insurance companies, and assumes from Employers Mutual an amount equal to its participation in the pool. All premiums, losses, settlement expenses, and other underwriting and administrative expenses, excluding the voluntary reinsurance business assumed by Employers Mutual from nonaffiliated insurance companies, are prorated among the parties on the basis of participation in the pool. Employers Mutual negotiates reinsurance agreements that provide protection to the pool and each of its participants, including protection against losses arising from catastrophic events. The aggregate participation of the Company's property and casualty insurance subsidiaries is 30 percent.

Operations of the pool give rise to inter-company balances with Employers Mutual, which are settled on a quarterly basis. The investment and income tax activities of the pool participants are not subject to the pooling agreement. The pooling agreement provides that Employers Mutual will make up any shortfall or difference resulting from an error in its systems and/or computation processes that would otherwise result in the required restatement of the pool participants' financial statements.

The purpose of the pooling agreement is to spread the risk of an exposure insured by any of the pool participants among all the companies. The pooling agreement produces a more uniform and stable underwriting result from year to year for all companies in the pool than might be experienced individually. In addition, each company benefits from the capacity of the entire pool, rather than being limited to policy exposures of a size commensurate with its own assets, and from the wide range of policy forms, lines of insurance written, rate filings and commission plans offered by each of the seven companies.

Reinsurance operations are conducted through EMC Reinsurance Company, and represented approximately 20 percent of consolidated premiums earned in 2009. The Company's reinsurance subsidiary is a party to a quota share reinsurance retrocessional agreement with Employers Mutual (the "quota share agreement"). Under the terms of the quota share agreement, the reinsurance subsidiary assumes a 100 percent quota share portion of Employers Mutual's assumed reinsurance business, exclusive of certain reinsurance contracts. This includes all premiums and related losses, settlement expenses, and other underwriting and administrative expenses of this business, subject to a maximum loss of \$2,000,000 per event. The cost of the \$2,000,000 cap on losses assumed per event, which is treated as a reduction to premiums written, is 10.5 percent. The reinsurance subsidiary does not directly reinsure any of the insurance business written by Employers Mutual or the other pool participants; however, the reinsurance subsidiary assumes reinsurance business from the Mutual Reinsurance Bureau (MRB) pool and this pool provides a small amount of reinsurance protection to the EMC Insurance Companies. As a result, the reinsurance subsidiary's assumed exposures include a small portion of the EMC Insurance Companies' direct business, after ceded reinsurance protections purchased by the MRB pool are applied. In addition, the reinsurance subsidiary does not reinsure any "involuntary" facility or pool business that Employers Mutual assumes pursuant to state law. The reinsurance subsidiary assumes all foreign currency exchange gain/loss associated with contracts incepting on January 1, 2006 and thereafter that are subject to the quota share agreement. Operations of the quota share agreement give rise to inter-company balances with Employers Mutual, which are settled on a quarterly basis. The investment and income tax activities of the reinsurance subsidiary are not subject to the quota share agreement.

Under the terms of the quota share agreement, the reinsurance subsidiary receives reinstatement premium income that is collected by Employers Mutual from the ceding companies when reinsurance coverage is reinstated after a loss event; however, the cap on losses assumed per event contained in the quota share agreement is automatically reinstated without cost. This arrangement can produce unusual underwriting results for the reinsurance subsidiary when a large loss event occurs because the reinstatement premium income received by the reinsurance subsidiary may approximate, or even exceed, the amount of losses retained.

Effective January 1, 2009, EMC Reinsurance Company began writing German assumed reinsurance business on a direct basis (outside the quota share agreement) as a result of regulatory changes in Germany.

Effective January 1, 2010, the terms of the quota share agreement were revised to increase the retention, or cap, on losses assumed per event from \$2,000,000 to \$3,000,000. The cost of this protection (10.5 percent of premiums written) remains unchanged.

INDUSTRY OVERVIEW

An insurance company's underwriting results reflect the profitability of its insurance operations, excluding investment income. Underwriting profit or loss is calculated by subtracting losses and expenses incurred from premiums earned.

Insurance companies collect cash in the form of insurance premiums and pay out cash in the form of loss and settlement expense payments. Additional cash outflows occur through the payment of acquisition and underwriting costs such as commissions, premium taxes, salaries and general overhead. During the loss settlement period, which varies by line of business and by the circumstances surrounding each claim and may cover several years, insurance companies invest the cash premiums; thereby earning interest and dividend income. This investment income supplements underwriting results and contributes to net earnings. Funds from called and matured fixed maturity securities are reinvested at current interest rates. The low interest rate environment that has existed during the last several years has had a negative impact on the insurance industry's investment income.

Insurance pricing has historically been cyclical in nature. Periods of excess capital and increased competition encourage price reductions and liberal underwriting practices (referred to as a soft market) as insurance companies compete for market share, while attempting to cover the inevitable underwriting losses from these actions with investment income. A prolonged soft market generally leads to a reduction in the adequacy of capital in the insurance industry. To cure this condition, underwriting practices are tightened, premium pricing increases and competition subsides as companies strive to strengthen their balance sheets (referred to as a hard market). The insurance industry is currently in the fifth year of a soft market; however, premium rates began to show some signs of stabilization during 2009. Management anticipates that overall industry pricing will remain relatively stable in 2010.

A substantial determinant of an insurance company's underwriting results is its loss and settlement expense reserving practices. Insurance companies must estimate the amount of losses and settlement expenses that will ultimately be paid to settle claims that have occurred to date (loss and settlement expense reserves). This estimation process is inherently subjective with the possibility of widely varying results, particularly for certain highly volatile types of claims (asbestos, environmental and various casualty exposures, such as products liability, where the loss amount and the parties responsible are difficult to determine). During a soft market, inadequate premium rates put pressure on insurance companies to under-estimate their loss and settlement expense reserves in order to report better results. Correspondingly, inadequate reserves play an integral part in bringing about a hard market, because increased profitability from higher premium rate levels can be used to strengthen inadequate reserves.

The United States Congress is currently studying, or has placed on its agenda, several issues of importance to the Company and the insurance industry. Most notably, these issues include Federal regulation of the insurance industry in addition to, or in place of, current state regulation, and legislation (referred to as the Insurance Industry Competition Act) that would amend the McCarran-Ferguson Act and permit the Federal Trade Commission and United States Department of Justice to enforce Federal antitrust laws and regulations on the insurance industry. The Company is closely monitoring the activity of the United States Congress on these issues through its membership in various organizations.

MANAGEMENT ISSUES AND PERSPECTIVES

Catastrophe and storm losses

The Company has historically reported catastrophe and storm losses net of development experienced on prior accident years' catastrophe and storm losses. This has not had a material impact on the reported amounts of catastrophe and storm losses because development associated with prior accident years' catastrophe and storm losses has historically been relatively small. During 2009, however, the Company experienced a larger amount of favorable development related to the record amount of catastrophe and storm losses incurred in 2008. As a result, the Company has changed its reporting of catastrophe and storm losses to include only current accident year events. Any material amount of development experienced on prior accident years' catastrophe and storm loss reserves is now reported separately. This change in reporting does not have any impact on the Company's results of operations; it only affects the reported amounts of catastrophe and storm losses.

Loss and settlement expense reserves

Liabilities for losses and settlement expenses are estimates at a given point in time of what an insurer expects to pay to settle claims, based on facts and circumstances then known. It can be expected that the insurer's ultimate liability for losses and settlement expenses may either exceed or be less than such estimates.

There is an inherent amount of uncertainty involved in the establishment of insurance liabilities. This uncertainty is greatest in the current and more recent accident years because a smaller percentage of the expected ultimate claims have been reported, adjusted and settled compared to more mature accident years. For this reason, carried reserves for these accident years reflect prudently conservative assumptions. As the carried reserves for these accident years run off, the overall expectation is that, more often than not, favorable development will occur. However, there is also the possibility that the ultimate settlement of liabilities associated with these accident years will show adverse development, and such adverse development could be substantial.

Care should be exercised when attempting to analyze the financial impact of the reported development amounts because, as noted above, the overall expectation is that, more often than not, favorable development will occur as the prior accident year reserves run off.

Midwest storm activity

During the past two years the Company has experienced above average levels of weather related losses. These losses were not the result of high concentrations of exposures in the affected areas, but rather reflect unusually active and severe weather patterns in the Midwest, where the Company writes the majority of its insurance business. Although the active Midwest weather patterns have resulted in increased loss frequency and severity during this period, management does not believe that this activity represents a permanent change in Midwest storm exposures.

MEASUREMENT OF RESULTS

The Company's consolidated financial statements are prepared on the basis of U.S. generally accepted accounting principles (also known as "GAAP"). The Company also prepares financial statements for each of its insurance subsidiaries based on statutory accounting principles that are filed with insurance regulatory authorities in the states where they do business. Statutory accounting principles are designed to address the concerns of state regulators and stress the measurement of the insurer's ability to satisfy its obligations to its policyholders and creditors.

Management evaluates the Company's operations by monitoring key measures of growth and profitability. Management measures the Company's growth by examining direct premiums written and, perhaps more importantly, premiums written assumed from affiliates. Management generally measures the Company's operating results by examining the Company's net income and return on equity as well as the loss and settlement expense, acquisition expense and combined ratios. The following provides further explanation of the key measures management uses to evaluate the Company's results:

Direct Premiums Written. Direct premiums written is the sum of the total policy premiums, net of cancellations, associated with policies underwritten and issued by the Company's property and casualty insurance subsidiaries. These direct premiums written are transferred to Employers Mutual under the terms of the pooling agreement and are reflected in the Company's consolidated financial statements as premiums written ceded to affiliates. See note 3 of Notes to Consolidated Financial Statements.

Premiums Written Assumed From Affiliates and Premiums Assumed Written From Nonaffiliates. For the property and casualty insurance segment, premiums written assumed from affiliates and nonaffiliates reflects the property and casualty insurance subsidiaries' aggregate 30 percent participation interest in 1) the total direct premiums written by all the participants in the pooling arrangement, and 2) the involuntary business assumed by the pool participants pursuant to state law, respectively. For the reinsurance segment, premiums written assumed from nonaffiliates reflects the business assumed by the reinsurance subsidiary through the quota share agreement and, beginning January 1, 2009, the German-based reinsurance business assumed outside the quota share agreement. See note 3 of Notes to Consolidated Financial Statements. Management uses premiums written assumed from affiliates and nonaffiliates, which excludes the impact of written premiums ceded to reinsurers, as a measure of the underlying growth of the Company's insurance business from period to period.

Net Premiums Written. Net premiums written is the sum of the premiums written assumed from affiliates plus premiums written assumed from nonaffiliates less premiums written ceded to nonaffiliates. Premiums written ceded to nonaffiliates is the portion of the Company's direct and assumed premiums written that is transferred to reinsurers in accordance with the terms of the underlying reinsurance contracts, based upon the risks they accept. See note 3 of Notes to Consolidated Financial Statements. Management uses net premiums written to measure the amount of business retained after cessions to reinsurers.

Loss and Settlement Expense Ratio. The loss and settlement expense ratio is the ratio (expressed as a percentage) of losses and settlement expenses incurred to premiums earned, and measures the underwriting profitability of a company's insurance business. The loss and settlement expense ratio is generally measured on both a gross (direct and assumed) and net (gross less ceded) basis. Management uses the gross loss and settlement expense ratio as a measure of the Company's overall underwriting profitability of the insurance business it writes and to assess the adequacy of the Company's pricing. The net loss and settlement expense ratio is meaningful in evaluating the Company's financial results, which are net of ceded reinsurance, as reflected in the consolidated financial statements. The loss and settlement expense ratios are generally calculated in the same way for GAAP and statutory accounting purposes.

Acquisition Expense Ratio. The acquisition expense ratio is the ratio (expressed as a percentage) of net acquisition and other expenses incurred to premiums earned, and measures a company's operational efficiency in producing, underwriting and administering its insurance business. For statutory accounting purposes, acquisition and other expenses of an insurance company exclude investment expenses. There is no such industry definition for determining an acquisition expense ratio for GAAP purposes. As a result, management applies the statutory definition to calculate the Company's acquisition expense ratio on a GAAP basis. The net acquisition expense ratio is meaningful in evaluating the Company's financial results, which are net of ceded reinsurance, as reflected in the consolidated financial statements.

GAAP Combined Ratio. The combined ratio (expressed as a percentage) is the sum of the loss and settlement expense ratio and the acquisition expense ratio, and measures a company's overall underwriting profit. If the combined ratio is at or above 100, an insurance company cannot be profitable without investment income (and may not be profitable if investment income is insufficient). Management uses the GAAP combined ratio in evaluating the Company's overall underwriting profitability and as a measure for comparison of the Company's profitability relative to the profitability of its competitors who prepare GAAP-basis financial statements.

Statutory Combined Ratio. The statutory combined ratio (expressed as a percentage) is calculated in the same manner as the GAAP combined ratio, but is based on results determined pursuant to statutory accounting rules and regulations. The statutory "trade combined ratio" differs from the statutory combined ratio in that the acquisition expense ratio is based on net premiums written rather than net premiums earned. Management uses the statutory trade combined ratio as a measure for comparison of the Company's profitability relative to the profitability of its competitors, all of whom must file statutory-basis financial statements with insurance regulatory authorities.

CRITICAL ACCOUNTING POLICIES

The following accounting policies are considered by management to be critically important in the preparation and understanding of the Company's financial statements and related disclosures. The assumptions utilized in the application of these accounting policies are complex and require subjective judgment.

Loss and settlement expense reserves

Processes and assumptions for establishing loss and settlement expense reserves

Liabilities for losses are based upon case-basis estimates of reported losses supplemented with bulk case loss reserves, and estimates of incurred but not reported (IBNR) losses. Case loss reserves are established independently of the IBNR loss reserves and the two amounts are added together to determine the total liability for losses. Under this methodology, adjustments to the individual case loss reserve estimates do not result in a corresponding adjustment in IBNR loss reserves. For direct insurance business, the Company's IBNR loss reserves are estimates of liability for events that have occurred, but have not yet been reported to the Company. For assumed reinsurance business, IBNR loss reserves are also used to record anticipated increases in reserves for claims that have previously been reported. An estimate of the expected expenses to be incurred in the settlement of the claims provided for in the loss reserves is established as the liability for settlement expenses.

Property and Casualty Insurance Segment

The Company's claims department establishes individual case loss reserves for direct business. Branch claims personnel establish case loss reserves for individual claims, with mandatory home office claims department review of reserves that exceed a specified threshold. The Company's case loss reserve philosophy is exposure based and implicitly assumes a consistent inflationary and legal environment. When claims department personnel establish case loss reserves, they take into account various factors that influence the potential exposure.

The Company has implemented specific line-of-business guidelines that are used to establish the individual case loss reserve estimates. These guidelines, which are used for both short-tail and long-tail claims, require the claims department personnel to reserve for the probable (most likely) exposure for each claim. Probable exposure is defined as what is likely to be awarded if the case were to be decided by a civil court in the applicable venue or, in the case of a workers' compensation case, by that state's workers' compensation commission. This evaluation process is repeated throughout the life of the claim at regular intervals, and as additional information becomes available. While performing these regular reviews, the branch claims personnel are able to make adjustments to the case loss reserves for location and time specific factors, such as legal venue, severity of claim, inflation, and changes in applicable laws.

To provide consistency in the reserving process, the Company utilizes established claims management processes and an automated claims system. Claims personnel conduct random case loss reserve reviews to verify the accuracy of the reserve estimates and adherence to the reserving guidelines. In addition, the Company has specific line-of-business management controls for case loss reserves. For example, all workers' compensation claim files are reviewed by management before declining benefits, and all casualty case loss reserves are reviewed every 60 days for reserve adequacy.

The Company's automated claims system utilizes an automatic diary process that helps ensure that case loss reserve estimates are reviewed on a regular basis. The claims system requires written documentation each time a case loss reserve is established or modified, and provides management with the information necessary to perform individual reserve reviews and monitor reserve development. In addition, the claims system produces monthly reports that allow management to analyze case loss reserve development in the aggregate, by branch, by line of business, or by claims adjuster.

The goal of the Company's claims department is to establish and maintain case loss reserves that are sufficient, but not excessive. Since specific guidelines are utilized for establishing case loss reserves, the Company does not incorporate a provision for uncertainty (either implicitly or explicitly) when setting individual case loss reserve estimates. The Company's actuaries do, however, review the adequacy of the aggregate case loss reserves on a quarterly basis and, if deemed appropriate, make recommendations for adjustments to management. Management reviews all recommendations submitted by the Company's actuaries and considers such recommendations in the determination of its best estimate of the Company's overall liability. Adjustments to the case loss reserves, when approved by management, are accomplished through the implementation of bulk case loss reserves in the applicable line(s) of business, which supplement the individual case loss reserves. For financial reporting purposes, bulk case loss reserves are included in case loss reserves.

At December 31, 2009, IBNR loss reserves accounted for \$73,755,000, or 18.0 percent, of the property and casualty insurance segment's total loss and settlement expense reserves, compared to \$80,463,000, or 18.8 percent, at December 31, 2008. IBNR loss reserves are, by nature, less precise than case loss reserves. A five percent change in IBNR loss reserves at December 31, 2009 would equate to \$2,397,000, net of tax, which represents 5.3 percent of the net income reported for 2009 and 0.7 percent of stockholders' equity.

The property and casualty insurance segment's formula IBNR loss reserves are established for each line of business by applying actuarially derived "IBNR factors" to the latest twelve months premiums earned. These factors are developed using a methodology that utilizes historical ratios of (1) actual IBNR claims that have emerged after prior year-ends to (2) corresponding prior years' premiums earned that have been adjusted to the current level of rate adequacy. In order to minimize the volatility that naturally exists in the early stages of IBNR claims emergence, IBNR claims are not utilized in this process until 18 months after the end of a respective calendar year. For example, during 2009 the actual IBNR claims reported in the 18 months following year-end 2007 were compared to the adjusted 2007 premiums earned. The 2007 ratios, together with the ratios for several prior years, were then used to develop the 2009 "IBNR factors" that were applied to premiums earned for each line of business. Included in the rate adequacy adjustment noted above is consideration of current frequency and severity trends compared to the trends underlying prior years' calculations. The selected trends are based on an analysis of industry and Company loss data.

The methodology used in estimating formula IBNR loss reserves assumes consistency in claims reporting patterns and immaterial changes in loss development patterns. Implicit in this assumption is that future IBNR claims emergence, relative to IBNR claims that have emerged following prior year-ends, will reflect the change in frequency and severity trends underlying the rate adequacy adjustments. If this projected relationship proves to be inaccurate, future IBNR claims may differ substantially from the estimated IBNR loss reserves. The following table displays the impact that a five percent variance in IBNR emergence from the projected level reflected in the December 31, 2009 IBNR factors would have on the Company's results of operations. This variance in IBNR emergence could occur in one year or over multiple years, depending when the claims were reported. A variance in IBNR emergence would also affect the Company's financial position in that the Company's equity would be impacted by an amount equivalent to the change in net income. A variance of this type would typically be recognized in loss and settlement expense reserves and, accordingly, would not have a material effect on liquidity because the claims have not been paid. A five percent variance in IBNR emergence is considered reasonably likely based on the range of actuarial indications developed during the analysis of the property and casualty insurance segment's carried reserves.

Line of business (\$ in thousands)	After-tax impact on earnings from a five percent variance in IBNR emergence from frequency and severity trends underlying rate adequacy adjustments
Personal auto liability	\$(80) to \$80
Commercial auto liability	(312) to 312
Auto physical damage	(34) to 34
Workers' compensation	(418) to 418
Other liability	(1,406) to 1,406
Property	(111) to 111
Homeowners	(37) to 37
All Other	(46) to 46

Ceded loss reserves are derived by applying the ceded contract terms to the direct loss reserves. For excess-of-loss contracts (excluding the catastrophe contract), this is accomplished by applying the ceded contract terms to the case loss reserves of the ceded claims. For the catastrophe excess-of-loss contract, ceded loss reserves are calculated by applying the contract terms to (1) the aggregate case loss reserves on claims stemming from catastrophes and (2) the estimate of IBNR loss reserves developed for each individual catastrophe. For quota share contracts, ceded loss reserves are calculated as the quota share percentage multiplied by both case and IBNR loss reserves on the direct business.

The methodology used for reserving settlement expenses is based on an analysis of historical ratios of paid expenses to paid losses. Assumptions underlying this methodology include stability in the mix of business, consistent claims processing procedures, immaterial impact of loss cost trends on development patterns, and a consistent philosophy regarding the defense of lawsuits. Based on this actuarial analysis, factors are derived for each line of business, which are then applied to loss reserves to generate the settlement expense reserves. The following table displays the impact on the Company's results of operations, for the latest ten accident years, of a one percent variance in the ratio of ultimate settlement expenses to ultimate losses due to departures from any of the above assumptions. This variance in the ultimate settlement expense ratio could occur in one year or over multiple years, depending on the loss and settlement expense payment patterns. A variance in the ultimate settlement expense ratio would also affect the Company's financial position in that the Company's equity would be impacted by an amount equivalent to the change in net income. A variance of this type would typically be recognized in loss and settlement expense reserves and, accordingly, would not have a material effect on liquidity because the expenses have not been paid. A one percent variance in the ratio of ultimate settlement expenses to ultimate losses is considered reasonably likely based on the range of actuarial indications developed during the analysis of the property and casualty insurance segment's carried reserves.

Line of business (\$ in thousands)	After-tax impact on earnings from a one percent variance in the ultimate settlement expense ratio
Personal auto liability	\$(47) to \$47
Commercial auto liability	(187) to 187
Auto physical damage	(29) to 29
Workers' compensation	(228) to 228
Other liability	(628) to 628
Property	(99) to 99
Homeowners	(70) to 70
All Other	(21) to 21

Following is a summary of the carried loss and settlement expense reserves for the property and casualty insurance segment at December 31, 2009 and 2008.

Line of business	December 31, 2009			
	Case	IBNR	Settlement expense	Total
	(\$ in thousands)			
Commercial lines:				
Automobile	\$ 45,386	\$ 9,575	\$ 10,313	\$ 65,274
Property	15,308	2,581	3,543	21,432
Workers' compensation	115,265	15,676	17,955	148,896
Liability	52,021	43,464	45,151	140,636
Bonds	3,352	(1,607)	626	2,371
Total commercial lines	231,332	69,689	77,588	378,609
Personal lines:				
Automobile	17,864	2,253	2,436	22,553
Property	6,073	1,813	1,417	9,303
Total personal lines	23,937	4,066	3,853	31,856
Total property and casualty insurance segment	\$ 255,269	\$ 73,755	\$ 81,441	\$ 410,465

	December 31, 2008			
<u>Line of business</u>	<u>Case</u>	<u>IBNR</u>	<u>Settlement expense</u>	<u>Total</u>
	(\$ in thousands)			
Commercial lines:				
Automobile	\$ 48,308	\$ 9,451	\$ 10,693	\$ 68,452
Property	18,432	4,228	3,430	26,090
Workers' compensation	115,072	16,189	17,458	148,719
Liability	56,496	44,866	46,469	147,831
Bonds	1,271	399	593	2,263
Total commercial lines	<u>239,579</u>	<u>75,133</u>	<u>78,643</u>	<u>393,355</u>
Personal lines:				
Automobile	18,578	2,435	2,433	23,446
Property	7,144	2,895	1,509	11,548
Total personal lines	<u>25,722</u>	<u>5,330</u>	<u>3,942</u>	<u>34,994</u>
Total property and casualty insurance segment	<u>\$ 265,301</u>	<u>\$ 80,463</u>	<u>\$ 82,585</u>	<u>\$ 428,349</u>

Internal actuarial evaluations of overall loss reserve levels are performed quarterly for all direct lines of business. There is a certain amount of random variation in loss development patterns, which results in some uncertainty regarding projected ultimate losses, particularly for longer-tail lines such as workers' compensation, other liability and commercial auto liability. Therefore, the reasonability of the actuarial projections is regularly monitored through an examination of loss ratio and claims severity trends implied by these projections. Following is a discussion of the major assumptions underlying the quarterly internal actuarial loss reserve evaluations.

One assumption underlying aggregate reserve estimation methods is that the claims inflation trends implicitly built into the historical loss and settlement expense development patterns will continue into the future. To estimate the sensitivity of the estimated ultimate loss and settlement expense payments to an unexpected change in inflationary trends, the actuarial department derived expected payment patterns separately for each major line of business. These patterns were applied to the December 31, 2009 loss and settlement expense reserves to generate estimated annual incremental loss and settlement expense payments for each subsequent calendar year. Then, for the purpose of sensitivity testing, an explicit annual inflationary variance of one percent was added to the inflationary trend that is implicitly embedded in the estimated payment pattern, and revised incremental loss and settlement expense payments were calculated. This unexpected claims inflation trend could arise from a variety of sources including a change in economic inflation, social inflation and, especially for the workers' compensation line of business, the introduction of new medical technologies and procedures, changes in the utilization of procedures and changes in life expectancy. The estimated cumulative impact that this unexpected one percent variance in the inflationary trend would have on the Company's results of operations over the lifetime of the underlying claims is shown below. A variance in the inflationary trend would also affect the Company's financial position in that the Company's equity would be impacted by an amount equivalent to the change in net income. A variance of this type would typically be recognized in loss and settlement expense reserves and, accordingly, would not have a material effect on liquidity because the claims have not been paid. A one percent variance in the projected inflationary trend is considered reasonably likely based on the range of actuarial indications developed during the analysis of the property and casualty insurance segment's carried reserves.

Line of business	After-tax impact on earnings from a one percent variance in the projected inflationary trend
(\$ in thousands)	
Personal auto liability	\$(170) to \$163
Commercial auto liability	(755) to 735
Auto physical damage	(16) to 16
Workers' compensation	(5,382) to 4,667
Other liability	(3,491) to 3,204
Property	(150) to 145
Homeowners	(47) to 47

A second assumption is that historical loss payment patterns have not changed. In other words, the percentage of ultimate losses that are not yet paid at any given stage of accident year development is consistent over time. The following table displays the impact on the Company's results of operations, for the latest ten accident years, of a five percent variance in unpaid losses to date from the percentages anticipated in the paid loss projection factors. That is, future loss payments under this scenario would be expected to differ from the original actuarial loss reserve estimates by these amounts. This variance in future loss payments could occur in one year or over multiple years. A variance in future loss payments would also affect the Company's financial position in that the Company's equity would be impacted by an amount equivalent to the change in net income. A variance of this type would typically be recognized in loss and settlement expense reserves and, accordingly, would not have a material effect on liquidity because the claims have not been paid. A five percent variance in projected future loss payments is considered reasonably likely based on the range of actuarial indications developed during the analysis of the property and casualty insurance segment's carried reserves.

Line of business	After-tax impact on earnings from a five percent variance in future loss payments
(\$ in thousands)	
Personal auto liability	\$(633) to \$573
Commercial auto liability	(1,810) to 1,636
Auto physical damage	(82) to 75
Workers' compensation	(3,441) to 3,112
Other liability	(3,173) to 2,871
Property	(567) to 514
Homeowners	(216) to 195
All Other	(108) to 99

A third assumption is that individual case loss reserve adequacy is consistent over time. The following table displays the impact on the Company's results of operations, for the latest ten accident years, of a five percent variance in individual case loss reserve adequacy from the level anticipated in the incurred loss projection factors. In other words, future loss payments under this scenario would be expected to vary from actuarial reserve estimates by these amounts. This variance in expected loss payments could occur in one year or over multiple years. A change in individual case loss reserve adequacy would also affect the Company's financial position in that the Company's equity would be impacted by an amount equivalent to the change in net income. A variance of this type would typically be recognized in loss and settlement expense reserves and, accordingly, would not have a material effect on liquidity because the claims have not been paid. A five percent variance in individual case loss reserve adequacy is considered reasonably likely based on the range of actuarial indications developed during the analysis of the property and casualty insurance segment's carried reserves.

Line of business	After-tax impact on earnings from a five percent variance in individual case loss reserve adequacy
(\$ in thousands)	
Personal auto liability	\$(606) to \$545
Commercial auto liability	(1,463) to 1,322
Auto physical damage	(65) to 60
Workers' compensation	(2,955) to 2,675
Other liability	(2,343) to 2,121
Property	(534) to 483
Homeowners	(183) to 167
All Other	(117) to 105

A fourth assumption is that IBNR emergence as a percentage of reported losses is historically consistent and will continue at the historical level. The following table displays the estimated impact on the Company's results of operations, for the latest ten accident years, of a five percent variance in IBNR losses from the level anticipated in the loss projection factors. Under this scenario, future loss payments would be expected to vary from actuarial reserve estimates by these amounts. This variance in IBNR emergence could occur in one year or over multiple years. A variance in IBNR emergence would also affect the Company's financial position in that the Company's equity would be impacted by an amount equivalent to the change in net income. A variance of this type would typically be recognized in loss and settlement expense reserves and, accordingly, would not have a material effect on liquidity because the claims have not been paid. A five percent variance in IBNR emergence is considered reasonably likely based on the range of actuarial indications developed during the analysis of the property and casualty insurance segment's carried reserves.

Line of business	After-tax impact on earnings from a five percent variance in IBNR emergence
(\$ in thousands)	
Personal auto liability	\$(52) to \$52
Commercial auto liability	(257) to 257
Auto physical damage	(12) to 12
Workers' compensation	(384) to 384
Other liability	(1,289) to 1,289
Property	(63) to 63
Homeowners	(29) to 29

An actuarial evaluation of the prior quarter's case and bulk case loss reserve adequacy is performed each quarter. If that analysis indicates that the aggregate reserves of the individual claim files established by the claims department combined with the carried bulk case loss reserve (if any) is not within a few percentage points of a benchmark established by the actuarial department, the actuarial department will recommend that an adjustment be made to the current quarter's bulk case loss reserve. Management reviews all recommendations submitted by the actuarial department and considers such recommendations in the determination of its best estimate of the Company's overall liability.

One of the variables impacting the estimation of IBNR loss reserves is the assumption that the vast majority of future construction defect losses will continue to occur in those states in which most construction defect claims have historically arisen. Since the vast majority of these losses have been confined to a relatively small number of states, which is consistent with industry experience, there is no provision in the IBNR loss reserve for a significant spread of construction defect claims to other states. It is also assumed that various underwriting initiatives implemented in recent years will gradually mitigate the amount of construction defect losses experienced. These initiatives include exclusionary endorsements, increased care regarding additional insured endorsements, a general reduction in the amount of contractor business written relative to the total commercial lines book of business, and underwriting restrictions on the writing of residential contractors. The estimation of the Company's IBNR loss reserves also does not contemplate substantial losses from potential mass torts such as Methyl Tertiary Butyl Ether (a gasoline additive that reduces emissions, but causes pollution), tobacco, silicosis, cell phones and lead. Further, consistent with general industry practice, the IBNR loss reserve for all liability lines does not provide for any significant retroactive expansion of coverage through judicial interpretation. If these assumptions prove to be incorrect, ultimate paid amounts on emerged IBNR claims may differ substantially from the carried IBNR loss reserves.

As previously noted, the estimation of settlement expense reserves assumes a consistent claims department philosophy regarding the defense of lawsuits. If the pool participants should in the future take a more aggressive defense posture, defense costs would increase and it is likely that the Company's carried settlement expense reserves would be deficient. However, such a change in philosophy would likely reduce losses, generating some offsetting redundancy in the loss reserves.

The property and casualty insurance subsidiaries have exposure to environmental and asbestos claims arising primarily from the other liability line of business. This exposure is closely monitored by management, and the IBNR loss reserves have been established to cover estimated ultimate losses. Currently, asbestos reserves are based on the results of an independent consultant's ground-up study of the pool participants' asbestos exposures that was completed in 2006. These reserves were increased in 2008 and again in 2009 based on examinations of the implied three-year survival ratio (ratio of loss reserves to the three-year average of loss payments). Environmental reserves are established in consideration of the implied three-year survival ratio. Estimation of ultimate liabilities for these exposures is unusually difficult due to unresolved issues such as whether coverage exists, the definition of an occurrence, the determination of ultimate damages and the allocation of such damages to financially responsible parties. Therefore, any estimation of these liabilities is subject to greater than normal variation and uncertainty, and ultimate payments for losses and settlement expenses for these exposures may differ significantly from the carried reserves.

Reinsurance Segment

The reinsurance book of business is comprised of two major components. The first is the Home Office Reinsurance Assumed Department ("HORAD"), which is the reinsurance business that is underwritten by Employers Mutual. The second is the MRB pool, which is a voluntary reinsurance pool in which Employers Mutual participates with four other unaffiliated insurers.

The primary actuarial methods used to project ultimate policy year losses on the assumed reinsurance business are paid development, incurred development and Bornhuetter-Ferguson. The assumptions underlying the various projection methods include stability in the mix of business, consistent claims processing procedures, immaterial impact of loss cost trends on development patterns, consistent case loss reserving practices and appropriate Bornhuetter-Ferguson expected loss ratio selections.

For the HORAD component, Employers Mutual records the case and IBNR loss reserves reported by the ceding companies. Since many ceding companies in the HORAD book of business do not report IBNR loss reserves, Employers Mutual establishes a bulk IBNR loss reserve, which is based on an actuarial reserve analysis, to cover the lag in reporting. For MRB, Employers Mutual records the case and IBNR loss reserves reported to it by the management of the pool, along with a relatively small IBNR loss reserve to cover a one month reporting lag. To verify the adequacy of the reported reserves, an actuarial evaluation of MRB's reserves is performed at each year-end.

At December 31, 2009, the carried reserves for HORAD and MRB combined were in the upper quartile of the range of actuarial reserve indications. This selection reflects the fact that there are inherent uncertainties involved in establishing reserves for assumed reinsurance business. Such uncertainties reflect the fact a reinsurance company generally has less knowledge than the ceding company about the underlying book of business and the ceding company's reserving practices. Because of these uncertainties, there is a risk that the reinsurance segment's reserves for losses and settlement expenses could prove to be inadequate, with a consequent adverse impact on the Company's future earnings and stockholders' equity.

At December 31, 2009, there was no backlog in the processing of assumed reinsurance information. Approximately \$79,374,000, or 55 percent, of the reinsurance segment's carried reserves were reported by the ceding companies. Employers Mutual receives loss reserve and paid loss data from its ceding companies on individual excess-of-loss business. If a claim involves a single or small group of claimants, a summary of the loss and claim outlook is normally provided. Summarized data is provided for catastrophe claims and pro rata business, which is subject to closer review if inconsistencies are suspected.

Carried reserves established in addition to those reported by the ceding companies totaled approximately \$66,313,000 at December 31, 2009. Since many ceding companies in the HORAD book of business do not report IBNR loss reserves, Employers Mutual establishes a bulk IBNR loss reserve to cover the lag in reporting. For the few ceding companies that do report IBNR loss reserves, Employers Mutual carries them as reported. These reported IBNR loss reserves are subtracted from the total IBNR loss reserve calculated by Employers Mutual's actuaries, with the difference carried as bulk IBNR loss reserves. Except for the small IBNR loss reserve established to cover the one-month lag in reporting, the MRB IBNR loss reserve is established by the management of MRB. Employers Mutual rarely records additional case loss reserves.

Assumed reinsurance losses tend to be reported later than direct losses. This lag is reflected in loss projection factors for assumed reinsurance that tend to be higher than for direct business. The result is that assumed reinsurance IBNR loss reserves as a percentage of total reserves tend to be higher than for direct loss reserves. IBNR loss reserves totaled \$88,795,000 and \$86,780,000 at December 31, 2009 and 2008, respectively, and accounted for approximately 61 percent and 60 percent, respectively, of the reinsurance segment's total loss and settlement expense reserves. IBNR loss reserves are, by nature, less precise than case loss reserves. A five percent change in IBNR loss reserves at December 31, 2009 would equate to \$2,886,000 net of tax, which represents 6.4 percent of the net income reported for 2009 and 0.8 percent of stockholders' equity.

Following is a summary of the carried loss and settlement expense reserves for the reinsurance segment at December 31, 2009 and 2008.

	December 31, 2009			
Line of business	Case	IBNR	Settlement expense	Total
	(\$ in thousands)			
Pro rata reinsurance:				
Property and casualty	\$ 3,046	\$ 1,602	\$ 222	\$ 4,870
Property	11,535	13,571	577	25,683
Crop	737	12	22	771
Casualty	1,438	5,138	72	6,648
Marine/Aviation	1,133	1,584	121	2,838
Total pro rata reinsurance	17,889	21,907	1,014	40,810
Excess-of-loss reinsurance:				
Property	13,041	12,044	534	25,619
Casualty	22,114	54,477	1,429	78,020
Surety	851	367	20	1,238
Total excess-of-loss reinsurance	36,006	66,888	1,983	104,877
Total reinsurance segment	\$ 53,895	\$ 88,795	\$ 2,997	\$ 145,687

	December 31, 2008			
<u>Line of business</u>	<u>Case</u>	<u>IBNR</u>	<u>Settlement expense</u>	<u>Total</u>
	(\$ in thousands)			
Pro rata reinsurance:				
Property and casualty	\$ 3,262	\$ 2,541	\$ 206	\$ 6,009
Property	12,341	14,462	466	27,269
Crop	740	12	6	758
Casualty	728	5,328	59	6,115
Marine/Aviation	1,499	1,410	20	2,929
Total pro rata reinsurance	18,570	23,753	757	43,080
Excess-of-loss reinsurance:				
Property	15,205	10,019	655	25,879
Casualty	20,312	52,689	1,502	74,503
Surety	889	319	13	1,221
Total excess-of-loss reinsurance	36,406	63,027	2,170	101,603
Total reinsurance segment	\$ 54,976	\$ 86,780	\$ 2,927	\$ 144,683

As previously noted, the assumptions implicit in the methodologies utilized to establish reserves for the reinsurance segment are stability in the mix of business, consistent claims processing procedures, immaterial impact of loss cost trends on development patterns, consistent case loss reserving practices and appropriate Bornhuetter-Ferguson expected loss ratio selections. The tables below display the impact on the Company's results of operations from (1) a five percent variance in case loss reserve adequacy from the level anticipated in the incurred loss projection factors, (2) a one percent variance in the implicit annual claims inflation rate, (3) a five percent variance in IBNR losses as a percentage of reported incurred losses (due, for example, to changes in mix of business or claims processing procedures) and (4) a five percent variance in the expected loss ratios used with the Bornhuetter-Ferguson method. In other words, under each scenario, future loss and settlement expense payments would be expected to vary from actuarial reserve estimates by the amounts shown below. These variances in future loss and settlement expense payments could occur in one year or over multiple years. Variances in future loss and settlement payments would also affect the Company's financial position in that the Company's equity would be impacted by an amount equivalent to the change in net income. Variances of this type would typically be recognized in loss and settlement expense reserves and, accordingly, would not have a material effect on liquidity because the claims have not been paid. Such variances are considered reasonably likely based on the range of actuarial indications developed during the analysis of the reinsurance segment's carried reserves.

The after-tax impact on the Company's earnings under each scenario is as follows:

	Reinsurance segment			
	MRB		HORAD	
	(\$ in thousands)			
(1) Five percent variance in case loss reserve adequacy from the level anticipated in the incurred loss projection factors	\$ (558)	to \$ 505	\$ (2,752)	to \$2,490
(2) One percent variance in the implicit annual claims inflation rate	(1,461)	to 1,248	(1,684)	to 1,612
(3) Five percent variance in IBNR losses from the level anticipated in the loss projection factors	(467)	to 467	(2,207)	to 2,207
(4) Five percent variance in the expected loss ratios used with the Bornhuetter-Ferguson method	(480)	to 480	(2,231)	to 2,231

To ensure the accuracy and completeness of the information received from the ceding companies, Employers Mutual's actuarial department carefully reviews the latest five HORAD policy years on a quarterly basis, and all policy years on an annual basis. Any significant unexplained departures from historical reporting patterns are brought to the attention of the reinsurance department's staff, who contacts the ceding company or broker for clarification.

Employers Mutual's actuarial department annually reviews the MRB reserves for reasonableness. These analyses use a variety of actuarial techniques, which are applied at a line-of-business level. MRB staff supplies the reserve analysis data, which is verified for accuracy by Employers Mutual's actuaries. This review process is replicated by certain other MRB member companies, using actuarial techniques they deem appropriate. Based on these reviews, Employers Mutual and the other MRB member companies have consistently found the MRB reserves to be appropriate.

For the HORAD book of business, paid and incurred loss development patterns for relatively short-tail lines of business (property and marine) are based on data reported by the ceding companies. Employers Mutual has determined that there is sufficient volume and stability in the reported losses to base projections of ultimate losses on these patterns. For longer tail lines of business (casualty), industry incurred development patterns are referenced due to the instability of development patterns based on reported historical losses.

For long-tail lines of business, unreliable estimates of unreported losses can result from the application of loss projection factors to reported losses. To some extent, this is also true for short-tail lines of business in the early stages of a policy year's development. Therefore, in addition to loss-based projections, Employers Mutual generates estimates of unreported losses based on premiums earned. The latter estimates are sometimes more stable and reliable than projections based on losses.

Disputes with ceding companies do not occur often. Employers Mutual performs claims audits and encourages prompt reporting of reinsurance claims. Employers Mutual also reviews claim reports for accuracy, completeness and adequate reserving. Most reinsurance contracts contain arbitration clauses to resolve disputes, but such disputes are generally resolved without arbitration due to the long-term and ongoing relationships that exist with those companies. There were no matters in dispute at December 31, 2009.

Toxic tort (primarily asbestos), environmental and other uncertain exposures (property and casualty insurance segment and reinsurance segment)

Toxic tort claims include those where the claimant seeks compensation for harm allegedly caused by exposure to a toxic substance or a substance that increases the risk of contracting a serious disease, such as cancer. Typically the injury is caused by latent effects of direct or indirect exposure to a substance or combination of substances through absorption, contact, ingestion, inhalation, implantation or injection. Examples of toxic tort claims include injuries arising out of exposure to asbestos, silica, mold, drugs, carbon monoxide, chemicals and lead.

Since 1989, the pool participants have included an asbestos exclusion in liability policies issued for most lines of business. The exclusion prohibits liability coverage for "bodily injury", "personal injury" or "property damage" (including any associated clean-up obligations) arising out of the installation, existence, removal or disposal of asbestos or any substance containing asbestos fibers. Therefore, the pool participants' current asbestos exposures are primarily limited to commercial policies issued prior to 1989. At present, the pool participants are defending approximately 900 asbestos bodily injury lawsuits, some of which involve multiple plaintiffs. Five former policyholders and one current policyholder dominate the pool participants' asbestos claims. Most of the lawsuits are subject to express reservation of rights based upon the lack of an injury within the applicable policy periods, because many asbestos lawsuits do not specifically allege dates of asbestos exposure or dates of injury. The pool participants' policyholders named as defendants in these asbestos lawsuits are typically peripheral defendants who have little or no exposure and are routinely dismissed from asbestos litigation with nominal or no payment (i.e., small contractors, insulators, electrical welding suppliers, furnace manufacturers, and gasket and building supply companies).

During 2003, the pool participants were presented with several hundred plaintiff lawsuits filed against three former policyholders representing approximately 66,500 claimants related to exposure to asbestos or products containing asbestos. The vast majority of the 66,500 claims are the result of multi-plaintiff lawsuits. These claims are based upon nonspecific asbestos exposure and nonspecific injuries. As a result, management did not establish a significant amount of case loss reserves for these claims. During the period 2006 through 2009, several of the multi-plaintiff lawsuits (including the vast majority of those associated with one former policyholder) were dismissed. During 2009, approximately 3,000 additional claims against one former policyholder were reported to the pool participants. As of December 31, 2009, approximately 5,500 of the claims remain open. During 2006, the pool participants received notice that another former policyholder was a named defendant in approximately 33,000 claims nationwide. As of December 31, 2009, approximately 27,000 of these claims remain open.

Prior to 2008, actual losses paid for asbestos-related claims had been minimal due to the plaintiffs' failure to identify an exposure to any asbestos-containing products associated with the pool participants' current and former policyholders. However, paid losses increased significantly during 2008 and 2009 as a result of claims attributed to two former policyholders. One of these former policyholders, a broker of various products, including asbestos, settled a claim for approximately \$450,000 (the Company's share) in 2008. Prior to 2008, the asbestos exposure associated with this former policyholder had been thought to be relatively small. At December 31, 2009, one additional claim associated with this former policyholder remains open, though similar exposure on that claim is not anticipated. The other former policyholder, a furnace manufacturer, had multiple claims settle for a total of approximately \$514,000 (the Company's share) in 2008 and 2009. The asbestos exposure associated with this former policyholder increased during this time period, and this trend may possibly continue into the future with increased per plaintiff settlements. Approximately 170 asbestos exposure claims associated with this former policyholder remain open. Defense costs for asbestos-related claims continue to be rather significant due to the large number of parties involved in the litigation proceedings and the length of time required to obtain judgments. Whenever possible, the pool participants have participated in cost sharing agreements with other insurance companies to reduce overall asbestos claim expenses.

The pool participants are defending approximately 67 claims as a result of lawsuits alleging "silica" exposure in Texas and Mississippi jurisdictions, some of which involve multiple plaintiffs. The plaintiffs allege employment exposure to "airborne respirable silica dust," causing "serious and permanent lung injuries" (i.e., silicosis). Silicosis injuries are identified in the upper lobes of the lungs, while asbestos injuries are localized in the lower lobes.

The plaintiffs in the silicosis lawsuits are sandblasters, gravel and concrete workers, ceramic workers and road construction workers. All of these lawsuits are subject to express reservation of rights based upon the lack of an injury within the applicable policy periods because many silica lawsuits, like asbestos lawsuits, do not specifically allege dates of exposure or dates of injury. The pool participants' policyholders (a refractory product manufacturer, small local concrete and gravel companies and a concrete cutting machine manufacturer) that have been named as defendants in these silica lawsuits have had little or no exposure and are routinely dismissed from silica litigation with nominal or no payment. While the expense of handling these lawsuits is high, it is not proportional to the number of plaintiffs, and is mitigated through cost sharing agreements with other insurance companies.

Since 2004, the pool participants have included a "pneumoconiosis dust" exclusion to their commercial lines liability policies in the majority of jurisdictions where such action was warranted. This exclusion precludes liability coverage due to "mixed dust" pneumoconiosis, pleural plaques, pleural effusion, mesothelioma, lung cancer, emphysema, bronchitis, tuberculosis or pleural thickening, or other pneumoconiosis-related ailments such as arthritis, cancer (other than lung), lupus, heart, kidney or gallbladder disease. "Mixed dust" includes dusts composed of asbestos, silica, fiberglass, coal, cement, or various other elements. It is anticipated that this mixed dust exclusion will further limit the pool participants' exposure in silica claims, and may be broad enough to limit exposure in other dust claims.

The Company's environmental claims are defined as 1) claims for bodily injury, personal injury, property damage, loss of use of property, diminution of property value, etc., allegedly due to contamination of air, and/or contamination of surface soil or surface water, and/or contamination of ground water, aquifers, wells, etc.; or 2) any/all claims for remediation or clean-up of hazardous waste sites by the United States Environmental Protection Agency, or similar state and local environmental or government agencies, usually presented in conjunction with Federal or local clean up statutes (i.e., CERCLA, RCRA, etc.).

Examples include, but are not limited to: chemical waste; hazardous waste treatment, storage and/or disposal facilities; industrial waste disposal facilities; landfills; superfund sites; toxic waste spills; and underground storage tanks. Widespread use of pollution exclusions since 1970 in virtually all lines of business, except personal lines, has resulted in limited exposure to environmental claims. Absolute pollution exclusions have been used since the 1980's; however, the courts in the State of Indiana have ruled that the absolute pollution exclusion is ambiguous.

The Company's current exposures to environmental claims include losses involving petroleum haulers, lead contamination, and soil and groundwater contamination in the State of Indiana. Claims from petroleum haulers are generally caused by overturned commercial vehicles and overfills at commercial and residential properties. Exposures for accident year losses preceding the 1980s include municipality exposures for closed landfills, small commercial businesses involved with disposing waste at landfills, leaking underground storage tanks and contamination from dry cleaning operations. As of December 31, 2009, all Methyl Tertiary Butyl Ether ("MTBE") claims related to the pool participants' policyholders have been dismissed.

During 2009 the Company completed a comprehensive policy search and coverage review, and began defending (pursuant to policies issued 1969-1975) a lawsuit filed against a municipalities' sewerage commission in United States District Court in Wisconsin in 2008. The company has a joint defense agreement with two other companies but currently retains the majority share. The lawsuit is potentially one of the largest CERCLA actions pending against numerous parties in the United States and seeks in excess of \$1.5 billion from the defendants. The Company has established reserves equal to policy limits for each of the six years of alleged liability (approximately \$90,000 in aggregate as the Company's share) along with associated settlement expenses. While the insured's summary judgment motion was successful, future appeals are anticipated.

The Company's exposure to asbestos and environmental claims through assumed reinsurance is very limited due to the fact that the Company's reinsurance subsidiary entered into the reinsurance marketplace in the early 1980's, after much attention had already been brought to these issues.

At December 31, 2009, the Company carried asbestos and environmental reserves for direct insurance and assumed reinsurance business totaling \$6,527,000, which represents 1.2 percent of total loss and settlement expense reserves. The asbestos and environmental reserves include \$2,149,000 of case loss reserves, \$3,895,000 of IBNR loss reserves and \$483,000 of bulk settlement expense reserves. Ceded reinsurance on these reserves totaled \$307,000.

The pool participants' non-asbestos direct product liability claims are considered to be highly uncertain exposures due to the many uncertainties inherent in determining the loss, and the significant periods of time that can elapse between the occurrence of the loss and the ultimate settlement of the claim. The majority of the pool participants' product liability claims arise from small to medium-sized manufacturers, contractors, petroleum distributors, and mobile home and auto dealerships. No specific claim trends are evident from the pool participants' manufacturers, as the claims activity on these policies is generally isolated and can be severe. Specific product liability coverage is provided to the pool participants' mobile home and auto dealership policyholders, and the claims from these policies tend to be relatively small. Certain construction defect claims are also reported under product liability coverage. During 2009, 48 of these claims were reported to the pool participants.

The Company has exposure to construction defect claims arising from general liability policies issued by the pool participants to contractors. Most of the pool participants' construction defect claims are concentrated in a limited number of states, and the pool participants have taken steps to mitigate this exposure. Construction defect is a highly uncertain exposure due to such issues as whether coverage exists, definition of an occurrence, determination of ultimate damages, and allocation of such damages to financially responsible parties. Newly reported construction defect claims numbered 415, 373 and 345 in 2009, 2008 and 2007, respectively, and produced incurred losses and paid settlement expenses of approximately \$2,913,000, \$2,855,000 and \$2,755,000 in each respective period. Incurred losses and paid settlement expenses on all construction defect claims totaled approximately \$4,604,000 in 2009. At December 31, 2009, the Company carried case loss reserves of approximately \$5,210,000 on 623 open construction defect claims.

The Company's assumed casualty excess reinsurance business is also considered a highly uncertain exposure due to the significant periods of time that can elapse during the settlement of the underlying claims, and the fact that a reinsurance company generally has less knowledge than the ceding company about the underlying book of business and the ceding company's reserving practices. Employers Mutual attempts to account for this uncertainty by establishing bulk IBNR loss reserves, using conservative assumed treaty limits and, to a much lesser extent, booking of individual treaty IBNR loss reserves (if reported by the ceding company) or establishing additional case loss reserves if the reported case loss reserves appear inadequate on an individual claim. While Employers Mutual is predominantly a property reinsurer, it does write casualty excess business oriented mainly towards shorter tail casualty lines of coverage. Employers Mutual avoids reinsuring large company working layer casualty risks, and does not write risks with heavy product liability exposures, risks with obvious latent injury manifestation, medical malpractice, and "for profit" Directors and Officers coverage. A small amount of casualty excess business on large companies is written, but generally on a "clash" basis only (layers above the limits written for any individual policyholder).

Following is a summary of loss and settlement expense reserves and payments associated with asbestos, environmental, products liability and casualty excess reinsurance exposures for 2009, 2008 and 2007:

(\$ in thousands)	Property and casualty insurance segment			Reinsurance segment		
	Case	IBNR	Settlement expense	Case	IBNR	Settlement expense
Reserves at 12/31/09						
Asbestos	\$ 1,796	\$ 2,128	\$ 201	\$ 144	\$ 429	\$ -
Environmental	146	679	282	63	659	-
Products ¹	6,098	4,990	6,141	-	-	-
Casualty excess ²	-	-	-	21,453	54,478	1,431
Reserves at 12/31/08						
Asbestos	\$ 1,562	\$ 1,731	\$ 1,128	\$ 139	\$ 442	\$ -
Environmental	82	756	292	61	660	-
Products ¹	5,418	4,816	7,488	-	-	-
Casualty excess ²	-	-	-	20,223	52,693	1,513
Reserves at 12/31/07						
Asbestos	\$ 1,527	\$ 2,015	\$ 1,126	\$ 149	\$ 449	\$ -
Environmental	147	939	321	100	627	-
Products ¹	6,633	4,749	7,347	-	-	-
Casualty excess ²	-	-	-	20,657	48,819	1,673
Paid during 2009						
Asbestos	\$ 323		\$ 921	\$ 8		\$ -
Environmental	30		213	-		-
Products ¹	1,898		2,302	-		-
Casualty excess ²	-		-	7,317		1,149
Paid during 2008						
Asbestos	\$ 863		\$ 625	\$ 16		\$ 1
Environmental	169		24	4		1
Products ¹	2,436		1,829	-		-
Casualty excess ²	-		-	7,230		945
Paid during 2007						
Asbestos	\$ 63		\$ 340	\$ 24		\$ -
Environmental	-		50	3		8
Products ¹	1,054		1,312	-		-
Casualty excess ²	-		-	6,403		856

¹ Products includes the portion of asbestos and environmental claims reported that are non-premises/operations claims.

² Casualty excess includes the asbestos and environmental claims reported above.

Following is a summary of the claim activity associated with asbestos, environmental and products liability exposures for 2009, 2008 and 2007:

	<u>Asbestos</u>	<u>Environmental</u>	<u>Products</u>
Open claims, 12/31/09	33,477	5	1,119
Reported in 2009	3,149	-	399
Disposed of in 2009	1,317	2	374
Open claims, 12/31/08	31,645	7	1,094
Reported in 2008	240	2	381
Disposed of in 2008	3,069	4	356
Open claims, 12/31/07	34,474	9	1,069
Reported in 2007	157	3	207
Disposed of in 2007	23,252	4	288

Variability of loss and settlement expense reserves

The Company does not determine a range of estimates for all components of the loss and settlement expense reserve at the time those reserves are established. At each quarter-end, however, an actuarially determined range of estimates is developed for the major components of the loss and settlement expense reserve. All reserves are reviewed, except for the involuntary workers' compensation pools, for which reliance is placed on a reserve opinion received from the National Council on Compensation Insurance certifying the reasonableness of those reserves. Shown below are the actuarially determined ranges of reserve estimates as of December 31, 2009 along with the statutory-basis carried reserves, which are displayed net of ceded reinsurance. The GAAP-basis loss and settlement expense reserves contained in the Company's financial statements are reported gross of ceded reinsurance and contain a small number of adjustments from the statutory-basis amounts presented here. The last two columns display the estimated after-tax impact on earnings if the reserves were moved to the high end-point or low end-point of the ranges.

	<u>Range of reserve estimates</u>			<u>After-tax impact on earnings</u>	
	<u>High</u>	<u>Low</u>	<u>Carried</u>	<u>Reserves at high</u>	<u>Reserves at low</u>
(\$ in thousands)					
Property and casualty insurance segment	\$ 394,715	\$ 342,774	\$ 385,475	\$ (6,007)	\$ 27,755
Reinsurance segment	144,430	118,126	144,052	(246)	16,852
	<u>\$ 539,145</u>	<u>\$ 460,900</u>	<u>\$ 529,527</u>	<u>\$ (6,253)</u>	<u>\$ 44,607</u>

For the property and casualty insurance segment, total carried reserves for direct business equal the individual case loss reserves established primarily by the claims adjusters in the sixteen branch offices, with assistance of the home office claims department, plus bulk case loss reserves, IBNR loss reserves and settlement expense reserves established by home office management. The precise location of total carried reserves within the actuarial range is unknown at the time the reserves are established because the actuarial evaluation of reserve adequacy is conducted after the establishment of the reserves.

As previously noted, assumed reinsurance business carries a high risk of volatility and uncertainty which, in management's opinion, warrants a high degree of conservatism. Therefore, management's objective is to carry reinsurance segment reserves in the upper quarter of the range of actuarial reserve estimates.

Changes in loss and settlement expense reserve estimates of prior periods

Loss and settlement expense reserves are estimates at a given time of what an insurer expects to pay on incurred losses, based on facts and circumstances then known. During the loss settlement period, which may be many years, additional facts regarding individual claims become known, and accordingly, it often becomes necessary to refine and adjust the estimates of liability. Such changes in the reserves for losses and settlement expenses are reflected in operating results in the year such changes are recorded.

For a detailed discussion of the development experienced on prior accident years' reserves during the past three years, see the discussion entitled "Loss and Settlement Expense Reserves" under the "Narrative Description of Business" heading in the Business Section under Part I, Item I of this Form 10-K.

Investments

Fair Value Measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following fair value hierarchy prioritizes inputs to valuation techniques used to measure fair value:

- Level 1 - Unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.
- Level 2 - Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; or valuations based on models where the significant inputs are observable (e.g., interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.
- Level 3 - Prices or valuation techniques that require significant unobservable inputs. The unobservable inputs may reflect the Company's own judgments about the assumptions that market participants would use.

The Company uses an independent pricing source to obtain the estimated fair value of a majority of its securities. The fair value is based on quoted market prices, where available. This is typically the case for equity securities and short-term investments, which are accordingly classified as Level 1 fair value measurements. In cases where quoted market prices are not available, fair value is based on a variety of valuation techniques depending on the type of security. Many of the fixed maturity securities in the Company's portfolio do not trade on a daily basis; however, observable inputs are utilized in their valuations, and these securities are therefore classified as Level 2 fair value measurements. Following is a brief description of the various pricing techniques used for different asset classes.

- U.S. Treasury securities (including bonds, notes, and bills) are priced according to a number of live data sources, including active market makers and inter-dealer brokers. Prices from these sources are reviewed based on the sources' historical accuracy for individual issues and maturity ranges.
- U.S. government-sponsored agencies and corporate securities (including fixed-rate corporate bonds, medium-term notes, and retail notes) are priced by determining a bullet (non-call) spread scale for each issuer for maturities going out to forty years. These spreads represent credit risk and are obtained from the new issue market, secondary trading, and dealer quotes. An option adjusted spread model is incorporated to adjust spreads of issues that have early redemption features. The final spread is then added to the U.S. Treasury curve. For notes with odd coupon payment dates, a cash discounting yield/price routine calculates prices from final yields.

- Obligations of states and political subdivisions are priced by tracking and analyzing actively quoted issues and trades reported by the Municipal Securities Rulemaking Board (MSRB). Municipal bonds with similar characteristics are grouped together into market sectors, and internal yield curves are constructed daily for these sectors. Individual bond evaluations are extrapolated from these sectors, with the ability to make individual spread adjustments for attributes such as discounts, premiums, alternative minimum tax, and/or whether or not the bond is callable.
- Mortgage-backed securities are priced with models using spreads and other information solicited from Wall Street buy- and sell-side sources, including primary and secondary dealers, portfolio managers, and research analysts, to produce pricing for each tranche. To determine a tranche's price, first the cash flow for each tranche is generated (using consensus prepayment speed assumptions including, as appropriate, a proprietary prepayment projection based on historical statistics of the underlying collateral), then a benchmark yield is determined (in relation to the U.S. Treasury curve for the maturity corresponding to the tranche's average life estimate), and finally collateral performance and tranche level attributes are incorporated to adjust the benchmark yield to determine the tranche-specific spread. This is then used to discount the cash flows to generate the price. When cash flows, or other security structure or market information, is not available to appropriately price a security, broker quotes may be used with a zero spread bid-side valuation, resulting in the same values for the mean and ask prices.

On a quarterly basis, the Company receives from its independent pricing service a list of fixed maturity securities that were priced solely from broker quotes. Since this is not an observable input, any fixed maturity security in the Company's portfolio that is on this list is classified as a Level 3 fair value measurement. At December 31, 2009, the Company did not hold any fixed maturity securities that were priced solely from broker quotes.

A small number of the Company's securities are not priced by the independent pricing service. One is an equity security that is reported as a Level 3 fair value measurement at December 31, 2009, since no reliable observable inputs are used in its valuation. This equity security continues to be reported at the fair value obtained from the Securities Valuation Office (SVO) of the National Association of Insurance Commissioners (NAIC). The SVO establishes a per share price for this security based on an annual review of that company's financial statements. This review is typically performed during the second quarter, and resulted in a fair value for the shares held by the Company of \$2,000 at December 31, 2009 and \$4,000 at December 31, 2008. The remaining two securities not priced by the Company's independent pricing service are fixed maturity securities. The two fixed maturity securities are classified as Level 2 fair value measurements and are carried at aggregate fair values of \$7,722,000 at December 31, 2009 and \$7,163,000 at December 31, 2008. The fair values for these two fixed maturity securities were obtained from the Company's investment custodian using independent pricing services which utilize similar pricing techniques as the Company's independent pricing service.

Prior to the fourth quarter of 2009, the Company held Class B shares of Insurance Services Office Inc. (now known as Verisk Analytics, Inc. ("Verisk")) following its Initial Public Offering on October 7, 2009). The Company was reporting this investment as a Level 3 fair value measurement at the fair value obtained from applying a 20 percent marketability discount to the quarterly valuations of the Class A shares produced by a nationally recognized independent financial advisory firm. This resulted in a fair value of \$14,966,000 for the Class B shares held at December 31, 2008. In conjunction with the Verisk Initial Public Offering, the Company sold its entire holding of Verisk common stock in the fourth quarter for proceeds of \$22,474,000, resulting in a realized capital gain in the same amount (before tax).

The estimated fair values obtained from the independent pricing sources are reviewed by the Company for reasonableness and any discrepancies are investigated for final valuation. For fixed maturity securities, this includes comparing valuations from the independent pricing source, the Company's investment custodian, the SVO, and an analytical service for fixed maturity securities. For equity securities, a similar comparison is done between the valuations from the independent pricing service, the Company's investment custodian, and the SVO. From these comparisons, material variances are identified and resolved to determine the final valuation used in the financial statements.

Investment Impairments

The Company regularly monitors its investments which have a fair value that is less than the carrying value for indications of “other-than-temporary” impairment. Several factors are used to determine whether the carrying value of an individual security has been “other-than-temporarily” impaired. Such factors include, but are not limited to (1) the security’s value and performance in the context of the overall markets, (2) length of time and extent the security’s fair value has been below carrying value, (3) key corporate events, and (4) for equity securities, the ability and intent to hold the security until recovery to its cost basis. Prior to April 1, 2009, the Company’s ability and intent to hold fixed maturity securities in an unrealized loss position until recovery was also considered in the determination of “other-than-temporary” impairments.

Effective April 1, 2009, the Company adopted the requirements for recognition, presentation, and disclosure of “other-than-temporary” impairments on fixed maturity securities from Investments-Debt and Equity Securities Topic 310 of the Financial Accounting Standards Board (FASB) *FASB Accounting Standards Codification*TM (ASC). This provision was a part of the originally issued Staff Position FAS 115-2 and FAS 124-2, “Recognition and Presentation of Other-Than-Temporary Impairments,” which was effective for interim and annual reporting periods ending after June 15, 2009. Under these requirements, the evaluation of an impaired fixed maturity security includes an assessment of whether the entity has the intent to sell the security and if it is more likely than not to be required to sell the security before recovery of its amortized cost basis. In addition, if the present value of cash flows expected to be collected is less than the amortized cost of the security, a credit loss is deemed to exist and the security is considered “other-than-temporarily” impaired. The portion of the impairment related to a credit loss is recognized through earnings and the portion of the impairment related to other factors is recognized through “other comprehensive income”.

When an equity security is deemed “other-than-temporarily” impaired, the carrying value is reduced to fair value and a realized loss is recognized and charged to income.

Deferred policy acquisition costs and related amortization

Acquisition costs consisting of commissions, premiums taxes and other underwriting expenses that vary with, and are directly related to, the production of business are deferred and amortized to expense as premium revenue is recognized.

Deferred policy acquisition costs and related amortization are calculated separately for the property and casualty insurance segment and the reinsurance segment. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to the estimated realizable value, which gives effect to the premium to be earned, related investment income, losses and settlement expenses and certain other costs expected to be incurred as the premium is earned. Deferred policy acquisition costs were not subject to limitation at December 31, 2009, and management does not anticipate future limitations to be likely due to the current adequacy of premium rates in both the insurance and reinsurance marketplaces.

Deferred income taxes

The realization of the deferred income tax asset is based upon projections indicating that a sufficient amount of future taxable income will be earned to utilize the tax deductions that will reverse in the future. These projections are based on the Company’s history of producing significant amounts of taxable income, the current premium rate environment for both the property and casualty insurance segment and the reinsurance segment, and loss and expense control initiatives that have been implemented in recent years. In addition, management has formulated tax-planning strategies that could be implemented to generate taxable income if needed. Should the projected taxable income and tax planning strategies not provide sufficient taxable income to recover the deferred tax asset, a valuation allowance would be required.

Benefit Plans

Employers Mutual sponsors two pension plans, including a defined benefit retirement plan (pension) and a supplemental retirement plan, and two postretirement benefit plans that provide retiree healthcare and life insurance coverage. Although the Company has no employees of its own, it is responsible for its share of the expenses and related prepaid assets and liabilities of these plans, as determined under the terms of the pooling agreement and the cost allocation methodologies applicable to its subsidiaries that do not participate in the pooling agreement.

The net periodic pension and postretirement benefit costs, as well as the prepaid assets and liabilities of these plans, are determined by actuarial valuations. Inherent in these valuations are key assumptions regarding the discount rate, the expected long-term rate of return on plan assets, the rate of future compensation increases (pension plans only), and the health care cost trend rate (healthcare postretirement plan only). The assumptions used in the actuarial valuations are updated annually. Material changes in the net periodic pension and postretirement benefit costs may occur in the future due to changes in these assumptions or changes in other factors, such as the number of plan participants, the level of benefits provided, asset values and applicable legislation or regulations.

The discount rate utilized in the valuations is based on an analysis of the total rate of return that could be generated by a hypothetical portfolio of high-quality bonds created to generate cash flows that match the plans' expected benefit payments. No callable bonds are used in this analysis and the discount rate produced by this analysis is compared to interest rates of applicable published indices for reasonableness. The discount rates used in the pension benefit valuations at December 31, 2009, 2008 and 2007 were 5.75 percent, 6.25 percent and 6.00 percent, respectively. The discount rates used in the postretirement benefit valuations at December 31, 2009, 2008 and 2007 were 6.00 percent, 6.25 percent and 6.25 percent, respectively. A 0.25 percentage point decrease in the discount rates used in the 2009 valuations would increase the Company's net periodic pension and postretirement benefit costs for 2010 by approximately \$91,000. Conversely, a 0.25 percentage point increase in the 2009 discount rates would decrease the Company's net periodic pension and postretirement benefit costs for 2010 by approximately \$87,000.

The expected long-term rate of return on plan assets is developed considering actual historical results, current and expected market conditions, the mix of plan assets and investment strategy. The expected long-term rate of return on plan assets produced by this analysis and used in the pension valuations at December 31, 2009, 2008 and 2007 was 7.50 percent. The expected long-term rate of return on plan assets used in the postretirement benefit valuations at December 31, 2009, 2008 and 2007 was 6.00 percent. The actual rate of return earned on plan assets during 2009, which reflects some recovery from the financial crisis, was approximately 18 percent for the pension plan and 10 percent for the postretirement benefit plans. The expected long-term rate of return assumption is subject to the general movement of the economy, but is generally less volatile than the discount rate assumption. A decrease in the expected long-term rate of return assumption increases future expenses, whereas an increase in the assumption reduces future expenses. A 0.25 percentage point change in the 2009 expected long-term rate of return assumption would change the Company's net periodic pension and postretirement benefit costs for 2010 by \$160,000. For detailed information regarding the current allocation of assets within the pension and postretirement benefit plans, see note 12 of Notes to Consolidated Financial Statements under Part II, Item 8 of this Form 10-K.

The health care cost trend rate assumption represents the anticipated change in the cost of health care benefits due to factors outside of the plan. These factors include health care inflation, changes in health care utilization and delivery patterns, technological advances, and the overall health of the plan participants. The health care cost trend rate assumption is based on published information and general economic conditions. The health care cost trend rate assumption for 2009 was 9 percent, and is assumed to decrease gradually to 5 percent in 2018 and remain at that level thereafter.

In accordance with GAAP, actuarial gains/losses contained in the valuations that result from (1) actual experience that differs from that assumed, or (2) a change in actuarial assumptions, is accumulated and, if in excess of a specified corridor, amortized to expense over future periods. As of December 31, 2009, the supplemental retirement and defined benefit pension plans, as well as the postretirement benefit plans, had accumulated actuarial losses in excess of the corridor and thus will be amortized into expense in 2010. The Company's share of the accumulated actuarial losses that will be amortized into expense during 2010 amounted to \$1,614,000. Prior service costs/credits for plan amendments are also contained in the valuations, and are amortized into expense/income over the future service periods. As of December 31, 2009, the postretirement benefit plans have prior service credits that are being amortized into income in future periods, while the defined benefit pension plan has prior service costs that are being amortized into expense in future periods. The net amount of prior service credit being amortized into income during 2010 is \$480,000.

In accordance with GAAP, the funded status of defined benefit retirement or other postretirement plans is recognized as a net asset or liability on the balance sheet. Changes in the funded status of the plans is recognized through other comprehensive income. Beginning in 2008, the pension and postretirement benefit plans' assets and obligations are measured as of the end of the Company's fiscal year.

RESULTS OF OPERATIONS

Segment information and consolidated net income for the three years ended December 31, 2009 are as follows:

(\$ in thousands)	Year ended December 31,		
	2009	2008	2007
Property and casualty insurance			
Premiums earned	\$ 308,079	\$ 315,598	\$ 320,836
Losses and settlement expenses	199,124	232,538	199,494
Acquisition and other expenses	119,342	109,877	119,152
Underwriting profit (loss)	<u>\$ (10,387)</u>	<u>\$ (26,817)</u>	<u>\$ 2,190</u>
Loss and settlement expense ratio	64.6%	73.7%	62.2%
Acquisition expense ratio	38.8%	34.8%	37.1%
Combined ratio	<u>103.4%</u>	<u>108.5%</u>	<u>99.3%</u>
Losses and settlement expenses:			
Insured events of current year	\$ 233,765	\$ 254,102	\$ 227,471
Decrease in provision for insured events of prior years	<u>(34,641)</u>	<u>(21,564)</u>	<u>(27,977)</u>
Total losses and settlement expenses	<u>\$ 199,124</u>	<u>\$ 232,538</u>	<u>\$ 199,494</u>
Catastrophe and storm losses	<u>\$ 27,899</u>	<u>\$ 44,439</u>	<u>\$ 22,466</u>
Increase (decrease) in provision for insured events of prior years:			
Three months ended March 31	\$ (16,839)	\$ (13,726)	\$ (15,785)
Three months ended June 30	(7,785)	(5,983)	(9,725)
Three months ended September 30	(6,568)	229	(6,307)
Three months ended December 31	<u>(3,449)</u>	<u>(2,084)</u>	<u>3,840</u>
	<u>\$ (34,641)</u>	<u>\$ (21,564)</u>	<u>\$ (27,977)</u>

(\$ in thousands)	Year ended December 31,		
	2009	2008	2007
Reinsurance			
Premiums earned	\$ 75,932	\$ 73,720	\$ 72,223
Losses and settlement expenses	49,625	61,727	48,345
Acquisition and other expenses	16,758	17,508	16,541
Underwriting profit (loss)	<u>\$ 9,549</u>	<u>\$ (5,515)</u>	<u>\$ 7,337</u>
Loss and settlement expense ratio	65.4%	83.7%	66.9%
Acquisition expense ratio	22.0%	23.8%	22.9%
Combined ratio	<u>87.4%</u>	<u>107.5%</u>	<u>89.8%</u>
Losses and settlement expenses:			
Insured events of current year	\$ 63,606	\$ 75,471	\$ 59,106
Decrease in provision for insured events of prior years	<u>(13,981)</u>	<u>(13,744)</u>	<u>(10,761)</u>
Total losses and settlement expenses	<u>\$ 49,625</u>	<u>\$ 61,727</u>	<u>\$ 48,345</u>
Catastrophe and storm losses	<u>\$ 3,566</u>	<u>\$ 8,045</u>	<u>\$ 782</u>
Decrease in provision for insured events of prior years:			
Three months ended March 31	\$ (4,219)	\$ (2,163)	\$ (2,305)
Three months ended June 30	(1,650)	(4,070)	(3,686)
Three months ended September 30	(2,178)	(4,468)	(1,196)
Three months ended December 31	<u>(5,934)</u>	<u>(3,043)</u>	<u>(3,574)</u>
	<u>\$ (13,981)</u>	<u>\$ (13,744)</u>	<u>\$ (10,761)</u>

(\$ in thousands)	Year ended December 31,		
	2009	2008	2007
Consolidated			
REVENUES			
Premiums earned	\$ 384,011	\$ 389,318	\$ 393,059
Net investment income	47,759	48,403	48,482
Realized investment gains (losses)	17,922	(24,456)	3,724
Other income	755	626	545
	<u>450,447</u>	<u>413,891</u>	<u>445,810</u>
LOSSES AND EXPENSES			
Losses and settlement expenses	248,749	294,265	247,839
Acquisition and other expenses	136,100	127,385	135,693
Interest expense	900	889	1,112
Other expense	2,173	1,642	2,247
	<u>387,922</u>	<u>424,181</u>	<u>386,891</u>
Income (loss) before income tax			
expense (benefit)	62,525	(10,290)	58,919
Income tax expense (benefit)	17,154	(8,585)	16,441
Net income (loss)	<u>\$ 45,371</u>	<u>\$ (1,705)</u>	<u>\$ 42,478</u>
Net income (loss) per share	<u>\$ 3.44</u>	<u>\$ (0.13)</u>	<u>\$ 3.09</u>
Loss and settlement expense ratio	64.8%	75.6%	63.1%
Acquisition expense ratio	35.4%	32.7%	34.5%
Combined ratio	<u>100.2%</u>	<u>108.3%</u>	<u>97.6%</u>
Losses and settlement expenses:			
Insured events of current year	\$ 297,371	\$ 329,573	\$ 286,577
Decrease in provision for insured			
events of prior years	<u>(48,622)</u>	<u>(35,308)</u>	<u>(38,738)</u>
Total losses and settlement expenses	<u>\$ 248,749</u>	<u>\$ 294,265</u>	<u>\$ 247,839</u>
Catastrophe and storm losses	<u>\$ 31,465</u>	<u>\$ 52,484</u>	<u>\$ 23,248</u>
Increase (decrease) in provision for insured			
events of prior years:			
Three months ended March 31	\$ (21,058)	\$ (15,889)	\$ (18,090)
Three months ended June 30	(9,435)	(10,053)	(13,411)
Three months ended September 30	(8,746)	(4,239)	(7,503)
Three months ended December 31	<u>(9,383)</u>	<u>(5,127)</u>	<u>266</u>
	<u>\$ (48,622)</u>	<u>\$ (35,308)</u>	<u>\$ (38,738)</u>

Year ended December 31, 2009 compared to year ended December 31, 2008

The Company reported net income of \$45,371,000 (\$3.44 per share) in 2009 compared to a net loss of \$1,705,000 (\$0.13 per share) in 2008. This improvement is attributed to several factors: a record amount of catastrophe and storm losses in 2008, a record amount of “other-than-temporary” investment impairment losses recognized in 2008 as a result of the financial crisis, and a realized investment gain of \$22,474,000 recognized in 2009 from the sale of the Company’s holdings of Verisk common stock. Another contributing factor to the improvement in net income was an improved underwriting performance by the Company’s reinsurance subsidiary in 2009.

Premium income

Premiums earned decreased 1.4 percent to \$384,011,000 in 2009 from \$389,318,000 in 2008. This decrease is primarily attributed to a moderate, but steady, decline in overall premium rate levels during the previous two years as a result of competitive market conditions associated with the current soft market. Premium rates stabilized during 2009, but did not improve to the extent anticipated one year ago due to the lagging effects of the weak economy, the very mild 2009 hurricane season, and a general strengthening in the capital base of the industry. The pool participants were able to achieve some increases in rates, though those increases were generally small and targeted to specific local markets and individual accounts. Pricing in the reinsurance marketplace improved with the January 1 renewals, but declined somewhat as the year progressed. Rates seem to be firming already for personal lines in many territories, and management anticipates that rates will begin to firm for commercial lines toward the latter half of 2010. Management expects to continue to implement rate increases in the low to mid-single digits as warranted.

Premiums earned for the property and casualty insurance segment decreased 2.4 percent to \$308,079,000 in 2009 from \$315,598,000 in 2008, primarily due to a 4.1 percent decline in premium rate levels implemented in 2008. Premium rates did improve somewhat in the personal lines of business during the second half of the year, but the commercial lines of business, which account for more than 80 percent of the property and casualty insurance segment’s premiums, remained very competitive. Filed rates for 2009 were up a modest 0.4 percent, representing the first positive change in four years. The competitiveness in the commercial lines of business is being driven, at least in part, by the weak economy. Companies know that any proposed rate increases on good business will likely be challenged by the insured and could result in the loss of the account. As a result, most companies are content to retain their good business at current pricing levels and wait for the economy to improve. New business premium increased approximately 13 percent in 2009 and accounted for approximately 13 percent of net written premiums, but was insufficient to cover premium declines resulting from prior year rate reductions and policies not retained. Approximately 39 percent of the new business came from the pool participants’ Premier and Leading agents (representing about 18 percent of the total agency force), which once again emphasizes the importance of building and strengthening agency relationships. Policy retention rates for the year declined slightly to approximately 86 percent in both commercial and personal lines, but continued to exceed industry averages. This decline is attributed to management’s willingness to walk away from underpriced business, efforts to limit exposures in coastal regions, and management’s decision to exit from personal lines in some regions of the country. Policy counts increased slightly in both the commercial and personal lines of business in 2009.

Premiums earned for the reinsurance segment increased 3.0 percent to \$75,932,000 in 2009 from \$73,720,000 in 2008. This increase is primarily associated with a moderate increase in reinsurance premium rate levels and the addition of a few new accounts. However, this premium growth was partially offset by a decrease in reinstatement premium income, a decline in business assumed from the MRB pool, and a decrease in the amount of earned but not reported (EBNR) premium recognized. Due to a loss of capital in the reinsurance industry in 2008 as a result of the economic crisis, reinsurance premium rate levels firmed somewhat in the first part of 2009 and the reinsurance segment was able to obtain moderate rate increases on most of its renewals (including the January 1 renewals). However, due to the mild hurricane season and a recovery in reinsurance company capital levels during 2009, premium rate levels subsided in the second half of the year. Premium rate levels for the January 1, 2010 renewal season were generally flat, with some moderate declines in premium rates on certain accounts.

Losses and settlement expenses

Losses and settlement expenses decreased 15.5 percent to \$248,749,000 in 2009 from \$294,265,000 in 2008, while the loss and settlement expense ratio decreased to 64.8 percent in 2009 from 75.6 percent in 2008. Storm losses, while higher than average due to active Midwest weather patterns, were significantly lower than the record amount experienced in 2008. Catastrophe and storm losses accounted for 8.2 percentage points of the combined ratio for the year ended December 31, 2009, which is higher than the 8-year average of 6.5 percentage points for the period 2000 to 2007, but significantly lower than the record 13.5 percentage points experienced in 2008. Other factors contributing to the improvement in the loss and settlement expense ratio were a decline in large losses, an increase in the amount of favorable development experienced on prior years' reserves, and strong underwriting performance in the reinsurance segment. Current actuarial analysis indicates that the level of reserve adequacy at December 31, 2009 is consistent with other recent evaluations. From management's perspective, this measure is more relevant to an understanding of the Company's results of operation than the composition of the underwriting results between the current and prior accident years.

The loss and settlement expense ratio for the property and casualty insurance segment decreased to 64.6 percent in 2009 from 73.7 percent in 2008. A record amount of Midwest storm losses in 2008, along with losses associated with Hurricanes Gustav and Ike, produced record levels of catastrophe and storm losses and elevated the loss and settlement expense ratio in 2008. The loss and settlement expense ratio returned to a more normal level in 2009, even though catastrophe and storm losses remained above long-term historical averages. While there were no reported hurricane losses in the United States in 2009, there was an elevated level of claims activity due to a high frequency of Midwestern storms. For the year, catastrophe and storm losses in the property and casualty insurance segment amounted to 9.1 percent of earned premiums compared to 14.1 percent in 2008. Other factors contributing to the improvement in the loss and settlement expense ratio include a general decline in claim frequency and severity (including large loss activity) and increased favorable development on prior years' catastrophe and storm loss reserves. Large losses, which the Company defines as losses greater than \$250,000, excluding catastrophe and storm losses, declined to \$22,938,000 in 2009, compared to \$24,895,000 in 2008 (a decrease of 0.5 percentage points in the loss and settlement expense ratio). Previously implemented premium rate level reductions continue to have a negative impact on the loss and settlement expense ratio, but to a lesser extent due to a reduction in the magnitude of rate decreases implemented in 2008 and 2009.

The loss and settlement expense ratio for the reinsurance segment decreased to 65.4 percent in 2009 from 83.7 percent in 2008. Factors contributing to the reinsurance segment's improvement include moderate rate increases, good results from the MRB pool, an increase in the amount of favorable development experienced on prior accident years' reserves due to a reduction in bulk IBNR reserves and the winding down of the MAERP Reinsurance Association (formerly known as Mutual Atomic Energy Reinsurance Pool), and a decline in catastrophe and storm losses from the large amount reported in 2008 (including \$2,000,000 of losses associated with Hurricane Ike).

Acquisition and other expenses

Acquisition and other expenses increased 6.8 percent to \$136,100,000 in 2009 from \$127,385,000 in 2008. The acquisition expense ratio increased to 35.4 percent in 2009 from 32.7 percent in 2008. These increases are attributed to the property and casualty insurance segment and reflect increases in net periodic pension benefit cost, executive bonuses and contingent salaries, and policyholder dividends. These increases were partially offset by a decline in the acquisition expense ratio in the reinsurance segment, resulting primarily from declines in commission and contingent commission expense.

For the property and casualty insurance segment, the acquisition expense ratio increased to 38.8 percent in 2009 from 34.8 percent in 2008. This increase is attributed to increases in net periodic pension benefit cost, executive bonuses, contingent salaries, and policyholder dividends. The increase in executive bonuses and contingent salaries is due to the improved underwriting results in 2009 (no expense for these items was incurred in 2008). The increase in net periodic pension benefit cost is due to a significant increase in the amount of actuarial losses being amortized and a decrease in the expected return on plan assets, both resulting from the severe decline in the financial markets during 2008. The increase in policyholder dividend expense is largely due to an increase in the estimated dividend payable on several safety dividend groups, as well as an increase in the estimated aggregate amount of dividends payable on individual workers' compensation policies as a result of good loss experience.

For the reinsurance segment, the acquisition expense ratio decreased to 22.0 percent in 2009 from 23.8 percent in 2008. This decline is primarily associated with decreases in commission expense (driven largely by fluctuations in the estimate of commission expense relative to the associated estimate of earned but not reported premiums) and contingent commission expense (reflecting a decline from the relatively high amount reported in 2008).

Investment results

Net investment income declined 1.3 percent to \$47,759,000 in 2009 from \$48,403,000 in 2008. Investment income was negatively impacted by a high level of call activity on the Company's U.S. government agency securities during 2009 as a result of the declining interest rate environment, a decline in yield on short-term investments and the elimination of dividends on the perpetual preferred stocks of Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae) during 2008. As of December 31, 2009, the majority of the proceeds received from the called securities had been reinvested.

The Company reported a net realized investment gain of \$17,922,000 in 2009 compared to a net realized investment loss of \$24,456,000 in 2008. The 2009 amount reflects a \$22,474,000 realized gain recognized on the disposal of the Company's holdings of Verisk common stock, and \$10,108,000 of "other-than-temporary" investment impairment losses recognized on 34 equity securities and three fixed maturity securities. The impairment losses on the three fixed maturity securities totaled \$2,657,000, and is attributed to a bankruptcy filing made by Great Lakes Chemical Corporation, now known as Chemtura Corporation (\$2,220,000), a planned disposal of US Freightways Corporation securities (\$350,000) and the determination of a credit loss (all contractual cash flows are not expected to be collected) on a residential mortgage-backed security (\$87,000). Included in the 2008 loss amount is \$16,017,000 of "other-than-temporary" investment impairment losses recognized on 38 equity securities as a result of the severe and prolonged turmoil in the financial markets, and \$14,904,000 of losses recognized on the perpetual preferred stocks of Freddie Mac and Fannie Mae when these companies were placed under conservatorship by the U.S. government.

The total rate of return on the Company's equity portfolio during 2009 was 21.80 percent, compared to 26.46 percent for the S&P 500. The current annualized yield on the bond portfolio was 5.27 percent and the effective duration was 6.12 years, which was up from 5.57 years at December 31, 2008.

Other expense

Other expense increased 32.3 percent to \$2,173,000 in 2009 from \$1,642,000 in 2008. This increase primarily reflects an increase in uncollectible premiums allocated to the property and casualty insurance subsidiaries through the pooling agreement, and a decrease in foreign currency exchange gains associated with the reinsurance subsidiary's foreign currency denominated reinsurance business.

Income tax

The Company reported income tax expense of \$17,154,000 in 2009, compared to an income tax benefit of \$8,585,000 in 2008. The effective tax rate was 27.4 percent in 2009, compared to 83.4 percent in 2008. The high effective tax rate for 2008 reflects the fact that a significant amount of the Company's investment income was received in the form of tax-exempt interest income. Due to the much larger amount of pretax income in 2009, tax exempt interest had less of an impact on the effective tax rate.

Year ended December 31, 2008 compared to year ended December 31, 2007

The Company reported a net loss of \$1,705,000 (\$0.13 per share) in 2008 compared to net income of \$42,478,000 (\$3.09 per share) in 2007. The net loss for 2008 was primarily attributed to two factors: a record amount of catastrophe and storm losses and a record amount of "other-than-temporary" investment impairment losses generated by the severe and prolonged turmoil in the financial markets. Other factors contributing to the net loss for 2008 included an expected decline in the amount of favorable development experienced on prior years' reserves, and a moderate, but steady, decline in overall premium rate levels.

Premium income

Premiums earned decreased 1.0 percent to \$389,318,000 in 2008 from \$393,059,000 in 2007. This decrease was primarily attributed to a moderate, but steady, decline in overall premium rate levels during the prior three years as a result of competitive market conditions associated with the current soft market. Premium rates showed some signs of stabilization during the fourth quarter as the insurance industry began responding to the significant decline in capital that occurred during 2008 as a result of the financial crisis and high level of catastrophe and storm losses.

Premiums earned for the property and casualty insurance segment decreased 1.6 percent to \$315,598,000 in 2008 from \$320,836,000 in 2007 as new business premium was not sufficient to offset the premium lost from declining rate levels and business not retained. New business policy counts were up in 2008, and helped generate a slight increase in total policy count in both the commercial and personal lines of business. However, while personal lines new business premium increased 9.9 percent, commercial lines new business premium declined 8.9 percent. The decline in commercial lines new business premium was attributed to a combination of declining rates (rate declines are larger in commercial lines of business) and reduced exposures on new business (with a corresponding reduction in premium). The growth in personal lines new business premium was occurring in selected territories which management had identified as having greater profit potential. Retention rates remained above industry standards, with commercial lines declining slightly to 86.2 percent, personal auto remaining steady at 87.5 percent, and personal property increasing slightly to 86.6 percent.

Premiums earned for the reinsurance segment increased 2.1 percent to \$73,720,000 in 2008 from \$72,223,000 in 2007. This increase was primarily attributed to the HORAD book of business and reflected an increase in both the estimate of earned but not reported (EBNR) premiums and accrued reinstatement premiums. Under the terms of the quota share agreement, the reinsurance segment receives reinstatement premium income that is collected by Employers Mutual from the ceding companies when coverage is reinstated after a loss event; however, the cap on losses assumed per event contained in the quota share agreement is automatically reinstated without cost to the reinsurance subsidiary. The increases in premium income in the HORAD book of business were largely offset by a decline in the amount of business assumed from the MRB pool. Both the MRB and HORAD books of business suffered from the loss of a few accounts, increased retentions by some of the ceding companies and lower premium rates driven by increased rate competition. This was evident during the January and July renewal seasons as the reinsurance segment experienced an overall decline in the average rate on-line for its accounts. There was some additional minor deterioration in rates during the July renewal period, but increased terms on those accounts with recent loss experience kept overall rate adequacy at a fairly consistent level with that achieved on the January renewals.

Losses and settlement expenses

Losses and settlement expenses increased 18.7 percent to \$294,265,000 in 2008 from \$247,839,000 in 2007. The loss and settlement expense ratio increased to 75.6 percent in 2008 from 63.1 percent in 2007. The large increase in the loss and settlement expense ratio was primarily attributed to a record \$50,774,000 of catastrophe and storm losses in 2008, compared to \$21,514,000 in 2007. Catastrophe and storm losses added 13.0 percentage points to the loss and settlement expense ratio in 2008, compared to 5.5 percentage points in 2007. The moderate, but steady, decline in premium rate levels experienced over the prior several years combined with an expected decline in the amount of favorable development experienced on prior years' reserves also contributed to the increase in the loss and settlement expense ratio. Current actuarial analysis indicated that reserve adequacy remained at a high level, and actually improved somewhat during 2008.

The loss and settlement expense ratio for the property and casualty insurance segment increased to 73.7 percent in 2008 from 62.2 percent in 2007. A record amount of Midwest storm losses, along with losses associated with Hurricanes Gustav and Ike, were the driving force behind this increase. Catastrophe and storm losses more than doubled to a record \$42,729,000 in 2008 from \$20,732,000 in 2007. These storm losses contributed 13.5 percentage points to the loss and settlement expense ratio in 2008, an increase of 7.0 percentage points over the comparable ratio in 2007. The record level of catastrophe and storm losses was caused by several severe storm systems that produced wind, tornado and hail losses over a wide geographic region of the Midwest, including a devastating EF5 tornado that struck Parkersburg, Iowa. Losses associated with Hurricanes Gustav and Ike totaled \$3,065,000 and \$3,185,000, respectively. Surprisingly, the majority of the property and casualty insurance segment's losses from Hurricane Ike occurred in the Midwest. When the massive hurricane advanced away from the coast of Texas, it merged with a cold front traveling across the Midwest and generated a significant amount of wind damage in Ohio and Kentucky.

An expected decline in the amount of favorable development experienced on prior years' reserves also contributed to the increase in the loss and settlement expense ratio of the property and casualty insurance segment. Lastly, the moderate, but steady, decline in premium rate levels over the prior several years was estimated to have added approximately 3 percentage points to the loss and settlement expense ratio in 2008.

The loss and settlement expense ratio for the reinsurance segment increased to 83.7 percent in 2008 from 66.9 percent in 2007. This increase reflected an increase in the amount of reported large losses, an increase in catastrophe and storm losses (including \$2,000,000 of losses associated with Hurricane Ike), and an increase in reported crop losses. An increase in the amount of favorable development experienced on prior years' reserves helped to limit the increase in the loss and settlement expense ratio.

Acquisition and other expenses

Acquisition and other expenses declined 6.1 percent to \$127,385,000 in 2008 from \$135,693,000 in 2007. The acquisition expense ratio declined to 32.7 percent in 2008 from 34.5 percent in 2007. These declines were attributed to the property and casualty insurance segment and reflected reductions in the amount of expense related to policyholder dividends, agents' profit share, executive bonuses and contingent salaries, and postretirement benefits.

For the property and casualty insurance segment, the acquisition expense ratio declined to 34.8 percent in 2008 from 37.1 percent in 2007. This decrease was attributed to declines in the amount of expense related to policyholder dividends, contingent commissions (in the form of agents' profit share), executive bonuses and contingent salaries, and postretirement benefits. The decline in policyholder dividend expense was largely due to a decrease in the estimated dividend payable on several of the Company's safety dividend groups. The declines in executive bonuses and contingent salaries, as well as agents' profit share expenses, reflected the large decline in underwriting profitability that occurred during 2008. The decline in postretirement benefits expense reflected a decrease in the service cost component and the amortization of a prior service credit resulting from a plan amendment that became effective in the first quarter.

For the reinsurance segment, the acquisition expense ratio increased to 23.8 percent in 2008 from 22.9 percent in 2007. This increase was primarily associated with an increase in contingent commission expense in the MRB business, and, to a lesser extent, an increase in estimated commission expense on earned but not reported premiums.

Investment results

Net investment income declined 0.2 percent to \$48,403,000 in 2008 from \$48,482,000 in 2007. Investment income was negatively impacted by the elimination of dividends on the perpetual preferred stocks of Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae), as well as a reduction in yields on cash and short term investments. There was a significant amount of call activity on the Company's U.S. government agency securities during 2008 as a result of the declining interest rate environment. The proceeds from these called securities were invested in short-term securities until attractive long-term opportunities were identified.

The Company reported net realized investment losses of \$24,456,000 in 2008 compared to net realized investment gains of \$3,724,000 in 2007. Included in the 2008 loss amount is \$16,017,000 of "other-than-temporary" investment impairment losses recognized on 38 equity securities as a result of the severe and prolonged turmoil in the financial markets, and \$14,904,000 of losses recognized on the perpetual preferred stocks of Freddie Mac and Fannie Mae when these companies were placed under conservatorship by the U.S. government. For comparative purposes, "other-than-temporary" investment impairment losses for 2007 totaled \$1,277,000 on 14 equity securities.

The total rate of return on the Company's equity portfolio during 2008 was negative 37.4 percent, compared to negative 37.0 percent for the S&P 500. The current annualized yield on the bond portfolio and cash was 5.6 percent and the effective duration was 5.57 years, which was up from 3.75 years at December 31, 2007.

Interest and other expense

Interest expense declined 20.1 percent in 2008 due to the redemption of the reinsurance subsidiary's \$11,000,000 of surplus notes on December 31, 2007. This decline in interest expense was partially offset by an increase in the interest rate on the surplus notes issued by the property and casualty insurance subsidiaries to 3.60 percent from 3.09 percent effective February 1, 2008. The 26.9 percent decrease in other expense was primarily due to fluctuations in foreign currency exchange rates recognized by the reinsurance subsidiary on its foreign contracts.

Income tax

The Company reported an income tax benefit of \$8,585,000 in 2008, compared to income tax expense of \$16,441,000 in 2007. The relatively high ratio of income tax benefit to pretax loss for 2008 reflects the fact that a significant amount of the Company's investment income was received in the form of tax-exempt interest income.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

Liquidity is a measure of a company's ability to generate sufficient cash flows to meet cash obligations. The Company had positive cash flows from operations of \$34,116,000 in 2009, \$30,684,000 in 2008 and \$37,862,000 in 2007. The Company typically generates substantial positive cash flows from operations because cash from premium payments is generally received in advance of cash payments made to settle claims. These positive cash flows provide the foundation of the Company's asset/liability management program and are the primary drivers of the Company's liquidity. When investing funds made available from operations, the Company invests in securities with maturities that approximate the anticipated payments of losses and settlement expenses of the underlying insurance policies. In addition, the Company maintains a portion of its investment portfolio in relatively short-term and highly liquid assets as a secondary source of liquidity should net cash flows from operating activities prove insufficient to fund current operating needs. As of December 31, 2009, the Company did not have any significant variations between the maturity dates of its investments and the expected payments of its loss and settlement expense reserves.

The Company is a holding company whose principal asset is its investment in its insurance subsidiaries. As a holding company, the Company is dependent upon cash dividends from its insurance company subsidiaries to meet all obligations, including cash dividends to stockholders and the funding of the Company's stock repurchase program. State insurance regulations restrict the maximum amount of dividends insurance companies can pay without prior regulatory approval. See note 6 of Notes to Consolidated Financial Statements for additional information regarding dividend restrictions. The maximum amount of dividends that the insurance company subsidiaries can pay to the Company in 2010 without prior regulatory approval is approximately \$44,986,000. The Company received \$12,500,000, \$25,005,000 and \$4,750,000 of dividends from its insurance company subsidiaries and paid cash dividends to its stockholders totaling \$9,507,000, \$9,731,000 and \$9,497,000 in 2009, 2008 and 2007, respectively. The excess dividends received from the insurance company subsidiaries in 2008 and 2009 were used to partially fund the Company's \$25,000,000 stock repurchase program. At December 31, 2009, approximately \$7,100,000 of the stock repurchase program remains available for the purchase of additional shares, which will necessitate the dividend of additional funds from the insurance company subsidiaries to the holding company.

The Company's insurance and reinsurance company subsidiaries must have adequate liquidity to ensure that their cash obligations are met; however, because of their participation in the pooling agreement and the quota share agreement, they do not have the daily liquidity concerns normally associated with an insurance or reinsurance company. This is because under the terms of the pooling and quota share agreements, Employers Mutual receives all premiums and pays all losses and expenses associated with the insurance business produced by the pool participants and the assumed reinsurance business ceded to the Company's reinsurance subsidiary, and then settles the inter-company balances generated by these transactions with the participating companies within 45 days after the end of each quarter.

At the insurance company subsidiary level, the primary sources of cash are premium income, investment income and maturing investments. The principal outflows of cash are payments of claims, commissions, premium taxes, operating expenses, income taxes, dividends, interest and principal payments on debt, and investment purchases. Cash outflows vary because of uncertainties regarding settlement dates for unpaid losses and the potential for large losses, either individually or in the aggregate. Accordingly, the insurance company subsidiaries maintain investment and reinsurance programs intended to provide adequate funds to pay claims without forced sales of investments. In addition, the insurance company subsidiaries have access to a line of credit maintained by Employers Mutual with the Federal Home Loan Bank to provide additional liquidity if needed.

The Company maintains a portion of its investment portfolio in relatively short-term and highly liquid investments to ensure the availability of funds to pay claims and expenses. At December 31, 2009, approximately 18 percent of the Company's fixed maturity securities were in U.S. government or U.S. government-sponsored agency securities. This is down from approximately 35 percent at December 31, 2008 due to a significant amount of call activity on the Company's U.S. government agency securities that occurred during 2009 due to the low interest rate environment. As of December 31, 2009, the majority of the proceeds received from the called securities had been reinvested. A variety of maturities are maintained in the Company's investment portfolio to assure adequate liquidity. The maturity structure of the fixed maturity securities is also established by the relative attractiveness of yields on short, intermediate and long-term securities. The Company does not invest in high-yield, non-investment grade debt securities. Any non-investment grade securities held by the Company are the result of rating downgrades subsequent to their purchase.

The Company invest for the long term and generally purchases fixed maturity securities intending to hold them to maturity. Despite this intent, the Company currently classifies purchases of fixed maturity securities as available-for-sale to provide flexibility in the management of its investment portfolio. At December 31, 2009, the Company had a net unrealized holding gain, net of deferred taxes, on its fixed maturity securities available-for-sale of \$17,541,000, compared to a net unrealized holding loss of \$5,468,000 at December 31, 2008. The fluctuation in the fair value of these investments is primarily due to changes in the interest rate environment during this time period, but also reflects fluctuations in risk premium spreads over U.S. Treasuries for corporate and U.S. government-sponsored agency securities. Since the Company does not actively trade in the bond market, such fluctuations in the fair value of these investments are not expected to have a material impact on the operations of the Company, as forced liquidations of investments are not anticipated. The Company closely monitors the bond market and makes appropriate adjustments in its portfolio as conditions warrant.

The majority of the Company's assets are invested in fixed maturity securities. These investments provide a substantial amount of investment income that supplements underwriting results and contributes to net earnings. As these investments mature, or are called, the proceeds are reinvested at current rates, which may be higher or lower than those now being earned; therefore, more or less investment income may be available to contribute to net earnings depending on the interest rate level.

The Company participates in a securities lending program administered by Mellon Bank, N.A. whereby certain fixed maturity securities from the investment portfolio are loaned to other institutions for short periods of time. The Company receives a fee for each security loaned out under this program and requires initial collateral equal to 102 percent of the fair value of the loaned securities. The collateral is primarily cash, but other forms of collateral are occasionally accepted, including letters of credit or U.S. Treasury securities. The cash collateral is invested in a Delaware business trust that is managed by Mellon Bank. In this trust, cash collateral funds of the Company are pooled with cash collateral funds of other security lenders administered by Mellon Bank, and these funds are invested in securities with high credit quality standards, maturity restrictions, and liquidity levels consistent with the short-term nature of securities lending transactions. The acceptable investments include time deposits, commercial paper, floating rate notes, asset-backed floating rate notes, and repurchase agreements. The earnings from this trust are used, in part, to pay the fee the Company receives for each security loaned under the program. The Company has a slight risk of a minor loss associated with the collateral pool if the aggregate fair value of the collateral pool were to decline below the aggregate liability represented by the collateral, assuming all securities loaned and backed by the collateral pool were returned. The Company had securities on loan with a fair value of \$14,493,000 and \$8,950,000 at December 31, 2009 and 2008, respectively. Collateral held in connection with these loaned securities totaled \$14,942,000 and \$9,323,000 at December 31, 2009 and 2008, respectively. Fluctuations in the amount of securities on loan are due to changes in demand for the type of securities the Company makes available to the program (primarily U.S. government agencies, U.S. treasuries and corporate bonds). During the fourth quarter of 2009, management decided to discontinue its participation in the securities lending program and as a result, began to unwind the program.

The Company held \$47,000 and \$67,000 in minority ownership interests in limited partnerships and limited liability companies at December 31, 2009 and 2008, respectively. The Company does not hold any other unregistered securities.

The Company's cash balance was \$279,000 and \$183,000 at December 31, 2009 and 2008, respectively.

Employers Mutual contributed \$17,000,000, \$15,000,000 and \$3,500,000 to its pension plan in 2009, 2008 and 2007, respectively, and plans to contribute approximately \$25,000,000 to the pension plan in 2010. The Company reimbursed Employers Mutual \$5,204,000, \$4,555,000 and \$1,069,000 for its share of the pension contributions in 2009, 2008 and 2007, respectively. Employers Mutual contributed \$2,550,000, \$12,200,000 and \$3,800,000 to its postretirement benefit plans in 2009, 2008 and 2007, respectively, and expects to contribute approximately \$2,750,000 to the postretirement benefit plans in 2010. The Company reimbursed Employers Mutual \$724,000, \$3,495,000 and \$1,083,000 for its share of the postretirement benefit plan contributions in 2009, 2008 and 2007, respectively.

Capital Resources

Capital resources consist of stockholders' equity and debt, representing funds deployed or available to be deployed to support business operations. For the Company's insurance and reinsurance company subsidiaries, capital resources are required to support premium writings. Regulatory guidelines suggest that the ratio of a property and casualty insurer's annual net premiums written to its statutory surplus should not exceed three to one. All of the Company's property and casualty insurance subsidiaries were well under this guideline at December 31, 2009.

The Company's insurance subsidiaries are required to maintain a certain minimum level of surplus on a statutory basis, and are subject to regulations under which the payment of dividends from statutory surplus is restricted and may require prior approval of their domiciliary insurance regulatory authorities. The Company's insurance subsidiaries are also subject to Risk Based Capital (RBC) requirements that may further impact their ability to pay dividends. RBC requirements attempt to measure minimum statutory capital needs based upon the risks in a company's mix of products and investment portfolio. At December 31, 2009, the Company's insurance subsidiaries had total adjusted statutory capital of \$327,244,000, which was well in excess of the minimum RBC requirement of \$56,862,000.

The Company's total cash and invested assets at December 31, 2009 and 2008 are summarized as follows:

	December 31, 2009			
	Amortized	Fair	Percent of	Carrying
(\$ in thousands)	cost	value	total fair value	value
Fixed maturity securities held-to-maturity	\$ 410	\$ 461	0.1 %	\$ 410
Fixed maturity securities available-for-sale ..	872,195	899,181	86.0	899,181
Equity securities available-for-sale	73,115	90,190	8.6	90,190
Cash	279	279	-	279
Short-term investments	55,390	55,390	5.3	55,390
Other long-term investments	47	47	-	47
	<u>\$ 1,001,436</u>	<u>\$ 1,045,548</u>	<u>100.0 %</u>	<u>\$ 1,045,497</u>

December 31, 2008				
(\$ in thousands)	Amortized cost	Fair value	Percent of	Carrying value
			total fair value	
Fixed maturity securities held-to-maturity	\$ 535	\$ 573	0.1 %	\$ 535
Fixed maturity securities available-for-sale ..	830,231	821,819	85.1	821,819
Equity securities available-for-sale	75,026	88,372	9.2	88,372
Cash	182	182	-	182
Short-term investments	54,373	54,373	5.6	54,373
Other long-term investments	67	67	-	67
	<u>\$ 960,414</u>	<u>\$ 965,386</u>	<u>100.0 %</u>	<u>\$ 965,348</u>

The amortized cost and estimated fair value of fixed maturity and equity securities at December 31, 2009 were as follows:

(\$ in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Securities held-to-maturity:				
Fixed maturity securities:				
Residential mortgage-backed	\$ 410	\$ 51	\$ -	\$ 461
Total securities held-to-maturity	<u>\$ 410</u>	<u>\$ 51</u>	<u>\$ -</u>	<u>\$ 461</u>
Securities available-for-sale:				
Fixed maturity securities:				
U.S. treasury	\$ 4,739	\$ 244	\$ -	\$ 4,983
US government-sponsored agencies	151,441	1,011	2,037	150,415
Obligations of states and political subdivisions	380,606	15,605	4,445	391,766
Commercial mortgage-backed	75,564	6,828	-	82,392
Residential mortgage-backed	31,017	962	924	31,055
Other asset-backed	9,164	739	18	9,885
Corporate	219,664	10,284	1,263	228,685
Total fixed maturity securities	<u>872,195</u>	<u>35,673</u>	<u>8,687</u>	<u>899,181</u>
Equity securities:				
Common stocks:				
Financial services	7,448	3,276	57	10,667
Information technology	13,366	6,326	-	19,692
Healthcare	10,067	2,902	34	12,935
Consumer staples	6,324	768	49	7,043
Consumer discretionary	6,100	1,500	19	7,581
Energy	6,995	1,859	43	8,811
Industrials	5,239	684	96	5,827
Other	8,076	1,324	29	9,371
Non-redeemable preferred stocks	9,500	16	1,253	8,263
Total equity securities	<u>73,115</u>	<u>18,655</u>	<u>1,580</u>	<u>90,190</u>
Total securities available-for-sale	<u>\$ 945,310</u>	<u>\$ 54,328</u>	<u>\$ 10,267</u>	<u>\$ 989,371</u>

The Company's property and casualty insurance subsidiaries have \$25,000,000 of surplus notes issued to Employers Mutual. Effective February 1, 2008, the interest rate on these surplus notes was increased from 3.09 percent to 3.60 percent. Future reviews of the interest rate will be conducted by the Inter-Company Committees of the Boards of Directors of the Company and Employers Mutual every five years. Payment of interest and repayment of principal can only be made out of the applicable subsidiary's statutory surplus and is subject to prior approval by the insurance commissioner of the respective state of domicile. The surplus notes are subordinate and junior in right of payment to all obligations or liabilities of the applicable insurance subsidiaries. Prior to December 31, 2007, the Company's reinsurance subsidiary had \$11,000,000 of surplus notes issued to Employers Mutual. These surplus notes were redeemed in the fourth quarter of 2007, along with accrued interest. Total interest expense incurred on these surplus notes was \$900,000, \$889,000 and \$1,111,000 in 2009, 2008 and 2007, respectively. At December 31, 2009, the Company's property and casualty insurance subsidiaries had received approval for the payment of interest accrued on the surplus notes during 2009.

As of December 31, 2009, the Company had no material commitments for capital expenditures.

Off-Balance Sheet Arrangements

Employers Mutual receives all premiums and pays all losses and expenses associated with the assumed reinsurance business ceded to the reinsurance subsidiary and the insurance business produced by the pool participants, and then settles the inter-company balances generated by these transactions with the participating companies on a quarterly basis. When settling the inter-company balances, Employers Mutual provides the reinsurance subsidiary and the pool participants with full credit for the premiums written during the quarter and retains all receivable amounts. Any receivable amounts that are ultimately deemed to be uncollectible are charged-off by Employers Mutual and the expense is charged to the reinsurance subsidiary or allocated to the pool members on the basis of pool participation. As a result, the Company has an off-balance sheet arrangement with an unconsolidated entity that results in a credit-risk exposure that is not reflected in the Company's financial statements. Based on historical data, this credit-risk exposure is not considered to be material to the Company's results of operations or financial position.

Investment Impairments and Considerations

The Company recorded "other-than-temporary" investment impairment losses totaling \$10,108,000 on 34 equity securities and three fixed maturity securities during 2009, compared to \$30,921,000 on 40 equity securities during 2008. Impairment losses on the three fixed maturity securities totaled \$2,657,000 and is attributed to a bankruptcy filing made by Great Lakes Chemical Corporation, now known as Chemtura Corporation (\$2,220,000), a planned disposal of US Freightways Corporation securities (\$350,000), and the determination of a credit loss (all contractual cash flows are not expected to be collected) on a residential mortgage-backed security (\$87,000). Included in the 2008 amount is \$14,904,000 of impairment losses on the perpetual preferred stocks of Freddie Mac and Fannie Mae resulting from the U.S. government placing these companies under conservatorship. The Company sold these perpetual preferred stocks during the fourth quarter of 2008 and recognized an additional loss of \$141,000.

The Company has no direct exposure to sub-prime residential lending, and holds no sub-prime residential collateralized debt obligations or sub-prime collateralized mortgage obligations. The Company does have indirect exposure to sub-prime residential lending markets as it has significant holdings of government agency securities, prime and Alt-A collateralized mortgage obligations, as well as fixed maturity and equity security holdings in both the banking and financial services sectors. While these holdings do not include companies engaged in originating residential lending as their primary business, they do include companies that may be indirectly engaged in this type of lending.

During the second quarter of 2008, management evaluated and implemented a new investment strategy targeting high-quality residential mortgage-backed securities. This investment strategy, which is being administered by Harris Investment Management, Inc., was designed to take advantage of the liquidity-induced market dislocation that existed in the securitized residential mortgage marketplace, and targeted AAA rated residential mortgage-backed securities (no securities backed by subprime mortgages were purchased). The investments were diversified with respect to key risk factors (such as vintage, originator and geography).

At December 31, 2009, the Company had unrealized losses on available-for-sale securities as presented in the table below. The estimated fair value is based on quoted market prices, where available. In cases where quoted market prices are not available, fair values are based on a variety of valuation techniques depending on the type of security. None of these securities are considered to be in concentrations by either security type or industry. The Company uses several factors to determine whether the carrying value of an individual security has been “other-than-temporarily” impaired. Such factors include, but are not limited to, the security’s value and performance in the context of the overall markets, length of time and extent the security’s fair value has been below carrying value, key corporate events and collateralization of fixed maturity securities. Based on these factors, the absence of management’s intent to sell these securities prior to recovery or maturity, and the fact that management does not anticipate that it will be forced to sell these securities prior to recovery or maturity, it was determined that the carrying value of these securities were not “other-than-temporarily” impaired at December 31, 2009 (note, however, that this schedule does include a relatively small amount of unrealized losses on an “other-than-temporarily” impaired residential mortgage-backed security). Risks and uncertainties inherent in the methodology utilized in this evaluation process include interest rate risk, equity price risk, and the overall performance of the economy, all of which have the potential to adversely affect the value of the Company’s investments. Should a determination be made at some point in the future that these unrealized losses are “other-than-temporary”, the Company’s earnings would be reduced by approximately \$6,674,000, net of tax; however, the Company’s financial position would not be affected because unrealized losses on available-for-sale securities are reflected in the Company’s financial statements as a component of stockholders’ equity, net of deferred taxes.

Following is a schedule of the length of time securities have continuously been in an unrealized loss position as of December 31, 2009.

(\$ in thousands)	Less than twelve months		Twelve months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Fixed maturity securities:						
U.S. government-sponsored agencies	\$ 102,036	\$ 2,037	\$ -	\$ -	\$ 102,036	\$ 2,037
Obligations of states and political subdivisions	83,488	3,832	6,314	613	89,802	4,445
Residential mortgage-backed	3,318	93	10,536	831	13,854	924
Other asset-backed	-	-	504	18	504	18
Corporate	43,994	685	18,831	578	62,825	1,263
Subtotal, fixed maturity securities	232,836	6,647	36,185	2,040	269,021	8,687
Equity securities:						
Common stocks:						
Financial services	1,093	57	-	-	1,093	57
Healthcare	1,550	34	-	-	1,550	34
Consumer staples	1,902	49	-	-	1,902	49
Consumer discretionary	407	19	-	-	407	19
Energy	1,502	43	-	-	1,502	43
Industrials	1,388	96	-	-	1,388	96
Other	2,078	29	-	-	2,078	29
Non-redeemable preferred stocks	-	-	5,247	1,253	5,247	1,253
Subtotal, equity securities	9,920	327	5,247	1,253	15,167	1,580
Total temporarily impaired securities	\$ 242,756	\$ 6,974	\$ 41,432	\$ 3,293	\$ 284,188	\$ 10,267

Following is a schedule of the maturity dates of the fixed maturity securities presented in the above table. Note that this schedule includes only fixed maturity securities available-for-sale, as the Company does not have any fixed maturity securities held-to-maturity with unrealized losses.

(\$ in thousands)	Book value	Fair value	Gross unrealized loss
Due in one year or less	\$ -	\$ -	\$ -
Due after one year through five years	10,688	10,602	86
Due after five years through ten years	30,969	30,574	395
Due after ten years	221,273	213,991	7,282
Mortgage-backed securities	14,778	13,854	924
	<u>\$ 277,708</u>	<u>\$ 269,021</u>	<u>\$ 8,687</u>

All non-investment grade fixed maturity securities held at December 31, 2009 (American Airlines, Weyerhaeuser Company and eight residential mortgage-backed securities) had an aggregate unrealized loss of \$593,000. The Company does not purchase non-investment grade securities. Any non-investment grade securities held by the Company are the result of rating downgrades that occurred subsequent to their purchase. The eight residential mortgage-backed securities that are new to this list in 2009 were the only securities on this list with unrealized losses at December 31, 2009. These securities were part of the 2008 investment strategy that targeted high-quality residential mortgage-backed securities.

Following is a schedule of gross realized losses recognized in 2009 from the sale of securities and from “other-than-temporary” investment impairments. The schedule is aged according to the length of time the underlying securities were in an unrealized loss position. This schedule does not include realized losses stemming from corporate actions such as calls, pay-downs, redemptions, etc.

(\$ in thousands)	Realized losses from sales			"Other-than-temporary" impairment losses	Total gross realized losses
	Book value	Sales price	Gross realized losses		
Fixed maturity securities:					
Three months or less	\$ 650	\$ 600	\$ 50	\$ -	\$ 50
Over three months to six months	-	-	-	-	-
Over six months to nine months	-	-	-	2,220	2,220
Over nine months to twelve months	-	-	-	-	-
Over twelve months	-	-	-	437	437
	<u>\$ 650</u>	<u>\$ 600</u>	<u>\$ 50</u>	<u>\$ 2,657</u>	<u>\$ 2,707</u>
Equity securities:					
Three months or less	\$ 13,355	\$ 12,212	\$ 1,143	\$ 2,526	\$ 3,669
Over three months to six months	4,425	3,542	883	1,649	2,532
Over six months to nine months	2,926	2,331	595	2,444	3,039
Over nine months to twelve months	818	758	60	179	239
Over twelve months	330	281	49	653	702
	<u>\$ 21,854</u>	<u>\$ 19,124</u>	<u>\$ 2,730</u>	<u>\$ 7,451</u>	<u>\$ 10,181</u>

The “other-than-temporary” impairment losses on fixed maturity securities are primarily from the impairment of Chemtura Corporation and US Freightways Corporation securities, both of which were subsequently sold during 2009 generating a net realized gain of \$798,000. The realized losses associated with securities that had been in an unrealized loss position for over twelve months are primarily from “other-than-temporary” impairment losses recognized on three equity securities.

LEASES, COMMITMENTS AND CONTINGENT LIABILITIES

The following table reflects the Company’s contractual obligations as of December 31, 2009. Included in the table are the estimated payments that the Company expects to make in the settlement of its loss reserves and with respect to its long-term debt. One of the Company’s property and casualty insurance subsidiaries leases office facilities in Bismarck, North Dakota with lease terms expiring in 2014. Employers Mutual has entered into various leases for branch and service office facilities with lease terms expiring through 2021. All lease costs are included as expenses under the pooling agreement, after allocation of a portion of the expenses to the subsidiaries that do not participate in the pooling agreement. Included in the following table is the Company’s current 30.0 percent aggregate participation percentage of all operating lease obligations of the parties to the pooling agreement.

	Payments due by period				
	Total	Less than 1 year	1 - 3 years	4 - 5 years	More than 5 years
Contractual obligations					
(\$ in thousands)					
Loss and settlement expense reserves (1)	\$ 556,152	\$ 214,740	\$ 204,365	\$ 80,819	\$ 56,228
Long-term debt (2)	25,000	-	-	-	25,000
Interest expense on long-term debt (3)	9,000	900	1,800	1,800	4,500
Real estate operating leases	7,517	1,226	2,108	1,662	2,521
Total	<u>\$ 597,669</u>	<u>\$ 216,866</u>	<u>\$ 208,273</u>	<u>\$ 84,281</u>	<u>\$ 88,249</u>

- (1) The amounts presented are estimates of the dollar amounts and time period in which the Company expects to pay out its gross loss and settlement expense reserves. These amounts are based on historical payment patterns and do not represent actual contractual obligations. The actual payment amounts and the related timing of those payments could differ significantly from these estimates.
- (2) Long-term debt reflects the surplus notes issued by the Company's property and casualty insurance subsidiaries to Employer Mutual, which have no maturity date. Excluded from long-term debt are pension and other postretirement benefit obligations.
- (3) Interest expense on long-term debt reflects the interest expense on the surplus notes issued by the Company's property and casualty insurance subsidiaries to Employers Mutual. Interest on the surplus notes is subject to approval by the issuing company's state of domicile regulatory authority. The balance shown under the heading "More than 5 years" represents interest expense for years six through ten. Since the surplus notes have no maturity date, total interest expense could be greater than the amount shown.

The participants in the pooling agreement are subject to guaranty fund assessments by states in which they write business. Guaranty fund assessments are used by states to pay policyholder liabilities of insolvent insurers domiciled in those states. Many states allow assessments to be recovered through premium tax offsets. Estimated guaranty fund assessments of \$1,236,000 and \$1,506,000 and related premium tax offsets of \$692,000 and \$936,000 have been accrued as of December 31, 2009 and 2008, respectively. The guaranty fund assessments are expected to be paid over the next two years and the premium tax offsets are expected to be realized within ten years of the payments. The participants in the pooling agreement are also subject to second-injury fund assessments, which are designed to encourage employers to employ a worker with a pre-existing disability. Estimated second-injury fund assessments of \$1,709,000 and \$1,576,000 have been accrued as of December 31, 2009 and 2008, respectively. The second-injury fund assessment accruals are based on projected loss payments. The periods over which the assessments will be paid is not known.

The participants in the pooling agreement have purchased annuities from life insurance companies, under which the claimant is payee, to fund future payments that are fixed pursuant to specific claim settlement provisions. The Company's share of case loss reserves eliminated by the purchase of these annuities was \$1,712,000 at December 31, 2009. The Company has a contingent liability of \$1,712,000 at December 31, 2009 should the issuers of these annuities fail to perform. The probability of a material loss due to failure of performance by the issuers of these annuities is considered remote. The Company's share of the amount due from any one life insurance company does not equal or exceed one percent of its subsidiaries' aggregate policyholders' surplus.

MARKET RISK

The main objectives in managing the Company's investment portfolios are to maximize after-tax investment return while minimizing credit risks, in order to provide maximum support for the underwriting operations. Investment strategies are developed based upon many factors including underwriting results, regulatory requirements, fluctuations in interest rates and consideration of other market risks. Investment decisions are centrally managed by investment professionals and are supervised by the investment committees of the respective boards of directors for each of the Company's subsidiaries.

Market risk represents the potential for loss due to adverse changes in the fair value of financial instruments, and is directly influenced by the volatility and liquidity in the markets in which the related underlying assets are traded. The market risks of the financial instruments of the Company relate to the investment portfolio, which exposes the Company to interest rate (inclusive of credit spreads) and equity price risk and, to a lesser extent, credit quality and prepayment risk. Monitoring systems and analytical tools are in place to assess each of these elements of market risk; however, there can be no assurance that future changes in interest rates, creditworthiness of issuers, prepayment activity, liquidity available in the market and other general market conditions will not have a material adverse impact on the Company's results of operations, liquidity or financial position.

Interest rate risk (inclusive of credit spreads) includes the price sensitivity of a fixed maturity security to changes in interest rates, and the affect on future earnings from short-term investments and maturing long-term investments given a change in interest rates. The following table illustrates the sensitivity of the Company's fixed maturity securities available-for-sale to hypothetical changes in market rates and prices.

(\$ in thousands)	Estimated fair value at December 31, 2009	Hypothetical change in interest rate (bp=basis points)	Estimated fair value after hypothetical change in interest rate	Hypothetical percentage increase (decrease) in Stockholders' Equity	
Fixed maturity securities:					
U.S. treasury	\$ 4,983	200 bp decrease	\$ 5,108	0.02	%
		100 bp decrease	5,043	0.01	
		100 bp increase	4,923	(0.01)	
		200 bp increase	4,863	(0.02)	
U.S. government-sponsored agencies	\$ 150,415	200 bp decrease	\$ 158,688	1.57	%
		100 bp decrease	155,980	1.06	
		100 bp increase	139,736	(2.03)	
		200 bp increase	128,304	(4.20)	
Obligations of states and political subdivisions	\$ 391,766	200 bp decrease	\$ 452,881	11.60	%
		100 bp decrease	424,283	6.17	
		100 bp increase	356,899	(6.62)	
		200 bp increase	324,774	(12.72)	
Commercial mortgage-backed	\$ 82,392	200 bp decrease	\$ 88,077	1.08	%
		100 bp decrease	85,111	0.52	
		100 bp increase	79,755	(0.50)	
		200 bp increase	77,284	(0.97)	
Residential mortgage-backed	\$ 31,055	200 bp decrease	\$ 33,850	0.53	%
		100 bp decrease	32,701	0.31	
		100 bp increase	29,223	(0.35)	
		200 bp increase	27,453	(0.68)	
Other asset-backed	\$ 9,885	200 bp decrease	\$ 11,051	0.22	%
		100 bp decrease	10,439	0.11	
		100 bp increase	9,371	(0.10)	
		200 bp increase	8,906	(0.19)	
Corporate	\$ 228,685	200 bp decrease	\$ 251,096	4.25	%
		100 bp decrease	240,119	2.17	
		100 bp increase	217,251	(2.17)	
		200 bp increase	206,503	(4.21)	
Total fixed maturity securities	\$ 899,181	200 bp decrease	\$ 1,000,751	19.27	%
		100 bp decrease	953,676	10.35	
		100 bp increase	837,158	(11.78)	
		200 bp increase	778,087	(22.99)	

The Company monitors interest rate risk through the analysis of interest rate simulations, and adjusts the average duration of its fixed maturity portfolio by investing in either longer or shorter term instruments given the results of interest rate simulations and judgments of cash flow needs. The effective duration of the Company's fixed maturity portfolio at December 31, 2009 was 6.12 years.

The valuation of the Company's marketable equity portfolio is subject to equity price risk. In general, equities have more year-to-year price variability than bonds. However, returns from equity securities have been consistently higher over longer time frames. The Company invests in a diversified portfolio of readily marketable equity securities. A hypothetical 10 percent decrease in the S&P 500 index as of December 31, 2009 would result in a corresponding pre-tax decrease in the fair value of the Company's equity portfolio of approximately \$8,193,000.

Fixed maturity securities held by the Company generally have an investment quality rating of "A" or better by independent rating agencies. The following table shows the composition of the Company's fixed maturity securities, by rating, as of December 31, 2009.

(\$ in thousands)	Securities held-to-maturity (at amortized cost)		Securities available-for-sale (at fair value)	
	Amount	Percent	Amount	Percent
Rating:				
AAA	\$ 410	100.0 %	\$ 287,073	31.9 %
AA	-	-	328,533	36.5
A	-	-	207,429	23.1
BAA	-	-	64,842	7.2
BA	-	-	8,504	1.0
B	-	-	2,800	0.3
Total fixed maturities	<u>\$ 410</u>	<u>100.0 %</u>	<u>\$ 899,181</u>	<u>100.0 %</u>

As of December 31, 2009, the Company held approximately \$202,040,000 of municipal securities that are enhanced by financial guaranty insurers, which represents approximately 22.5 percent of the Company's total fixed maturity portfolio. Municipal securities insurance guarantees the payment of principal and interest if the issuer defaults. The credit rating of insurance enhanced municipal securities is usually based on the credit rating of the insurer. These securities have an average rating of "AA". Approximately \$41,217,000 of the securities have been pre-refunded, which means that funds have been set aside in escrow to satisfy the future interest and principal obligations of the security. A summary of the financial guaranty insurers backing the Company's insurance enhanced municipal securities, including the pre-refunded bonds that are escrowed, is as follows.

(\$ in thousands)	Total	Pre-refunded securities	Exposure net of pre-refunded securities
Ambac Financial Group, Inc.	\$ 36,883	\$ 8,954	\$ 27,929
Assured Guaranty Corp. (FSA)	30,068	-	30,068
Financial Guaranty Ins. Co.	9,349	4,067	5,282
Financial Guaranty Ins. Co. (FGRMB)	20,188	-	20,188
PSF - Texas Permanent School Fund	40,010	11,690	28,320
MBIA Inc.	58,420	15,875	42,545
Other	7,122	631	6,491
Total Guaranteed	<u>\$ 202,040</u>	<u>\$ 41,217</u>	<u>\$ 160,823</u>

The following table shows the total fair value of the Company's municipal securities by rating, both with and without insurance enhancement.

(\$ in thousands)	With insurance enhancements	Without insurance enhancements
Rating:		
AAA	\$ 53,935	\$ 8,553
AA	104,818	129,812
A	42,821	57,272
BAA	466	-
No rating	-	6,403
Total	<u>\$ 202,040</u>	<u>\$ 202,040</u>

The Company has no insurance enhanced asset-backed securities. As of December 31, 2009, the Company had no direct investment in the entities that provided financial guarantees to any security held by the Company.

Ratings for preferred stocks and fixed maturity securities with initial maturities greater than one year are assigned by nationally recognized statistical rating organizations (referred to generically as NRSROs, which includes such organizations as Moody's Investor's Services, Inc., Standard and Poor, etc.). The NRSROs' rating processes seek to evaluate the quality of a security by examining the factors that affect returns to investors. NRSROs' ratings are based on quantitative and qualitative factors, as well as the economic, social and political environment in which the issuing entity exists. The quantitative factors include debt coverage, sales and income growth, cash flows and liquidity ratios. Qualitative factors include management quality, access to capital markets and the quality of earnings and balance sheet items. Ratings for securities with initial maturities less than one year are based on ratings of NRSROs, or the credit rating of the issuer's parent company. For further discussion of credit risk and related topics (impairment losses on equity securities, residential mortgage-backed securities, unrealized losses in the investment portfolios, and non-investment grade securities held by the Company) see the section entitled "Investment Impairments and Considerations" within this Management's Discussion and Analysis of Financial Condition and Results of Operations.

Prepayment risk refers to changes in prepayment patterns that can shorten or lengthen the expected timing of principal repayments and thus the average life and the effective yield of a security. Such risk exists primarily within the portfolio of mortgage-backed securities. Prepayment risk is monitored regularly through the analysis of interest rate simulations. At December 31, 2009, the effective duration of the mortgage-backed securities is 3.9 years with an average life of 4.0 years and a yield to maturity of 6.2 percent. At December 31, 2008, the effective duration of the mortgage-backed securities was 6.7 years, with an average life of 5.3 years and a yield to maturity of 5.7 percent.

IMPACT OF INFLATION

Inflation has a widespread effect on the Company's results of operations, primarily through increased losses and settlement expenses. The Company considers inflation, including social inflation that reflects an increasingly litigious society and increasing jury awards, when setting loss and settlement expense reserve amounts. Premiums are also affected by inflation, although they are often restricted or delayed by competition and the regulatory rate-setting environment.

NEW ACCOUNTING PRONOUNCEMENTS

The FASB recognized the complexity of its standard-setting process and embarked on a revised process in 2004 that culminated in the release on July 1, 2009, of the FASB ASC. The Codification does not change how the Company accounts for its transactions or the nature of related disclosures made. However, when referring to guidance issued by the FASB, the Company now refers to topics in the ASC rather than the previous FASB Statement numbers, Interpretations, Staff Positions, etc. This change was made effective by the FASB for periods ending on or after September 15, 2009. References to GAAP in this Form 10-K have been updated to reflect guidance in the Codification.

In May 2009, the FASB updated its guidance related to the Subsequent Events Topic 855 of the FASB ASC (issued as SFAS No. 165, "Subsequent Events"), which sets forth the period after the balance sheet date during which management shall evaluate events or transactions for potential recognition or disclosure, the circumstances under which an entity shall recognize events or transactions occurring after the balance sheet date, and disclosures to make about events or transactions that occur after the balance sheet date. This pronouncement was effective for interim and annual reporting periods ending after June 15, 2009. In February 2010, the FASB updated its guidance related to the Subsequent Events Topic 855, which removed the requirement to disclose the date through which subsequent events were evaluated for Securities and Exchange Commission filers. This pronouncement was effective immediately. Adoption of this pronouncement had no effect on the consolidated financial position or operating results of the Company.

The Fair Value Measurements and Disclosures Topic 820 of the FASB ASC has undergone substantial changes in recent years, including the issuance of several pronouncements predating the Codification. In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which defined fair value, established a framework for measuring fair value, and expanded disclosures about fair value measurements. These requirements were effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company adopted this pronouncement effective January 1, 2008, which resulted in additional disclosures, but no impact on the Company's consolidated financial position or operating results. In October 2008, the FASB issued FSP FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market For That Asset Is Not Active," which was followed in April 2009 by FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." Both of these pronouncements were intended to clarify the determination of fair value in markets that are not, at the measurement date, providing fair values representative of orderly transactions. Adoption of these pronouncements had no effect on the consolidated financial position or operating results of the Company.

In April 2009, the FASB updated its guidance related to the Investments-Debt and Equity Securities Topic 310 of the FASB ASC (issued as Staff Position (FSP) FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments"). This pronouncement established guidance for evaluating "other-than-temporary" impairments for fixed maturity securities, and required changes to the financial statement presentation and disclosure of fixed maturity and equity security "other-than-temporary" impairments. Included is a requirement that the evaluation of an impaired fixed maturity security include an assessment of whether the entity has the intent to sell the security and if it is more likely than not to be required to sell the security before recovery of its amortized cost basis. In addition, if the present value of cash flows expected to be collected is less than the amortized cost of the security, a credit loss is deemed to exist and the security is considered "other-than-temporarily" impaired. The portion of the impairment related to a credit loss is recognized through earnings and the impairment related to other factors is recognized through "other comprehensive income". This pronouncement was effective for interim and annual reporting periods ending after June 15, 2009. A cumulative effect adjustment from retained earnings to "accumulated other comprehensive income" was required for previously "other-than-temporarily" impaired fixed maturity securities still owned that had a non-credit component of the loss as of the date of adoption. The Company adopted this pronouncement in the second quarter of 2009. For further discussion of this statement, see Note 1 of the Consolidated Financial Statements.

In April 2009, the FASB updated its guidance related to the Financial Instruments Topic 825 of the FASB ASC (issued as FSP FAS 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments”). This pronouncement established quarterly disclosure requirements in interim financial statements of the fair value disclosures that were previously only required annually. This pronouncement was effective for interim and annual reporting periods ending after June 15, 2009. Adoption resulted in the addition of quarterly fair value disclosures, but had no effect on the consolidated financial position or operating results of the Company.

In December 2008, the FASB updated its guidance related to the Compensation-Retirement Benefits Topic 715 of the FASB ASC (issued as FSP FAS 132(R)-1, “Employers’ Disclosures about Postretirement Benefit Plan Assets”). This pronouncement established guidance on employers’ disclosures about plan assets of defined benefit pension or other postretirement plans, and was intended to address a lack of transparency surrounding the types of assets and associated risks in an employer’s defined benefit pension or other postretirement plans. The plan asset disclosures required are effective for fiscal years ending after December 15, 2009. Adoption resulted in additional disclosures, but had no effect on the consolidated financial position or operating results of the Company.

In December 2007, the FASB updated its guidance related to the Business Combinations Topic 805 of the FASB ASC (issued as SFAS No. 141 (revised 2007), “Business Combinations,” a replacement of SFAS No. 141, “Business Combinations”). This pronouncement retained the fundamental requirements of the acquisition method of accounting (previously referred to as “purchase method”) to be used for all business combinations, and was to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Adoption of this statement had no effect on the consolidated financial position or operating results of the Company.

Management's Report on Internal Control Over Financial Reporting

The management of EMC Insurance Group Inc. and Subsidiaries is responsible for the preparation, integrity and objectivity of the accompanying Consolidated Financial Statements, as well as all other financial information in this report. The Consolidated Financial Statements and the accompanying notes have been prepared in accordance with U.S. generally accepted accounting principles and include amounts that are based on management's estimates and judgments where necessary.

Management is responsible for establishing and maintaining adequate internal control over financial reporting, including safeguarding of assets and reliability of financial records. The Company's internal control over financial reporting, designed by or under the supervision of management, includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements. This control structure is further reinforced by a program of internal audits, including audits of the Company's decentralized branch locations, which requires responsive management action.

There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, adequate internal controls can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control may vary over time.

Management assessed the effectiveness of the Company's internal control over financial reporting based on criteria established in "Internal Control – Integrated Framework," issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management believes that, as of December 31, 2009, the Company maintained effective internal control over financial reporting.

The Audit Committee of the Board of Directors is comprised of three outside directors who are independent of the Company's management. The Audit Committee is responsible for the selection of the independent registered public accounting firm. It meets periodically with management, the independent registered public accounting firm, and the internal auditors to ensure that they are carrying out their responsibilities. In addition to reviewing the Company's financial reports, the Audit Committee is also responsible for performing an oversight role by reviewing and monitoring the financial, accounting and auditing procedures of the Company. The independent registered public accounting firm and the internal auditors have full and free access to the Audit Committee, with or without the presence of management, to discuss the adequacy of internal control over financial reporting and any other matters which they believe should be brought to the attention of the Audit Committee.

The Company's financial statements and internal control over financial reporting have been audited by Ernst & Young LLP, an independent registered public accounting firm. Management has made available to Ernst & Young LLP all of the Company's financial records and related data, as well as the minutes of the stockholders' and directors' meetings. Furthermore, management believes that all representations made to Ernst & Young LLP during its audit were valid and appropriate. Their reports with respect to the fairness of presentation of the Company's financial statements and the effectiveness of the Company's internal control over financial reporting appear elsewhere in this annual report.



Bruce G. Kelley
President and Chief Executive Officer



Mark E. Reese
Senior Vice President and Chief Financial Officer

**Report of Independent Registered Public Accounting Firm
on Internal Control Over Financial Reporting**

The Board of Directors and Stockholders
EMC Insurance Group Inc.

We have audited EMC Insurance Group Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). EMC Insurance Group Inc. and Subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, EMC Insurance Group Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2009 and 2008, and the related statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2009 of EMC Insurance Group Inc. and Subsidiaries and our report dated March 15, 2010 expressed an unqualified opinion thereon.

Ernst & Young LLP

Des Moines, Iowa
March 15, 2010

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
EMC Insurance Group Inc.

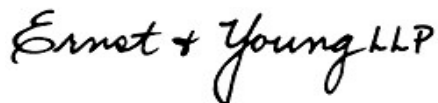
We have audited the accompanying consolidated balance sheets of EMC Insurance Group Inc. and Subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of EMC Insurance Group Inc. and Subsidiaries at December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in response to new accounting standards, the Company changed its methods of accounting for other-than-temporary impairments effective April 1, 2009 and for the accounting for its pension and other post-retirement benefits effective January 1, 2008.

We also have audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), EMC Insurance Group Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 15, 2010 expressed an unqualified opinion thereon.

The logo for Ernst & Young LLP is written in a stylized, cursive script. The word "Ernst" is followed by an ampersand, then "Young", and finally "LLP".

Des Moines, Iowa
March 15, 2010

EMC INSURANCE GROUP INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31,	
	<u>2009</u>	<u>2008</u>
ASSETS		
Investments:		
Fixed maturities:		
Securities held-to-maturity, at amortized cost		
(fair value \$460,877 and \$572,852)	\$ 410,005	\$ 534,759
Securities available-for-sale, at fair value		
(amortized cost \$858,129,177 and \$821,306,951)	884,688,114	812,868,835
Fixed maturity securities on loan:		
Securities available-for-sale, at fair value		
(amortized cost \$14,065,597 and \$8,923,745)	14,492,872	8,950,052
Equity securities available-for-sale, at fair value		
(cost \$73,114,920 and \$75,025,666)	90,189,979	88,372,207
Other long-term investments, at cost	47,083	66,974
Short-term investments, at cost	55,390,096	54,373,082
Total investments	<u>1,045,218,149</u>	<u>965,165,909</u>
Balances resulting from related party transactions with		
Employers Mutual:		
Reinsurance receivables	30,544,558	36,355,047
Prepaid reinsurance premiums	5,112,386	4,157,055
Deferred policy acquisition costs	36,650,628	34,629,429
Other assets	2,058,189	2,534,076
Cash	278,534	182,538
Accrued investment income	11,082,132	12,108,129
Accounts receivable	1,611,740	23,041
Income taxes recoverable	-	11,859,539
Deferred income taxes	15,044,357	30,819,592
Goodwill	941,586	941,586
Securities lending collateral	14,941,880	9,322,863
Other assets	2,303,654	-
Total assets	<u>\$ 1,165,787,793</u>	<u>\$ 1,108,098,804</u>

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

	December 31,	
	2009	2008
LIABILITIES		
Balances resulting from related party transactions with Employers Mutual:		
Losses and settlement expenses	\$ 553,787,770	\$ 573,031,853
Unearned premiums	159,486,096	154,446,205
Other policyholders' funds	7,918,665	6,418,870
Surplus notes payable	25,000,000	25,000,000
Indebtedness to related party	13,488,724	20,667,196
Employee retirement plans	18,176,720	19,331,007
Other liabilities	20,335,197	16,964,452
Losses and settlement expenses	2,363,807	-
Income taxes payable	5,488,760	-
Securities lending obligation	14,941,880	9,322,863
Other liabilities	2,382,489	-
Total liabilities	<u>823,370,108</u>	<u>825,182,446</u>
STOCKHOLDERS' EQUITY		
Common stock, \$1 par value, authorized 20,000,000 shares; issued and outstanding, 13,114,481 shares in 2009 and 13,267,668 shares in 2008	13,114,481	13,267,668
Additional paid-in capital	92,804,282	95,639,349
Accumulated other comprehensive income (loss):		
Net unrealized losses on fixed maturity securities with "other-than-temporary" impairments	(104,847)	-
Other net unrealized gains	28,744,673	3,207,576
Employee retirement plans	(12,587,484)	(13,137,688)
Total accumulated other comprehensive income (loss)	<u>16,052,342</u>	<u>(9,930,112)</u>
Retained earnings	220,446,580	183,939,453
Total stockholders' equity	<u>342,417,685</u>	<u>282,916,358</u>
Total liabilities and stockholders' equity	<u>\$ 1,165,787,793</u>	<u>\$ 1,108,098,804</u>

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME

All balances presented below, with the exception of net investment income, realized investment gains (losses) and income tax expense (benefit), and other items specifically identified, are the result of related party transactions with Employers Mutual.

	Year ended December 31,		
	2009	2008	2007
REVENUES			
Premiums earned:			
Related party transactions	\$ 380,315,958	\$ 389,317,798	\$ 393,059,397
Other transactions	3,694,943	-	-
Total premiums earned	<u>384,010,901</u>	<u>389,317,798</u>	<u>393,059,397</u>
Investment income, net	47,759,306	48,403,373	48,481,987
Net realized investment gains, excluding			
impairment losses on available-for-sale securities	28,030,648	6,465,320	5,000,367
Total "other-than-temporary" impairment losses on			
available-for-sale securities	(10,269,680)	(30,920,859)	(1,276,578)
Portion of impairment losses on fixed maturity			
available-for-sale securities recognized in other			
comprehensive income (before taxes)	161,303	-	-
Net impairment losses on available-for-sale securities	(10,108,377)	(30,920,859)	(1,276,578)
Net realized investment gains (losses)	17,922,271	(24,455,539)	3,723,789
Other income	755,178	626,499	544,422
	<u>450,447,656</u>	<u>413,892,131</u>	<u>445,809,595</u>
LOSSES AND EXPENSES			
Losses and settlement expenses:			
Related party transactions	246,218,424	294,265,293	247,839,181
Other transactions	2,531,035	-	-
Total losses and settlement expenses	<u>248,749,459</u>	<u>294,265,293</u>	<u>247,839,181</u>
Dividends to policyholders	9,090,655	5,822,521	7,632,714
Amortization of deferred policy acquisition costs:			
Related party transactions	87,087,782	87,863,949	88,730,235
Other transactions	904,967	-	-
Total amortization of deferred policy acquisition costs	<u>87,992,749</u>	<u>87,863,949</u>	<u>88,730,235</u>
Other underwriting expenses	39,016,979	33,698,721	39,330,006
Interest expense	900,000	889,375	1,111,469
Other expense:			
Related party transactions	2,200,795	1,642,326	2,247,301
Other transactions	(27,798)	-	-
Total other expense	<u>2,172,997</u>	<u>1,642,326</u>	<u>2,247,301</u>
	<u>387,922,839</u>	<u>424,182,185</u>	<u>386,890,906</u>
Income (loss) before income tax expense (benefit)	<u>62,524,817</u>	<u>(10,290,054)</u>	<u>58,918,689</u>
INCOME TAX EXPENSE (BENEFIT)			
Current	15,716,019	(8,048,404)	15,426,959
Deferred	1,438,184	(536,277)	1,013,695
	<u>17,154,203</u>	<u>(8,584,681)</u>	<u>16,440,654</u>
Net income (loss)	<u>\$ 45,370,614</u>	<u>\$ (1,705,373)</u>	<u>\$ 42,478,035</u>
Net income (loss) per common share			
-basic and diluted	<u>\$ 3.44</u>	<u>\$ (0.13)</u>	<u>\$ 3.09</u>
Average number of common shares outstanding			
-basic and diluted	<u>13,207,105</u>	<u>13,534,147</u>	<u>13,762,663</u>

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year ended December 31,		
	2009	2008	2007
Net income (loss)	<u>\$ 45,370,614</u>	<u>\$ (1,705,373)</u>	<u>\$ 42,478,035</u>
OTHER COMPREHENSIVE INCOME (LOSS)			
Change in unrealized holding gains (losses) on investment securities, before deferred income tax expense (benefit)	56,362,613	(80,021,357)	19,061,343
Deferred income tax expense (benefit)	<u>19,726,915</u>	<u>(28,007,475)</u>	<u>6,671,470</u>
	<u>36,635,698</u>	<u>(52,013,882)</u>	<u>12,389,873</u>
Reclassification adjustment for realized investment (gains) losses included in net income (loss), before income tax (expense) benefit	(17,074,771)	24,455,539	(3,720,964)
Income tax (expense) benefit	<u>(5,976,170)</u>	<u>8,559,439</u>	<u>(1,302,337)</u>
	<u>(11,098,601)</u>	<u>15,896,100</u>	<u>(2,418,627)</u>
Change in unrealized holding gains on fixed maturity securities with "other-than-temporary" impairment, before deferred income tax expense	1,676,197	-	-
Deferred income tax expense	<u>586,669</u>	<u>-</u>	<u>-</u>
	<u>1,089,528</u>	<u>-</u>	<u>-</u>
Reclassification adjustment for realized investment gains from disposals of fixed maturity securities with "other- than-temporary" impairment included in net income (loss), before income tax expense	(847,500)	-	-
Income tax expense	<u>(296,625)</u>	<u>-</u>	<u>-</u>
	<u>(550,875)</u>	<u>-</u>	<u>-</u>
Adjustments associated with Employers Mutual's retirement benefit plans, before deferred income tax expense (benefit):			
Net actuarial gain (loss)	1,290,887	(25,231,745)	5,865,615
Prior service (cost) credit	<u>(444,421)</u>	<u>(503,910)</u>	<u>6,527,855</u>
	<u>846,466</u>	<u>(25,735,655)</u>	<u>12,393,470</u>
Deferred income tax expense (benefit)	296,262	(9,007,478)	4,337,715
	<u>550,204</u>	<u>(16,728,177)</u>	<u>8,055,755</u>
Other comprehensive income (loss)	<u>26,625,954</u>	<u>(52,845,959)</u>	<u>18,027,001</u>
Total comprehensive income (loss)	<u>\$ 71,996,568</u>	<u>\$ (54,551,332)</u>	<u>\$ 60,505,036</u>

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Year ended December 31,		
	2009	2008	2007
COMMON STOCK			
Beginning of year	\$ 13,267,668	\$ 13,777,880	\$ 13,741,663
Issuance of common stock through			
Employers Mutual's stock option plans	17,383	55,351	36,217
Repurchase of common stock	(170,570)	(565,563)	-
End of year	<u>13,114,481</u>	<u>13,267,668</u>	<u>13,777,880</u>
ADDITIONAL PAID-IN CAPITAL			
Beginning of year	95,639,349	108,030,228	107,016,563
Issuance of common stock through			
Employers Mutual's stock option plans	301,489	1,073,485	812,724
Increase in additional paid-in capital resulting from stock-based compensation expense associated with Employers Mutual's stock option plans allocated to the Company	282,528	232,318	200,941
Repurchase of common stock	(3,419,084)	(13,696,682)	-
End of year	<u>92,804,282</u>	<u>95,639,349</u>	<u>108,030,228</u>
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)			
Beginning of year	(9,930,112)	42,961,904	24,934,903
Cumulative effect adjustment resulting from adoption of ASC			
Topic 310 impairment loss provision, net of deferred income taxes	(643,500)	-	-
Change in unrealized gains (losses) on investment securities, net of deferred income taxes	25,537,097	(36,117,782)	9,971,246
Change in unrealized gains on fixed maturity securities with "other- than-temporary" impairment, net of deferred income taxes	538,653	-	-
Adjustments associated with Employers Mutual's retirement benefit plans, net of deferred income taxes:			
Change in funded status	550,204	(16,728,177)	8,055,755
Adoption of ASC Topic 715 measurement date provision	-	(46,057)	-
End of year	<u>16,052,342</u>	<u>(9,930,112)</u>	<u>42,961,904</u>
RETAINED EARNINGS			
Beginning of year	183,939,453	195,581,980	162,601,193
Adjustment resulting from adoption of ASC Topic 715 measurement date provision, net of deferred income taxes	-	(205,751)	-
Net income (loss)	45,370,614	(1,705,373)	42,478,035
Dividends paid to public stockholders (\$.72, \$.72, \$.69 per share in 2009, 2008 and 2007)	(3,856,533)	(4,080,949)	(4,127,246)
Dividends paid to Employers Mutual (\$.72, \$.72, \$.69 per share in 2009, 2008 and 2007)	(5,650,454)	(5,650,454)	(5,370,002)
Cumulative effect adjustment resulting from adoption of ASC			
Topic 310 impairment loss provision, net of deferred income taxes	643,500	-	-
End of year	<u>220,446,580</u>	<u>183,939,453</u>	<u>195,581,980</u>
Total stockholders' equity	<u>\$ 342,417,685</u>	<u>\$ 282,916,358</u>	<u>\$ 360,351,992</u>

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	2009	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	<u>\$ 45,370,614</u>	<u>\$ (1,705,373)</u>	<u>\$ 42,478,035</u>
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Balances resulting from related party transactions with Employers Mutual:			
Losses and settlement expenses	(19,244,083)	21,429,847	3,054,024
Unearned premiums	5,039,891	(3,710,478)	2,502,884
Other policyholders' funds	1,499,795	(1,854,317)	952,651
Indebtedness to related party	(7,178,472)	14,748,800	(12,702,955)
Employee retirement plans	(307,821)	(5,899,941)	1,596,649
Reinsurance receivables	5,810,489	(3,082,642)	4,533,164
Prepaid reinsurance premiums	(955,331)	308,781	341,986
Commission payable	(179,246)	(2,391,417)	(1,936,492)
Interest payable	10,625	116,875	(339,900)
Deferred policy acquisition costs	(2,021,199)	58,375	(1,025,396)
Stock-based compensation plans	282,528	232,318	97,734
Other, net	4,082,250	(2,914,152)	1,706,128
Accrued investment income	1,025,997	(820,124)	75,809
Accrued income tax:			
Current	17,348,299	(8,232,206)	(1,706,709)
Deferred	1,438,184	(536,277)	1,013,695
Net realized investment (gains) losses	(17,922,271)	24,455,539	(3,723,789)
Losses and settlement expenses	2,363,807	-	-
Accounts receivable	(1,588,699)	58,100	123,905
Amortization of premium/discount on fixed maturity securities	(759,488)	422,783	820,215
	<u>(11,254,745)</u>	<u>32,389,864</u>	<u>(4,616,397)</u>
Net cash provided by operating activities	<u>\$ 34,115,869</u>	<u>\$ 30,684,491</u>	<u>\$ 37,861,638</u>

CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED

	Year ended December 31,		
	2009	2008	2007
CASH FLOWS FROM INVESTING ACTIVITIES			
Maturities of fixed maturity securities			
held-to-maturity	\$ 125,104	\$ 102,708	\$ 5,046,674
Purchases of fixed maturity securities			
available-for-sale	(394,329,176)	(334,445,914)	(176,793,575)
Disposals of fixed maturity securities			
available-for-sale	353,055,272	329,392,042	146,978,045
Purchases of equity securities			
available-for-sale	(58,392,638)	(49,809,546)	(70,986,257)
Disposals of equity securities			
available-for-sale	79,296,458	47,903,365	53,730,914
Disposals of other long-term investments	19,891	35,014	450,215
Net (purchases) sales of short-term investments	(1,017,015)	(1,077,773)	23,427,342
Net cash used in investing activities	(21,242,104)	(7,900,104)	(18,146,642)
CASH FLOWS FROM FINANCING ACTIVITIES			
Balances resulting from related party transactions			
with Employers Mutual:			
Issuance of common stock through Employers			
Mutual's stock option plans	318,872	1,128,836	848,941
Dividends paid to Employers Mutual	(5,650,454)	(5,650,454)	(5,370,002)
Redemption of surplus note	-	-	(11,000,000)
Repurchase of common stock	(3,589,654)	(14,262,245)	-
Dividends paid to public stockholders	(3,856,533)	(4,080,949)	(4,127,246)
Net cash used in financing activities	(12,777,769)	(22,864,812)	(19,648,307)
NET INCREASE (DECREASE) IN CASH	95,996	(80,425)	66,689
Cash at the beginning of the year	182,538	262,963	196,274
Cash at the end of the year	\$ 278,534	\$ 182,538	\$ 262,963
Income taxes (received) paid	\$ (1,632,280)	\$ 172,823	\$ 17,125,274
Interest paid	\$ 889,375	\$ 782,402	\$ 1,459,964

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Basis of Presentation

EMC Insurance Group Inc., a 60 percent owned subsidiary of Employers Mutual Casualty Company (Employers Mutual), is an insurance holding company with operations in property and casualty insurance and reinsurance. Both commercial and personal lines of insurance are written, with a focus on medium-sized commercial accounts. Approximately 38 percent of the premiums written are in Iowa and contiguous states. The term "Company" is used interchangeably to describe EMC Insurance Group Inc. (Parent Company only) and EMC Insurance Group Inc. and its subsidiaries.

The Company's subsidiaries include EMCASCO Insurance Company, Illinois EMCASCO Insurance Company, Dakota Fire Insurance Company, EMC Reinsurance Company and EMC Underwriters, LLC.

The consolidated financial statements have been prepared on the basis of U.S. generally accepted accounting principles (GAAP), which differ in some respects from those followed in reports to insurance regulatory authorities. All significant inter-company balances and transactions have been eliminated.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. The Company has evaluated all subsequent events through the date the financial statements were issued.

Property and Casualty Insurance and Reinsurance Operations

Property and casualty insurance premiums are recognized as revenue ratably over the terms of the respective policies. Unearned premiums are calculated on the daily pro rata method. Both domestic and foreign assumed reinsurance premiums are recognized as revenues ratably over the terms of the contract period. Amounts paid as ceded reinsurance premiums are reported as prepaid reinsurance premiums and are amortized over the remaining contract period in proportion to the amount of reinsurance protection provided. Reinsurance reinstatement premiums are recognized in the same period as the loss event that gave rise to the reinstatement premiums.

Acquisition costs consisting of commissions, premium taxes and other underwriting expenses that vary with and are directly related to the production of business have been deferred and are being amortized as premium revenue is recognized. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value, which gives effect to the premium to be earned, related investment income, losses and settlement expenses and certain other costs expected to be incurred as the premium is earned.

Certain commercial lines of business, primarily workers' compensation, are eligible for policyholder dividends in accordance with provisions of the underlying insurance policies. Net premiums written subject to policyholder dividends represented approximately 60 percent of the Company's total net premiums written in 2009. Policyholder dividends are accrued over the terms of the underlying policies.

Liabilities for losses are based upon case-basis estimates of reported losses supplemented with bulk case loss reserves, estimates of unreported losses based upon prior experience adjusted for current trends, and estimates of losses expected to be paid under assumed reinsurance contracts. Liabilities for settlement expenses are provided by estimating expenses expected to be incurred in settling the claims provided for in the loss reserves. Changes in estimates are reflected in current operating results (see note 4).

Ceded reinsurance amounts with nonaffiliated reinsurers relating to reinsurance receivables for paid and unpaid losses and settlement expenses and prepaid reinsurance premiums are reported on the balance sheet on a gross basis. Amounts ceded to Employers Mutual relating to the affiliated reinsurance pooling agreement (see note 2) have not been grossed up because the contracts provide that receivables and payables may be offset upon settlement.

Based on current information, the liabilities for losses and settlement expenses are considered to be adequate. Since the provisions are necessarily based on estimates, the ultimate liability may be more or less than such provisions.

Investments

Securities classified as held-to-maturity are purchased with the intent and ability to be held to maturity and are carried at amortized cost. Unrealized holding gains and losses on securities held-to-maturity are not reflected in the financial statements. All other securities have been classified as securities available-for-sale and are carried at fair value, with unrealized holding gains and losses reported as a component of accumulated other comprehensive income (loss) in stockholders' equity, net of deferred income taxes. Other long-term investments represent minor ownership interests in limited partnerships and limited liability companies and are carried at cost. Short-term investments represent money market funds, U.S. Treasury bills and commercial paper that are carried at cost, which approximates fair value.

The Company uses independent pricing sources to obtain the estimated fair value of securities. The fair value is based on quoted market prices, where available. In cases where quoted market prices are not available, the fair value is based on a variety of valuation techniques depending on the type of investment. The fair values obtained from independent pricing sources are reviewed for reasonableness and any discrepancies are investigated for final valuation (see note 8).

Premiums and discounts on fixed maturity securities are amortized over the life of the security as an adjustment to yield using the effective interest method. Gains and losses realized on the disposition of investments are included in net income. The cost of investments sold is determined on the specific identification method using the highest cost basis first. Included in investments at December 31, 2009 and 2008 are securities on deposit with various regulatory authorities as required by law amounting to \$11,725,251 and \$11,692,234, respectively.

The Company regularly monitors its investments that have a fair value that is less than the carrying value for indications of "other-than-temporary" impairment. Several factors are used to determine whether the carrying value of an individual security has been "other-than-temporarily" impaired. Such factors include, but are not limited to (1) the security's value and performance in the context of the overall markets, (2) length of time and extent the security's fair value has been below carrying value, (3) key corporate events, and (4) for equity securities, the ability and intent to hold the security until recovery to its cost basis. Prior to April 1, 2009, the Company's ability and intent to hold fixed maturity securities in an unrealized loss position until recovery was also considered in the determination of "other-than-temporary" impairments.

In April 2009, the Financial Accounting Standards Board (FASB) updated its guidance related to the Investments-Debt and Equity Securities Topic 310 of the FASB Accounting Standards CodificationTM (Codification or ASC) (issued as Staff Position (FSP) FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments"). This pronouncement established guidance for evaluating "other-than-temporary" impairments for fixed maturity securities, and required changes to the financial statement presentation and disclosure of fixed maturity and equity security "other-than-temporary" impairments. Included is a requirement that the evaluation of an impaired fixed maturity security include an assessment of whether the entity has the intent to sell the security and if it is more likely than not to be required to sell the security before recovery of its amortized cost basis. In addition, if the present value of cash flows expected to be collected is less than the amortized cost of the security, a credit loss is deemed to exist and the security is considered "other-than-temporarily" impaired. The portion of the impairment related to a credit loss is recognized through earnings and the impairment related to other factors is recognized through "other comprehensive income". This pronouncement was effective for interim and annual reporting periods ending after June 15, 2009. A cumulative effect adjustment from retained earnings to "accumulated other comprehensive income" was required for previously "other-than-temporarily" impaired fixed maturity securities still owned that had a non-credit component of the loss as of the date of adoption. Adoption resulted in a cumulative effect adjustment to increase retained earnings and decrease "accumulated other comprehensive income" by \$643,500, net of tax. Adoption also resulted in additional disclosures for fixed maturity and equity securities.

When an equity security is deemed "other-than-temporarily" impaired, the carrying value is reduced to fair value and a realized loss is recognized and charged to income.

The Company participates in a securities lending program administered by Mellon Bank, N.A. whereby certain fixed maturity securities from the investment portfolio are loaned to other institutions for short periods of time. The Company receives a fee for each security loaned out under this program and requires initial collateral equal to 102 percent of the fair value of the loaned securities. The collateral is primarily cash, but other forms of collateral are occasionally accepted, including letters of credit or U.S. Treasury securities. The cash collateral is invested in a Delaware business trust that is managed by Mellon Bank. In this trust, cash collateral funds of the Company are pooled with cash collateral funds of other security lenders administered by Mellon Bank, and these funds are invested in securities with high credit quality standards, maturity restrictions, and liquidity levels consistent with the short-term nature of securities lending transactions. The acceptable investments include time deposits, commercial paper, floating rate notes, asset-backed floating rate notes, and repurchase agreements. The earnings from this trust are used, in part, to pay the fee the Company receives for each security loaned under the program. The Company has a slight risk of a minor loss associated with the collateral pool if the aggregate fair value of the collateral pool were to decline below the aggregate liability represented by the collateral, assuming all securities loaned and backed by the collateral pool were returned. The securities on loan to others are segregated from the other invested assets on the Company's balance sheet. In accordance with relevant accounting literature, the collateral held by the Company is accounted for as a secured borrowing and is recorded as an asset on the Company's balance sheet, with a corresponding liability reflecting the Company's obligation to return this collateral upon the return of the loaned securities. During the fourth quarter of 2009, management decided to discontinue its participation in the securities lending program and as a result, began to unwind the program.

Income Taxes

The Company files a consolidated Federal income tax return with its subsidiaries. Consolidated income taxes/benefits are allocated among the entities based upon separate tax liabilities.

Deferred income taxes are provided for temporary differences between the tax basis of assets and liabilities and the reported amounts of those assets and liabilities for financial reporting purposes. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Income tax expense provisions increase or decrease in the same period in which a change in tax rates is enacted. A valuation allowance is established to reduce deferred tax assets to their net realizable value if it is "more likely than not" that a tax benefit will not be realized.

An assessment of the Company's current tax positions indicated no uncertainties that would warrant different recognition and valuation from that applied in the Company's tax returns.

Stock-Based Compensation

The Company has no stock-based compensation plans of its own; however, Employers Mutual has several stock plans that utilize the common stock of the Company. The Company receives the current fair value for all shares issued under these plans. Employers Mutual also has a stock appreciation rights (SAR) agreement in effect with an executive officer of the Company. The SAR agreement is based upon the market price of the Company's common stock, and because it will be settled in cash it is considered to be a liability-classified award. A portion of the compensation expense recognized by Employers Mutual, as the requisite service period for granted options and SARs is rendered, is allocated to the Company's property and casualty insurance subsidiaries through their participation in the pooling agreement (see note 2). Because a portion of Employers Mutual's stock compensation expense is reflected in the Company's financial statements and issuances of the Company's stock under Employers Mutual's stock option plans have an impact on the Company's capital accounts, the disclosures required by FASB ASC Topic 718 are included in the Company's consolidated financial statements.

Employee Retirement Plans

Employers Mutual has various employee retirement plans including a defined benefit retirement plan, a supplemental retirement plan, and two postretirement benefit plans that provide retiree healthcare and life insurance coverage. Although the Company has no employees of its own, it is responsible for its share of the expenses and related prepaid assets and liabilities of these plans as determined under the terms of the pooling agreement, and the costs allocated by Employers Mutual to subsidiaries that do not participate in the pooling agreement (see note 2). Accordingly, the Company recognizes its share of the funded status of Employers Mutual's defined benefit retirement and other postretirement plans as a net asset or liability on the balance sheet, with changes in the funded status of the plans recognized through "other comprehensive income."

Effective January 1, 2008, the Company adopted the measurement date provision of the Compensation-Retirement Benefits Topic 715 of the FASB ASC. This provision was a part of the originally issued Statement of Financial Accounting Standards (SFAS) No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." This pronouncement included a requirement, which was effective for fiscal years ending after December 15, 2008, to measure the plans' assets and obligations as of the end of the employer's fiscal year. This pronouncement provided two approaches to measure the adjustment from a previously reported non-fiscal year-end measurement date to a fiscal year-end measurement date, both of which required the adjustment be recorded to beginning retained earnings and "accumulated other comprehensive income", as applicable. The Company elected to apply the approach under which the Company's previous November 1, 2007 measurement date was used to obtain the adjustment for the two month transition period. As a result, on January 1, 2008, the Company recorded a \$205,751 decrease to retained earnings and a \$46,057 decrease to "accumulated other comprehensive income" to record the net periodic cost associated with the two month transition period.

Foreign Currency Transactions

Included in the underlying reinsurance business assumed by Employers Mutual and EMC Reinsurance Company are reinsurance transactions conducted with foreign cedants denominated in their local functional currencies. In accordance with the terms of the quota share agreement (see note 2), the reinsurance subsidiary assumes all foreign currency exchange gains/losses associated with contracts incepting on January 1, 2006 and thereafter that are subject to the quota share agreement. The assets and liabilities resulting from these foreign reinsurance transactions are reported in U.S. dollars based on the foreign currency exchange rates that existed at the balance sheet dates. The foreign currency exchange rate gains/losses reported in the consolidated statements of income that resulted from these foreign reinsurance transactions are reported in U.S. dollars measured at the foreign currency exchange rates that existed at the inception of each reinsurance contract. The foreign currency exchange rate gains/losses resulting from these re-measurements to U.S. dollars are reported as other income/expense in the consolidated statements of income.

Net Income Per Share - Basic and Diluted

The Company's basic and diluted net income per share is computed by dividing net income by the weighted average number of common shares outstanding during each period. As previously noted, the Company receives the current fair value for all shares issued under Employers Mutual's stock plans. As a result, the Company had no potential common shares outstanding during 2009, 2008 and 2007 that would have been dilutive to the calculation of net income per share.

Goodwill

Goodwill represents the excess of cost over the fair value of net assets of acquired subsidiaries. Goodwill is not amortized, but is subject to annual impairment testing to determine if the carrying value of the goodwill exceeds the estimated fair value of net assets. If the carrying amount of the subsidiary (including goodwill) exceeds the computed fair value, an impairment loss is recognized through earnings equal to the excess amount, but not greater than the balance of the goodwill. An annual impairment test is completed in the fourth quarter of each year and goodwill was not deemed to be impaired in 2009, 2008 or 2007.

New Accounting Pronouncements

The FASB recognized the complexity of its standard-setting process and embarked on a revised process in 2004 that culminated in the release on July 1, 2009, of the FASB ASC. The Codification does not change how the Company accounts for its transactions or the nature of related disclosures made. However, when referring to guidance issued by the FASB, the Company now refers to topics in the ASC rather than the previous FASB Statement numbers, Interpretations, Staff Positions, etc. This change was made effective by the FASB for periods ending on or after September 15, 2009. References to GAAP in this Form 10-K have been updated to reflect guidance in the Codification.

In May 2009, the FASB updated its guidance related to the Subsequent Events Topic 855 of the FASB ASC (issued as SFAS No. 165, "Subsequent Events"), which sets forth the period after the balance sheet date during which management shall evaluate events or transactions for potential recognition or disclosure, the circumstances under which an entity shall recognize events or transactions occurring after the balance sheet date, and disclosures to make about events or transactions that occur after the balance sheet date. This pronouncement was effective for interim and annual reporting periods ending after June 15, 2009. In February 2010, the FASB updated its guidance related to the Subsequent Events Topic 855 of the FASB, which removed the requirement to disclose the date through which subsequent events were evaluated for Securities and Exchange Commission filers. This pronouncement was effective immediately. Adoption of this pronouncement had no effect on the consolidated financial position or operating results of the Company.

The Fair Value Measurements and Disclosures Topic 820 of the FASB ASC has undergone substantial changes in recent years, including the issuance of several pronouncements predating the Codification. In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which defined fair value, established a framework for measuring fair value, and expanded disclosures about fair value measurements. These requirements were effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company adopted this pronouncement effective January 1, 2008, which resulted in additional disclosures, but no impact on the Company's consolidated financial position or operating results. In October 2008, the FASB issued FSP FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market For That Asset Is Not Active," which was followed in April 2009 by FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." Both of these pronouncements were intended to clarify the determination of fair value in markets that are not, at the measurement date, providing fair values representative of orderly transactions. Adoption of these pronouncements had no effect on the consolidated financial position or operating results of the Company.

In April 2009, the FASB updated its guidance related to the Financial Instruments Topic 825 of the FASB ASC (issued as FSP FAS 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments”). This pronouncement established quarterly disclosure requirements in interim financial statements of the fair value disclosures that were previously only required annually. This pronouncement was effective for interim and annual reporting periods ending after June 15, 2009. Adoption resulted in the addition of quarterly fair value disclosures, but had no effect on the consolidated financial position or operating results of the Company.

In December 2008, the FASB updated its guidance related to the Compensation-Retirement Benefits Topic 715 of the FASB ASC (issued as FSP FAS 132(R)-1, “Employers’ Disclosures about Postretirement Benefit Plan Assets”). This pronouncement established guidance on employers’ disclosures about plan assets of defined benefit pension or other postretirement plans, and was intended to address a lack of transparency surrounding the types of assets and associated risks in an employer’s defined benefit pension or other postretirement plans. The plan asset disclosures required are effective for fiscal years ending after December 15, 2009. Adoption resulted in additional disclosures, but had no effect on the consolidated financial position or operating results of the Company.

In December 2007, the FASB updated its guidance related to the Business Combinations Topic 805 of the FASB ASC (issued as SFAS No. 141 (revised 2007), “Business Combinations,” a replacement of SFAS No. 141, “Business Combinations”). This pronouncement retained the fundamental requirements of the acquisition method of accounting (previously referred to as “purchase method”) to be used for all business combinations, and was to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Adoption of this statement had no effect on the consolidated financial position or operating results of the Company.

2. AFFILIATION AND TRANSACTIONS WITH AFFILIATES

Property and Casualty Insurance Subsidiaries

The Company’s three property and casualty insurance subsidiaries and two subsidiaries and an affiliate of Employers Mutual are parties to reinsurance pooling agreements with Employers Mutual (collectively the “pooling agreement”). Under the terms of the pooling agreement, each company cedes to Employers Mutual all of its insurance business, with the exception of any voluntary reinsurance business assumed from nonaffiliated insurance companies, and assumes from Employers Mutual an amount equal to its participation in the pool. All premiums, losses, settlement expenses, and other underwriting and administrative expenses, excluding the voluntary reinsurance business assumed by Employers Mutual from nonaffiliated insurance companies, are prorated among the parties on the basis of participation in the pool. Employers Mutual negotiates reinsurance agreements that provide protection to the pool and each of its participants, including protection against losses arising from catastrophic events. The aggregate participation of the Company’s property and casualty insurance subsidiaries in the pooling agreement is 30 percent.

Operations of the pool give rise to inter-company balances with Employers Mutual, which are settled on a quarterly basis. The investment and income tax activities of the pool participants are not subject to the pooling agreement. The pooling agreement provides that Employers Mutual will make up any shortfall or difference resulting from an error in its systems and/or computational processes that would otherwise result in the required restatement of the pool participants’ financial statements.

The purpose of the pooling agreement is to spread the risk of an exposure insured by any of the pool participants among all the companies. The pooling agreement produces a more uniform and stable underwriting result from year to year for all companies in the pool than might be experienced individually. In addition, each company benefits from the capacity of the entire pool, rather than being limited to policy exposures of a size commensurate with its own assets, and from the wide range of policy forms, lines of insurance written, rate filings and commission plans offered by each of the companies.

Reinsurance Subsidiary

The Company's reinsurance subsidiary assumes a 100 percent quota share portion of Employers Mutual's assumed reinsurance business, exclusive of certain reinsurance contracts. This includes all premiums and related losses, settlement expenses, and other underwriting and administrative expense of this business, subject to a maximum loss of \$2,000,000 per event, with the cost of this protection treated as a reduction to the assumed premiums written. The reinsurance subsidiary does not directly reinsure any of the insurance business written by Employers Mutual or the other pool participants; however, the reinsurance subsidiary assumes reinsurance business from the Mutual Reinsurance Bureau (MRB) pool and this pool provides a small amount of reinsurance protection to the EMC Insurance Companies. As a result, the reinsurance subsidiary's assumed exposures include a small portion of the EMC Insurance Companies' direct business, after ceded reinsurance protections purchased by the MRB pool are applied. In addition, the reinsurance subsidiary does not reinsure any "involuntary" facility or pool business that Employers Mutual assumes pursuant to state law. Operations of the quota share agreement give rise to inter-company balances with Employers Mutual, which are settled on a quarterly basis. The investment and income tax activities of the reinsurance subsidiary are not subject to the quota share agreement.

Under the terms of the quota share agreement, the reinsurance subsidiary receives reinstatement premium income that is collected by Employers Mutual from the ceding companies when reinsurance coverage is reinstated after a loss event; however, the cap on losses assumed per event contained in the quota share agreement is automatically reinstated without cost. This arrangement can produce unusual underwriting results for the reinsurance subsidiary when a large event occurs because the reinstatement premium income received by the reinsurance subsidiary may approximate, or even exceed, the amount of losses retained.

Premiums assumed by the reinsurance subsidiary from Employers Mutual amounted to \$72,206,486, \$73,617,740 and \$71,002,733 in 2009, 2008 and 2007, respectively. It is customary in the reinsurance business for the assuming company to compensate the ceding company for the acquisition expenses incurred in the generation of the business. Commissions paid by the reinsurance subsidiary to Employers Mutual amounted to \$14,111,273, \$15,766,979 and \$17,386,129 in 2009, 2008 and 2007, respectively.

Employers Mutual retains 10.5 percent of the net assumed premiums written subject to cession to the reinsurance subsidiary as compensation for the \$2,000,000 cap on losses assumed per event, which totaled \$8,471,152, \$8,636,718 and \$8,329,929 in 2009, 2008 and 2007, respectively. Employers Mutual retained losses and settlement expenses in excess of the \$2,000,000 cap totaling (\$7,467) in 2009, \$11,195,887 in 2008 and (\$52,664) in 2007.

As a result of regulatory changes in Germany, Employers Mutual ceased being an approved reinsurer in Germany beginning January 1, 2009. To avoid the loss of this assumed reinsurance business, the Company's reinsurance subsidiary began writing this business on a direct basis (outside the quota share agreement) effective January 1, 2009. Since this business is written outside the quota share agreement, it is not subject to the \$2,000,000 cap on losses per event. Management has determined that this business has a low risk of generating losses above \$2,000,000 per event and has therefore elected to not purchase stand-alone reinsurance coverage for these risks. Premium income on this business amounted to \$3,694,943 in 2009.

The reinsurance subsidiary assumes all foreign currency exchange gain/loss associated with contracts incepting on January 1, 2006 and thereafter that are subject to the quota share agreement, as well as the German business written directly. The net foreign currency exchange gain (loss) assumed by the reinsurance subsidiary was \$29,238 in 2009, \$256,606 in 2008 and (\$512,281) in 2007.

Effective January 1, 2010, the terms of the quota share agreement were revised to increase the retention, or cap, on losses assumed per event from \$2,000,000 to \$3,000,000. The cost for this protection (10.5 percent of premiums written) remains unchanged.

Services Provided by Employers Mutual

The Company does not have any employees of its own. Employers Mutual performs all operations for all of its subsidiaries and affiliate. Such services include data processing, claims, financial, actuarial, legal, auditing, marketing and underwriting. Employers Mutual allocates a portion of the cost of these services to its subsidiaries that do not participate in the pooling agreement based upon a number of criteria, including usage of the services and the number of transactions. The remaining costs are charged to the pooling agreement and each pool participant shares in the total cost in accordance with its pool participation percentage. Costs allocated to the Company by Employers Mutual for services provided to the holding company and its subsidiaries that do not participate in the pooling agreement amounted to \$2,597,523, \$2,643,930 and \$2,314,211 in 2009, 2008 and 2007, respectively. Costs allocated to the Company through the operation of the pooling agreement amounted to \$72,480,519, \$63,887,041 and \$66,646,772 in 2009, 2008 and 2007, respectively.

Investment expenses are based on actual expenses incurred by the Company plus an allocation of other investment expenses incurred by Employers Mutual, which is based on a weighted average of total invested assets and number of investment transactions. Investment expenses allocated to the Company by Employers Mutual amounted to \$1,217,193, \$1,464,337 and \$1,455,808 in 2009, 2008 and 2007, respectively.

3. REINSURANCE

The parties to the pooling agreement cede insurance business to other insurers in the ordinary course of business for the purpose of limiting their maximum loss exposure through diversification of their risks. In its consolidated financial statements, the Company treats risks to the extent they are reinsured as though they were risks for which the Company is not liable. Insurance ceded by the pool participants does not relieve their primary liability as the originating insurers. Employers Mutual evaluates the financial condition of the reinsurers of the parties to the pooling agreement and monitors concentrations of credit risk arising from similar geographic regions, activities or economic characteristics of the reinsurers to minimize exposure to significant losses from reinsurer insolvencies.

As of December 31, 2009, reinsurance ceded to two nonaffiliated reinsurers totaled \$16,900,107, which represents a significant portion of the total prepaid reinsurance premiums and reinsurance receivables for losses and settlement expenses. These amounts reflect the property and casualty insurance subsidiaries' aggregate pool participation percentage of amounts ceded by Employers Mutual to these organizations on a mandatory basis. Credit risk associated with these amounts is minimal, as all companies participating in these organizations are responsible for the liabilities of such organizations on a pro rata basis.

The effect of reinsurance on premiums written and earned, and losses and settlement expenses incurred, for the three years ended December 31, 2009 is presented below.

	Year ended December 31, 2009		
	Property and casualty insurance	Reinsurance	Total
Premiums written			
Direct	\$ 247,722,866	\$ -	\$ 247,722,866
Assumed from nonaffiliates	2,251,157	78,094,405	80,345,562
Assumed from affiliates	333,862,328	-	333,862,328
Ceded to nonaffiliates	(23,298,602)	(2,192,976)	(25,491,578)
Ceded to affiliates	(247,722,866)	-	(247,722,866)
Net premiums written	<u>\$ 312,814,883</u>	<u>\$ 75,901,429</u>	<u>\$ 388,716,312</u>
Premiums earned			
Direct	\$ 230,497,985	\$ -	\$ 230,497,985
Assumed from nonaffiliates	2,364,787	77,741,189	80,105,976
Assumed from affiliates	328,927,476	-	328,927,476
Ceded to nonaffiliates	(23,213,227)	(1,809,324)	(25,022,551)
Ceded to affiliates	(230,497,985)	-	(230,497,985)
Net premiums earned	<u>\$ 308,079,036</u>	<u>\$ 75,931,865</u>	<u>\$ 384,010,901</u>
Losses and settlement expenses incurred			
Direct	\$ 154,142,419	\$ -	\$ 154,142,419
Assumed from nonaffiliates	1,523,446	51,256,602	52,780,048
Assumed from affiliates	202,616,957	673,957	203,290,914
Ceded to nonaffiliates	(5,016,118)	(2,305,385)	(7,321,503)
Ceded to affiliates	(154,142,419)	-	(154,142,419)
Net losses and settlement expenses incurred	<u>\$ 199,124,285</u>	<u>\$ 49,625,174</u>	<u>\$ 248,749,459</u>

Year ended December 31, 2008

	Property and casualty insurance	Reinsurance	Total
Premiums written			
Direct	\$ 225,800,262	\$ -	\$ 225,800,262
Assumed from nonaffiliates	2,363,372	74,828,903	77,192,275
Assumed from affiliates	334,003,825	-	334,003,825
Ceded to nonaffiliates	(23,379,828)	(1,211,163)	(24,590,991)
Ceded to affiliates	(225,800,262)	-	(225,800,262)
Net premiums written	<u>\$ 312,987,369</u>	<u>\$ 73,617,740</u>	<u>\$ 386,605,109</u>
Premiums earned			
Direct	\$ 216,190,918	\$ -	\$ 216,190,918
Assumed from nonaffiliates	2,518,711	74,826,573	77,345,284
Assumed from affiliates	336,767,947	-	336,767,947
Ceded to nonaffiliates	(23,688,609)	(1,106,824)	(24,795,433)
Ceded to affiliates	(216,190,918)	-	(216,190,918)
Net premiums earned	<u>\$ 315,598,049</u>	<u>\$ 73,719,749</u>	<u>\$ 389,317,798</u>
Losses and settlement expenses incurred			
Direct	\$ 167,303,334	\$ -	\$ 167,303,334
Assumed from nonaffiliates	2,119,545	62,585,778	64,705,323
Assumed from affiliates	240,123,192	756,424	240,879,616
Ceded to nonaffiliates	(9,704,486)	(1,615,160)	(11,319,646)
Ceded to affiliates	(167,303,334)	-	(167,303,334)
Net losses and settlement expenses incurred	<u>\$ 232,538,251</u>	<u>\$ 61,727,042</u>	<u>\$ 294,265,293</u>

Year ended December 31, 2007

	Property and casualty insurance	Reinsurance	Total
Premiums written			
Direct	\$ 209,843,738	\$ -	\$ 209,843,738
Assumed from nonaffiliates	3,140,966	71,683,155	74,824,121
Assumed from affiliates	346,763,126	-	346,763,126
Ceded to nonaffiliates	(25,651,328)	(680,422)	(26,331,750)
Ceded to affiliates	(209,843,738)	-	(209,843,738)
Net premiums written	<u>\$ 324,252,764</u>	<u>\$ 71,002,733</u>	<u>\$ 395,255,497</u>
Premiums earned			
Direct	\$ 203,150,361	\$ -	\$ 203,150,361
Assumed from nonaffiliates	3,343,646	72,521,772	75,865,418
Assumed from affiliates	343,485,730	-	343,485,730
Ceded to nonaffiliates	(25,993,310)	(298,441)	(26,291,751)
Ceded to affiliates	(203,150,361)	-	(203,150,361)
Net premiums earned	<u>\$ 320,836,066</u>	<u>\$ 72,223,331</u>	<u>\$ 393,059,397</u>
Losses and settlement expenses incurred			
Direct	\$ 107,713,031	\$ -	\$ 107,713,031
Assumed from nonaffiliates	2,332,368	47,707,087	50,039,455
Assumed from affiliates	203,528,764	719,675	204,248,439
Ceded to nonaffiliates	(6,366,807)	(81,906)	(6,448,713)
Ceded to affiliates	(107,713,031)	-	(107,713,031)
Net losses and settlement expenses incurred	<u>\$ 199,494,325</u>	<u>\$ 48,344,856</u>	<u>\$ 247,839,181</u>

Individual lines in the above tables are defined as follows:

- “Direct” represents policies issued by the property and casualty insurance subsidiaries.
- “Assumed from nonaffiliates” for the property and casualty insurance subsidiaries represents the aggregate pool participation percentage of involuntary business assumed by the pool participants pursuant to state law. For the reinsurance subsidiary, this represents the reinsurance business assumed through the quota share agreement, and, starting January 1, 2009, German-based reinsurance business assumed outside the quota share agreement.
- “Assumed from affiliates” for the property and casualty insurance subsidiaries represents the aggregate pool participation percentage of all the pool members’ direct business. Losses and settlement expenses incurred also includes claim-related services provided by Employers Mutual that is allocated to the property and casualty insurance subsidiaries and the reinsurance subsidiary.
- “Ceded to nonaffiliates” for the property and casualty insurance subsidiaries represents the aggregate pool participation percentage of ceded reinsurance agreements that provide protection to the pool and each of its participants. This line also includes a limited amount of reinsurance business that is assumed under the quota share agreement and ceded on a 100 percent basis to other insurance companies in connection with “fronting” activities conducted by Employers Mutual.
- “Ceded to affiliates” represents the cession of the property and casualty insurance subsidiaries’ direct business to Employers Mutual under the terms of the pooling agreement.

4. LIABILITY FOR LOSSES AND SETTLEMENT EXPENSES

The following table sets forth a reconciliation of beginning and ending reserves for losses and settlement expenses of the Company. Amounts presented are on a net basis, with a reconciliation of beginning and ending reserves to the gross amounts presented in the consolidated financial statements.

	Year ended December 31,		
	2009	2008	2007
Gross reserves at beginning of year	\$ 573,031,853	\$ 551,602,006	\$ 548,547,982
Re-valuation due to foreign currency exchange rates	(227,385)	(597,023)	(190,027)
Ceded reserves at beginning of year	(33,009,340)	(31,878,286)	(35,608,811)
Net reserves at beginning of year	539,795,128	519,126,697	512,749,144
<u>Incurred losses and settlement expenses</u>			
Provision for insured events of the current year	297,371,751	329,573,313	286,577,209
Decrease in provision for insured events of prior years	(48,622,292)	(35,308,020)	(38,738,028)
Total incurred losses and settlement expenses	248,749,459	294,265,293	247,839,181
<u>Payments</u>			
Losses and settlement expenses attributable to insured events of the current year	111,501,112	133,469,612	104,196,419
Losses and settlement expenses attributable to insured events of prior years	149,228,524	140,127,250	137,265,209
Total payments	260,729,636	273,596,862	241,461,628
Net reserves at end of year	527,814,951	539,795,128	519,126,697
Ceded reserves at end of year	28,170,575	33,009,340	31,878,286
Gross reserves at end of year, before foreign currency re-valuation	555,985,526	572,804,468	551,004,983
Re-valuation due to foreign currency exchange rates	166,051	227,385	597,023
Gross reserves at end of year	\$ 556,151,577	\$ 573,031,853	\$ 551,602,006

There is an inherent amount of uncertainty involved in the establishment of insurance liabilities. This uncertainty is greatest in the current and more recent accident years because a smaller percentage of the expected ultimate claims have been reported, adjusted and settled compared to more mature accident years. For this reason, carried reserves for these accident years reflect prudently conservative assumptions. As the carried reserves for these accident years run off, the overall expectation is that, more often than not, favorable development will occur. However, there is also the possibility that the ultimate settlement of liabilities associated with these accident years will show adverse development, and such adverse development could be substantial.

Changes in reserve estimates are reflected in operating results in the year such changes are recorded. Following is an analysis of the reserve development the Company has experienced during the past three years. Care should be exercised when attempting to analyze the financial impact of the reported development amounts because, as noted above, the overall expectation is that, more often than not, favorable development will occur as the prior accident year reserves run off.

2009 Development

For the property and casualty insurance segment, the December 31, 2009 estimate of loss and settlement expense reserves for accident years 2008 and prior decreased \$34,641,246 from the estimate at December 31, 2008. This decrease represents 8.1 percent of the December 31, 2008 gross carried reserves and is primarily attributed to decreased severity associated with the final settlement of closed claims, lower than expected IBNR emergence, as well as favorable development on settlement expense reserves.

For the reinsurance segment, the December 31, 2009 estimate of loss and settlement expense reserves for accident years 2008 and prior decreased \$13,981,046 from the estimate at December 31, 2008. This decrease represents 9.7 percent of the December 31, 2008 gross carried reserves and is largely attributed to the 2008 accident year in the Home Office Reinsurance Assumed Department (also known as "HORAD") book of business. During the fourth quarter, the reinsurance segment experienced \$4,160,000 of favorable development associated with a reduction in bulk IBNR reserves and the winding down of the MAERP Reinsurance Association (formerly known as Mutual Atomic Energy Reinsurance Pool).

2008 Development

For the property and casualty insurance segment, the December 31, 2008 estimate of loss and settlement expense reserves for accident years 2007 and prior decreased \$21,564,256 from the estimate at December 31, 2007. This decrease represented 5.3 percent of the December 31, 2007 gross carried reserves and is primarily attributed to lower than expected emergence during 2008 of losses estimated to have been incurred but not reported (IBNR) at December 31, 2007, as well as favorable development on settlement expense reserves and decreased severity associated with the final settlement of closed claims.

For the reinsurance segment, the December 31, 2008 estimate of loss and settlement expense reserves for accident years 2007 and prior decreased \$13,743,764 from the estimate at December 31, 2007. This decrease represented 9.7 percent of the December 31, 2007 gross carried reserves and is largely attributed to the 2005, 2006 and 2007 accident years in the HORAD book of business.

2007 Development

For the property and casualty insurance segment, the December 31, 2007 estimate of loss and settlement expense reserves for accident years 2006 and prior decreased \$27,976,811 from the estimate at December 31, 2006. This decrease represented 6.8 percent of the December 31, 2006 gross carried reserves and is primarily attributed to decreased severity associated with the final settlement of closed claims.

For the reinsurance segment, the December 31, 2007 estimate of loss and settlement expense reserves for accident years 2006 and prior decreased \$10,761,217 from the estimate at December 31, 2006. This decrease represented 7.8 percent of the December 31, 2006 gross carried reserves and is largely attributed to the 2004, 2005 and 2006 accident years in the HORAD book of business.

5. ASBESTOS AND ENVIRONMENTAL RELATED CLAIMS

The Company has exposure to asbestos and environmental related claims associated with the insurance business written by the parties to the pooling agreement and the reinsurance business assumed from Employers Mutual by the reinsurance subsidiary. These exposures are not considered to be significant. Asbestos and environmental losses paid by the Company have averaged only \$946,458 per year over the past five years, but have increased during the past two years. Reserves for asbestos and environmental related claims for direct insurance and assumed reinsurance business totaled \$6,526,964 and \$6,853,100 (\$6,219,546 and \$6,788,975 net of reinsurance) at December 31, 2009 and 2008, respectively.

At present, the pool participants are defending approximately 900 asbestos bodily injury lawsuits, some of which involve multiple plaintiffs. Five former policyholders and one current policyholder dominate the pool participants' asbestos claims. Most of the defenses are subject to express reservation of rights based upon the lack of an injury within the applicable policy periods, because many asbestos lawsuits do not specifically allege dates of asbestos exposure or dates of injury. During 2003, the pool participants were presented with several hundred plaintiff lawsuits (primarily multi-plaintiff lawsuits) filed against three former policyholders representing approximately 66,500 claimants related to exposure to asbestos or products containing asbestos. These claims are based upon nonspecific asbestos exposure and nonspecific injuries. As a result, management did not establish a significant amount of case loss reserves associated with these claims. During the period 2006 through 2009, several of the multi-plaintiff lawsuits (including the vast majority of those associated with one former policyholder) were dismissed. During 2009, approximately 3,000 additional claims against one former policyholder were reported to the pool participants. As of December 31, 2009, approximately 5,500 of the claims remain open. During 2006, the pool participants received notice that another former policyholder was a named defendant in approximately 33,000 claims nationwide. As of December 31, 2009, approximately 27,000 of these claims remain open.

Prior to 2008, actual losses paid for asbestos-related claims had been minimal due to the plaintiffs' failure to identify an exposure to any asbestos-containing product associated with the pool participants' current and former policyholders. However, paid losses increased significantly during 2008 and 2009 as a result of claims attributed to two former policyholders. One of these former policyholders, a broker of various products, including asbestos, settled a claim for approximately \$450,000 (the Company's share) in 2008. Prior to 2008, the asbestos exposure associated with this former policyholder had been thought to be relatively small. At December 31, 2009, one additional claim associated with this former policyholder remains open, though similar exposure on that claim is not anticipated. The other former policyholder, a furnace manufacturer, had multiple claims settle for a total of approximately \$514,000 (the Company's share) in 2008 and 2009. The asbestos exposure associated with this former policyholder increased during this time period, and this trend may possibly continue into the future with increased per plaintiff settlements. Approximately 170 asbestos exposure claims associated with this former policyholder remain open. Defense costs for asbestos-related claims continue to be rather significant due to the large number of parties involved in the litigation proceedings and the length of time required to obtain judgments. Whenever possible, the pool participants have participated in cost sharing agreements with other insurance companies to reduce overall asbestos claim expenses.

Estimating loss and settlement expense reserves for asbestos and environmental claims is very difficult due to the many uncertainties surrounding these types of claims. These uncertainties exist because the assignment of responsibility varies widely by state and claims often emerge long after a policy has expired, which makes assignment of damages to the appropriate party and to the time period covered by a particular policy difficult. In establishing reserves for these types of claims, management monitors the relevant facts concerning each claim, the current status of the legal environment, social and political conditions, and claim history and trends within the Company and the industry.

6. STATUTORY INFORMATION AND DIVIDEND RESTRICTIONS

The Company's insurance subsidiaries are required to file financial statements with state regulatory authorities. The accounting principles used to prepare these statutory financial statements follow prescribed or permitted accounting practices that differ from GAAP. Prescribed statutory accounting principles include state laws, regulations and general administrative rules issued by the state of domicile, as well as a variety of publications and manuals of the National Association of Insurance Commissioners (NAIC). Permitted accounting practices encompass all accounting practices not prescribed, but allowed by the state of domicile. The Company's insurance subsidiaries had no permitted accounting practices during 2009, 2008 and 2007.

Statutory surplus of the Company's insurance subsidiaries was \$327,244,159 and \$284,492,170 at December 31, 2009 and 2008, respectively. Statutory net income (loss) of the Company's insurance subsidiaries was \$46,824,981, (\$3,961,799) and \$47,304,097 for 2009, 2008 and 2007, respectively.

The NAIC utilizes a risk-based capital model to help state regulators assess the capital adequacy of insurance companies and identify insurers that are in, or are perceived as approaching, financial difficulty. This model establishes minimum capital needs based on the risks applicable to the operations of the individual insurer. The risk-based capital requirements for property and casualty insurance companies measure three major areas of risk: asset risk, credit risk and underwriting risk. Companies having less statutory surplus than required by the risk-based capital requirements are subject to varying degrees of regulatory scrutiny and intervention, depending on the severity of the inadequacy. At December 31, 2009, the Company's insurance subsidiaries had total adjusted statutory capital of \$327,244,159, which is well in excess of the minimum risk-based capital requirement of \$56,862,112.

The amount of retained earnings of the Company's insurance subsidiaries available for distribution as dividends are limited by law to a percentage of the statutory unassigned surplus of each of the subsidiaries as of the previous December 31, as determined in accordance with accounting practices prescribed by insurance regulatory authorities of the state of domicile of each subsidiary. Subject to this limitation, the maximum dividend that may be paid within a 12 month period without prior approval of the insurance regulatory authorities is generally restricted to the greater of 10 percent of statutory surplus as regards policyholders as of the preceding December 31, or net income of the preceding calendar year on a statutory basis, not greater than earned statutory surplus. At December 31, 2009, \$44,986,178 was available for distribution to the Company in 2010 without prior approval.

7. SEGMENT INFORMATION

The Company's operations consist of a property and casualty insurance segment and a reinsurance segment. The property and casualty insurance segment writes both commercial and personal lines of insurance, with a focus on medium-sized commercial accounts. The reinsurance segment provides reinsurance for other insurers and reinsurers. The segments are managed separately due to differences in the insurance products sold and the business environment in which they operate. The accounting policies of the segments are described in note 1, Summary of Significant Accounting Policies.

Summarized financial information for the Company's segments is as follows:

<u>Year ended</u>	Property and casualty insurance	Reinsurance	Parent company	Consolidated
<u>December 31, 2009</u>				
Premiums earned	\$ 308,079,036	\$ 75,931,865	\$ -	\$ 384,010,901
Underwriting profit (loss)	(10,387,142)	9,548,201	-	(838,941)
Net investment income	35,679,586	12,069,177	10,543	47,759,306
Realized investment gains (losses)	19,581,814	(1,659,543)	-	17,922,271
Other income	752,635	2,543	-	755,178
Interest expense	900,000	-	-	900,000
Other expenses	855,846	(29,237)	1,346,388	2,172,997
Income (loss) before income tax expense (benefit)	\$ 43,871,047	\$ 19,989,615	\$ (1,335,845)	\$ 62,524,817
Assets	\$ 883,361,416	\$ 280,261,990	\$ 342,901,891	\$ 1,506,525,297
Eliminations	-	-	(340,269,959)	(340,269,959)
Reclassifications	-	-	(467,545)	(467,545)
Net assets	\$ 883,361,416	\$ 280,261,990	\$ 2,164,387	\$ 1,165,787,793

<u>Year ended</u>	Property and casualty insurance	Reinsurance	Parent company	Consolidated
<u>December 31, 2008</u>				
Premiums earned	\$ 315,598,049	\$ 73,719,749	\$ -	\$ 389,317,798
Underwriting loss	(26,817,043)	(5,515,643)	-	(32,332,686)
Net investment income	36,329,609	11,912,452	161,312	48,403,373
Realized investment losses	(16,811,900)	(7,643,639)	-	(24,455,539)
Other income	626,499	-	-	626,499
Interest expense	889,375	-	-	889,375
Other expenses	568,848	(256,599)	1,330,077	1,642,326
Loss before income tax benefit	\$ (8,131,058)	\$ (990,231)	\$ (1,168,765)	\$ (10,290,054)
Assets	\$ 850,336,068	\$ 254,075,728	\$ 283,633,097	\$ 1,388,044,893
Eliminations	-	-	(279,905,123)	(279,905,123)
Reclassifications	(40,966)	-	-	(40,966)
Net assets	\$ 850,295,102	\$ 254,075,728	\$ 3,727,974	\$ 1,108,098,804

<u>Year ended</u>	Property and casualty insurance	Reinsurance	Parent company	Consolidated
<u>December 31, 2007</u>				
Premiums earned	\$ 320,836,066	\$ 72,223,331	\$ -	\$ 393,059,397
Underwriting gain	2,189,628	7,337,633	-	9,527,261
Net investment income	36,000,281	12,267,193	214,513	48,481,987
Realized investment gains	3,460,933	262,856	-	3,723,789
Other income	544,422	-	-	544,422
Interest expense	772,500	338,969	-	1,111,469
Other expenses	776,020	519,771	951,510	2,247,301
Income (loss) before income tax expense (benefit)	<u>\$ 40,646,744</u>	<u>\$ 19,008,942</u>	<u>\$ (736,997)</u>	<u>\$ 58,918,689</u>

The following table displays the net premiums earned of the property and casualty insurance segment and the reinsurance segment for the three years ended December 31, 2009, by line of insurance.

	Year ended December 31,		
	2009	2008	2007
<u>Property and casualty insurance segment</u>			
Commercial lines:			
Automobile	\$ 65,721,232	\$ 68,931,452	\$ 71,707,064
Property	62,114,549	61,312,130	61,800,450
Workers' compensation	65,612,659	65,233,460	63,198,459
Liability	62,872,730	68,265,379	71,135,884
Other	8,820,064	8,960,806	8,562,606
Total commercial lines	<u>265,141,234</u>	<u>272,703,227</u>	<u>276,404,463</u>
Personal lines:			
Automobile	23,516,997	22,838,791	23,462,308
Property	18,844,395	19,434,328	20,320,952
Liability	576,410	621,703	648,343
Total personal lines	<u>42,937,802</u>	<u>42,894,822</u>	<u>44,431,603</u>
Total property and casualty insurance	<u>\$ 308,079,036</u>	<u>\$ 315,598,049</u>	<u>\$ 320,836,066</u>
<u>Reinsurance segment</u>			
Pro rata reinsurance:			
Property and casualty	\$ 7,379,461	\$ 8,710,942	\$ 9,940,681
Property	19,978,045	18,236,058	14,894,538
Crop	2,176,737	4,208,882	3,741,830
Casualty	1,086,934	1,334,915	1,725,814
Marine/Aviation	373,016	615,602	478,684
Total pro rata reinsurance	<u>30,994,193</u>	<u>33,106,399</u>	<u>30,781,547</u>
Excess-of-loss reinsurance:			
Property	35,221,000	29,385,844	30,281,252
Casualty	9,741,047	11,220,250	11,166,094
Surety	(24,375)	7,256	(5,562)
Total excess-of-loss reinsurance	<u>44,937,672</u>	<u>40,613,350</u>	<u>41,441,784</u>
Total reinsurance	<u>\$ 75,931,865</u>	<u>\$ 73,719,749</u>	<u>\$ 72,223,331</u>
Consolidated	<u>\$ 384,010,901</u>	<u>\$ 389,317,798</u>	<u>\$ 393,059,397</u>

8. DISCLOSURES ABOUT THE FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount and the estimated fair value of the Company's financial instruments is summarized below.

	Carrying amount	Estimated fair value
<u>December 31, 2009</u>		
Assets:		
Fixed maturity securities:		
Held-to-maturity	\$ 410,005	\$ 460,877
Available-for-sale	899,180,986	899,180,986
Equity securities available-for-sale	90,189,979	90,189,979
Short-term investments	55,390,096	55,390,096
Other long-term investments	47,083	47,083
Securities lending collateral	14,941,880	14,941,880
Liabilities:		
Surplus notes	25,000,000	22,752,800
Securities lending obligation	14,941,880	14,941,880
<u>December 31, 2008</u>		
Assets:		
Fixed maturity securities:		
Held-to-maturity	\$ 534,759	\$ 572,852
Available-for-sale	821,818,887	821,818,887
Equity securities available-for-sale	88,372,207	88,372,207
Short-term investments	54,373,082	54,373,082
Other long-term investments	66,974	66,974
Securities lending collateral	9,322,863	9,322,863
Liabilities:		
Surplus notes	25,000,000	23,290,761
Securities lending obligation	9,322,863	9,322,863

The estimated fair value of fixed maturity securities, equity securities, short-term investments, securities lending collateral and securities lending obligation is based on quoted market prices, where available. In cases where quoted market prices are not available, fair values are based on a variety of valuation techniques depending on the type of security.

Other long-term investments, consisting primarily of holdings in limited partnerships and limited liability companies, are valued by the various fund managers. In management's opinion, these values reflect fair value at December 31, 2009 and 2008.

The fair value of the surplus notes is estimated using discounted cash flow analysis based on the Company's current incremental borrowing rate for similar debt obligations.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following fair value hierarchy prioritizes inputs to valuation techniques used to measure fair value:

Level 1 - Unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2 - Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; or valuations based on models where the significant inputs are observable (e.g., interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.

Level 3 - Prices or valuation techniques that require significant unobservable inputs. The unobservable inputs may reflect the Company's own judgements about the assumptions that market participants would use.

The Company uses an independent pricing source to obtain the estimated fair value of a majority of its securities. The fair value is based on quoted market prices, where available. This is typically the case for equity securities and short-term investments, which are accordingly classified as Level 1 fair value measurements. In cases where quoted market prices are not available, fair value is based on a variety of valuation techniques depending on the type of security. Many of the fixed maturity securities in the Company's portfolio do not trade on a daily basis; however, observable inputs are utilized in their valuations, and these securities are therefore classified as Level 2 fair value measurements. Following is a brief description of the various pricing techniques used for different asset classes.

- U.S. Treasury securities (including bonds, notes, and bills) are priced according to a number of live data sources, including active market makers and inter-dealer brokers. Prices from these sources are reviewed based on the sources' historical accuracy for individual issues and maturity ranges.
- U.S. government-sponsored agencies and corporate securities (including fixed-rate corporate bonds, medium-term notes, and retail notes) are priced by determining a bullet (non-call) spread scale for each issuer for maturities going out to forty years. These spreads represent credit risk and are obtained from the new issue market, secondary trading, and dealer quotes. An option adjusted spread model is incorporated to adjust spreads of issues that have early redemption features. The final spread is then added to the U.S. Treasury curve. For notes with odd coupon payment dates, a cash discounting yield/price routine calculates prices from final yields.
- Obligations of states and political subdivisions are priced by tracking and analyzing actively quoted issues and trades reported by the Municipal Securities Rulemaking Board (MSRB). Municipal bonds with similar characteristics are grouped together into market sectors, and internal yield curves are constructed daily for these sectors. Individual bond evaluations are extrapolated from these sectors, with the ability to make individual spread adjustments for attributes such as discounts, premiums, alternative minimum tax, and/or whether or not the bond is callable.
- Mortgage-backed securities are priced with models using spreads and other information solicited from Wall Street buy- and sell-side sources, including primary and secondary dealers, portfolio managers, and research analysts, to produce pricing for each tranche. To determine a tranche's price, first the cash flow for each tranche is generated (using consensus prepayment speed assumptions including, as appropriate, a proprietary prepayment projection based on historical statistics of the underlying collateral), then a benchmark yield is determined (in relation to the U.S. Treasury curve for the maturity corresponding to the tranche's average life estimate), and finally collateral performance and tranche level attributes are incorporated to adjust the benchmark yield to determine the tranche-specific spread. This is then used to discount the cash flows to generate the price. When cash flows or other security structure or market information is not available to appropriately price a security, broker quotes may be used with a zero spread bid-side valuation, resulting in the same values for the mean and ask prices.

On a quarterly basis, the Company receives from its independent pricing service a list of fixed maturity securities that were priced solely from broker quotes. Since this is not an observable input, any fixed maturity security in the Company's portfolio that is on this list is classified as a Level 3 fair value measurement. At December 31, 2009, the Company did not hold any fixed maturity securities that were priced solely from broker quotes.

A small number of the Company's securities are not priced by the independent pricing service. One is an equity security that is reported as a Level 3 fair value measurement at December 31, 2009, since no reliable observable inputs are used in its valuation. This equity security continues to be reported at the fair value obtained from the Securities Valuation Office (SVO) of the National Association of Insurance Commissioners (NAIC). The SVO establishes a per share price for this security based on an annual review of that company's financial statements. This review is typically performed during the second quarter, and resulted in a fair value for the shares held by the Company of \$2,014 at December 31, 2009 and \$3,641 at December 31, 2008. The remaining two securities not priced by the Company's independent pricing service are fixed maturity securities. These two fixed maturity securities are classified as Level 2 fair value measurements and are carried at aggregate fair values of \$7,722,288 at December 31, 2009 and \$7,162,662 at December 31, 2008. The fair values for these two fixed maturity securities were obtained from the Company's investment custodian using independent pricing services which utilize similar pricing techniques as the Company's independent pricing service.

Prior to the fourth quarter of 2009, the Company held Class B shares of Insurance Services Office Inc. (now known as Verisk Analytics, Inc. ("Verisk")) following its Initial Public Offering on October 7, 2009). The Company was reporting this investment as a Level 3 fair value measurement at the fair value obtained from applying a 20 percent marketability discount to the quarterly valuations of the Class A shares produced by a nationally recognized independent financial advisory firm. This resulted in a fair value of \$14,965,502 for the Class B shares at December 31, 2008. The Company sold its entire holding of Verisk during the fourth quarter of 2009 in conjunction with Verisk's Initial Public Offering. This sale resulted in a realized capital gain of \$22,473,792 (before tax).

The estimated fair values obtained from the independent pricing sources are reviewed by the Company for reasonableness and any discrepancies are investigated for final valuation. For fixed maturity securities, this includes comparing valuations from the independent pricing source, the Company's investment custodian, the SVO, and an analytical service for fixed maturity securities. For equity securities, a similar comparison is done between the valuations from the independent pricing service, the Company's investment custodian, and the SVO. From these comparisons, material variances are identified and resolved to determine the final valuation used in the financial statements.

The Company's fixed maturity and equity securities available-for-sale, as well as short-term investments, are measured at fair value on a recurring basis. No assets or liabilities are currently measured at fair value on a non-recurring basis. Presented in the table below are the Company's assets that are measured at fair value on a recurring basis, as of December 31, 2009 and 2008.

Description	Fair value measurements at December 31, 2009 using			
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Fixed maturity securities				
available-for-sale	\$ 899,180,986	\$ -	\$ 899,180,986	\$ -
Equity securities				
available-for-sale	90,189,979	90,187,965	-	2,014
Short-term investments	55,390,096	55,390,096	-	-
	<u>\$ 1,044,761,061</u>	<u>\$ 145,578,061</u>	<u>\$ 899,180,986</u>	<u>\$ 2,014</u>

Description	Fair value measurements at December 31, 2008 using			
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Fixed maturity securities				
available-for-sale	\$ 821,818,887	\$ -	\$ 821,818,887	\$ -
Equity securities				
available-for-sale	88,372,207	73,403,064	-	14,969,143
Short-term investments	54,373,082	54,373,082	-	-
	<u>\$ 964,564,176</u>	<u>\$ 127,776,146</u>	<u>\$ 821,818,887</u>	<u>\$ 14,969,143</u>

Presented in the table below is a reconciliation of the assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2009 and 2008. Any unrealized gains or losses on these securities would be recognized in other comprehensive income (loss). Any gains or losses from disposals or impairments of these securities would be reported as realized investment gains or losses in net income.

	Fair value measurements using significant unobservable inputs (Level 3)		
	Fixed maturity securities available-for-sale	Equity securities available-for-sale	Total
Balance at December 31, 2008	\$ -	\$ 14,969,143	\$ 14,969,143
Total realized and unrealized gains (losses):			
Included in other comprehensive income	-	(14,967,129)	(14,967,129)
Included in net realized investment gains	-	22,473,792	22,473,792
Purchases, sales, issuances and settlements	-	(22,473,792)	(22,473,792)
Balance at December 31, 2009	<u>\$ -</u>	<u>\$ 2,014</u>	<u>\$ 2,014</u>

	Fair value measurements using significant unobservable inputs (Level 3)		
	Fixed maturity securities available-for-sale	Equity securities available-for-sale	Total
Balance at January 1, 2008	\$ 743,356	\$ 10,186,964	\$ 10,930,320
Total unrealized gains included in			
other comprehensive income (loss)	-	4,782,179	4,782,179
Purchases, sales, issuances and settlements	(46,795)	-	(46,795)
Transfers out of Level 3	(696,561)	-	(696,561)
Balance at December 31, 2008	<u>\$ -</u>	<u>\$ 14,969,143</u>	<u>\$ 14,969,143</u>

9. INVESTMENTS

Investments of the Company's insurance subsidiaries are subject to the insurance laws of the state of their incorporation. These laws prescribe the kind, quality and concentration of investments that may be made by insurance companies. In general, these laws permit investments, within specified limits and subject to certain qualifications, in federal, state and municipal obligations, corporate bonds, preferred and common stocks and real estate mortgages. The Company believes that it is in compliance with these laws.

The amortized cost and estimated fair value of securities held-to-maturity and available-for-sale as of December 31, 2009 and 2008 are as follows. Securities classified as held-to-maturity are carried at amortized cost. All other securities have been classified as available-for-sale and are carried at fair value.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
December 31, 2009				
Securities held-to-maturity:				
Fixed maturity securities:				
Residential mortgage-backed	\$ 410,005	\$ 50,872	\$ -	\$ 460,877
Total securities held-to-maturity	<u>\$ 410,005</u>	<u>\$ 50,872</u>	<u>\$ -</u>	<u>\$ 460,877</u>
Securities available-for-sale:				
Fixed maturity securities:				
U.S. treasury	\$ 4,739,194	\$ 243,851	\$ -	\$ 4,983,045
U.S. government-sponsored agencies	151,440,800	1,011,484	2,036,754	150,415,530
Obligations of states and political subdivisions	380,605,547	15,604,731	4,445,466	391,764,812
Commercial mortgage-backed	75,563,896	6,827,805	-	82,391,701
Residential mortgage-backed	31,017,352	961,646	923,703	31,055,295
Other asset-backed	9,164,445	739,434	18,270	9,885,609
Corporate	219,663,540	10,284,043	1,262,589	228,684,994
Total fixed maturity securities	<u>872,194,774</u>	<u>35,672,994</u>	<u>8,686,782</u>	<u>899,180,986</u>
Equity securities:				
Common stocks:				
Financial services	7,447,765	3,276,169	57,465	10,666,469
Information technology	13,366,462	6,326,591	-	19,693,053
Healthcare	10,066,840	2,901,926	33,513	12,935,253
Consumer staples	6,323,889	768,181	48,849	7,043,221
Consumer discretionary	6,100,052	1,499,876	18,561	7,581,367
Energy	6,995,036	1,858,794	42,775	8,811,055
Industrials	5,239,316	683,747	96,293	5,826,770
Other	8,075,560	1,324,137	29,406	9,370,291
Non-redeemable preferred stocks	9,500,000	15,500	1,253,000	8,262,500
Total equity securities	<u>73,114,920</u>	<u>18,654,921</u>	<u>1,579,862</u>	<u>90,189,979</u>
Total securities available-for-sale	<u>\$ 945,309,694</u>	<u>\$ 54,327,915</u>	<u>\$ 10,266,644</u>	<u>\$ 989,370,965</u>

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
<u>December 31, 2008</u>				
Securities held-to-maturity:				
Fixed maturity securities:				
Residential mortgage-backed	\$ 534,759	\$ 38,093	\$ -	\$ 572,852
Total securities held-to-maturity	<u>\$ 534,759</u>	<u>\$ 38,093</u>	<u>\$ -</u>	<u>\$ 572,852</u>
Securities available-for-sale:				
Fixed maturity securities:				
U.S. treasury	\$ 4,730,985	\$ 442,062	\$ -	\$ 5,173,047
U.S. government-sponsored agencies	282,152,396	3,410,866	682,890	284,880,372
Obligations of states and political subdivisions	301,326,007	7,291,171	8,525,393	300,091,785
Commercial mortgage-backed	31,001,558	2,366,742	3,275,086	30,093,214
Residential mortgage-backed	41,242,066	573,352	2,794,186	39,021,232
Other asset-backed	9,677,383	41,184	609,339	9,109,228
Corporate	153,499,337	3,020,196	9,621,407	146,898,126
Debt securities issued by foreign governments	6,600,964	8,261	57,342	6,551,883
Total fixed maturity securities	<u>830,230,696</u>	<u>17,153,834</u>	<u>25,565,643</u>	<u>821,818,887</u>
Equity securities:				
Common stocks:				
Financial services	8,190,462	15,560,209	293,354	23,457,317
Information technology	11,913,152	1,606,225	1,174,331	12,345,046
Healthcare	11,276,843	262,405	1,920,754	9,618,494
Consumer staples	8,107,473	316,847	336,315	8,088,005
Consumer discretionary	5,401,525	672,211	558,218	5,515,518
Energy	7,313,125	2,456,741	203,424	9,566,442
Industrials	5,006,872	340,293	239,338	5,107,827
Other	8,316,214	349,031	420,787	8,244,458
Non-redeemable preferred stocks	9,500,000	-	3,070,900	6,429,100
Total equity securities	<u>75,025,666</u>	<u>21,563,962</u>	<u>8,217,421</u>	<u>88,372,207</u>
Total securities available-for-sale	<u>\$ 905,256,362</u>	<u>\$ 38,717,796</u>	<u>\$ 33,783,064</u>	<u>\$ 910,191,094</u>

U.S. government-sponsored agency securities declined significantly in 2008 and 2009 due to a high level of call activity that resulted from the declining interest rate environment. The proceeds from these called securities were initially invested in short-term securities until suitable long-term investment opportunities were identified. During 2009, a portion of those proceeds were reinvested back into U.S. government-sponsored agency securities. The remaining proceeds were invested in obligations of states and political subdivisions, corporate securities, and commercial mortgage-backed securities.

The following table sets forth the estimated fair value and gross unrealized losses associated with investment securities that were in an unrealized loss position as of December 31, 2009 and 2008, listed by length of time the securities were in an unrealized loss position.

December 31, 2009	Less than twelve months		Twelve months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Fixed maturity securities:						
U.S. government-sponsored agencies	\$ 102,035,965	\$ 2,036,754	\$ -	\$ -	\$ 102,035,965	\$ 2,036,754
Obligations of states and political subdivisions	83,487,876	3,832,182	6,314,420	613,284	89,802,296	4,445,466
Residential mortgage-backed	3,317,513	93,216	10,535,690	830,487	13,853,203	923,703
Other asset-backed	-	-	503,730	18,270	503,730	18,270
Corporate	43,994,473	684,520	18,830,648	578,069	62,825,121	1,262,589
Total, fixed maturity securities	232,835,827	6,646,672	36,184,488	2,040,110	269,020,315	8,686,782
Equity securities:						
Common stocks:						
Financial services	1,092,716	57,465	-	-	1,092,716	57,465
Healthcare	1,550,018	33,513	-	-	1,550,018	33,513
Consumer staples	1,901,671	48,849	-	-	1,901,671	48,849
Consumer discretionary	406,500	18,561	-	-	406,500	18,561
Energy	1,502,064	42,775	-	-	1,502,064	42,775
Industrials	1,387,906	96,293	-	-	1,387,906	96,293
Other	2,078,197	29,406	-	-	2,078,197	29,406
Non-redeemable preferred stocks	-	-	5,247,000	1,253,000	5,247,000	1,253,000
Total, equity securities	9,919,072	326,862	5,247,000	1,253,000	15,166,072	1,579,862
Total temporarily impaired securities	\$ 242,754,899	\$ 6,973,534	\$ 41,431,488	\$ 3,293,110	\$ 284,186,387	\$ 10,266,644

December 31, 2008	Less than twelve months		Twelve months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Fixed maturity securities:						
U.S. government-sponsored agencies	\$ 87,086,543	\$ 682,890	\$ -	\$ -	\$ 87,086,543	\$ 682,890
Obligations of states and political subdivisions	158,396,837	8,405,003	997,842	120,390	159,394,679	8,525,393
Commercial mortgage-backed	20,814,315	3,275,086	-	-	20,814,315	3,275,086
Residential mortgage-backed	23,496,497	2,794,186	-	-	23,496,497	2,794,186
Other asset-backed	6,313,510	609,339	-	-	6,313,510	609,339
Corporate	88,779,231	9,621,407	-	-	88,779,231	9,621,407
Debt securities issued by foreign governments	5,543,901	57,342	-	-	5,543,901	57,342
Total, fixed maturity securities	390,430,834	25,445,253	997,842	120,390	391,428,676	25,565,643
Equity securities:						
Common stocks:						
Financial services	3,016,517	293,354	-	-	3,016,517	293,354
Information technology	3,447,833	1,174,331	-	-	3,447,833	1,174,331
Healthcare	7,417,668	1,920,754	-	-	7,417,668	1,920,754
Consumer staples	4,646,967	336,315	-	-	4,646,967	336,315
Consumer discretionary	2,887,949	558,218	-	-	2,887,949	558,218
Energy	717,509	203,424	-	-	717,509	203,424
Industrials	2,045,989	239,338	-	-	2,045,989	239,338
Other	3,586,838	420,787	-	-	3,586,838	420,787
Non-redeemable preferred stocks	1,215,000	285,000	5,214,100	2,785,900	6,429,100	3,070,900
Total, equity securities	28,982,270	5,431,521	5,214,100	2,785,900	34,196,370	8,217,421
Total temporarily impaired securities	\$ 419,413,104	\$ 30,876,774	\$ 6,211,942	\$ 2,906,290	\$ 425,625,046	\$ 33,783,064

Unrealized losses on fixed maturity securities totaled \$8,686,782 (includes \$161,303 related to the non-credit component of an “other-than-temporary” impairment of a residential mortgage-backed security) at December 31, 2009 and were primarily associated with three different sectors: municipal, U.S. government-sponsored agencies, and asset-backed securities. The primary factor contributing to these unrealized losses was an increase in interest rates in the second half of 2009. In addition, certain municipal and asset-backed securities experienced a widening of risk premium spread over U.S. Treasuries. All but seven of these securities (those seven being residential mortgage-backed securities) are considered investment grade by credit rating agencies. Because management does not intend to sell these securities, does not believe it will be required to sell these securities before recovery, and believes it will collect the amounts due on these securities, it was determined that these securities were not “other-than-temporarily” impaired at December 31, 2009.

All of the Company’s preferred stock holdings are perpetual preferred stocks. The Company evaluates perpetual preferred stocks for “other-than-temporary” impairment similar to fixed maturity securities since they have debt-like characteristics such as periodic cash flows in the form of dividends and call features, are rated by rating agencies and are priced like other long-term callable fixed maturity securities. There was no evidence of any credit deterioration in the issuers of the preferred stocks and the Company does not intend to sell these securities before recovery, nor does it believe it will be required to sell these securities before recovery; therefore, it was determined that the securities were not “other-than-temporarily” impaired at December 31, 2009.

The unrealized losses on common stocks at December 31, 2009 are not concentrated in a particular sector or an individual security. The Company believes the unrealized losses on common stocks are primarily due to general fluctuations in the equity markets. Because the Company has the ability and intent to hold these securities for a reasonable amount of time to allow for recovery, it was determined that the securities were not "other-than-temporarily" impaired at December 31, 2009.

The amortized cost and estimated fair value of fixed maturity securities at December 31, 2009, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations, with or without call or prepayment penalties.

	Amortized cost	Estimated fair value
Securities held-to-maturity:		
Due in one year or less	\$ -	\$ -
Due after one year through five years	-	-
Due after five years through ten years	-	-
Due after ten years	-	-
Mortgage-backed securities	410,005	460,877
Totals	<u>\$ 410,005</u>	<u>\$ 460,877</u>
Securities available-for-sale:		
Due in one year or less	\$ 10,059,020	\$ 10,276,382
Due after one year through five years	89,607,825	95,076,292
Due after five years through ten years	102,481,508	106,900,987
Due after ten years	563,465,173	573,480,329
Mortgage-backed securities	106,581,248	113,446,996
Totals	<u>\$ 872,194,774</u>	<u>\$ 899,180,986</u>

A summary of realized investment gains and (losses) is as follows:

	Year ended December 31,		
	2009	2008	2007
Fixed maturity securities			
held-to-maturity: (1)			
Gross realized investment gains	\$ -	\$ -	\$ 2,825
Gross realized investment losses	-	-	-
Fixed maturity securities			
available-for-sale:			
Gross realized investment gains	1,636,291	272,522	217,805
Gross realized investment losses	(50,000)	-	-
"Other-than-temporary" impairments	(2,657,094)	-	-
Equity securities			
available-for-sale:			
Gross realized investment gains	29,173,686	9,433,726	8,369,378
Gross realized investment losses	(2,729,329)	(3,240,928)	(3,589,641)
"Other-than-temporary" impairments	(7,451,283)	(30,920,859)	(1,276,578)
Totals	<u>\$ 17,922,271</u>	<u>\$ (24,455,539)</u>	<u>\$ 3,723,789</u>

(1) Investment gains realized on fixed maturity securities held-to-maturity are the result of calls and prepayments.

The amounts reported as “other-than-temporary” impairments on equity securities available-for-sale reflect the impairment of 34 equity securities for the year ended December 31, 2009, compared to 40 equity securities for the year ended December 31, 2008 and 14 equity securities for the year ended December 31, 2007. The large amount of impairment losses recognized during 2009 and 2008 is a result of the severe and prolonged turmoil in the financial markets. Included in the amount for 2008 is \$14,904,000 of losses recognized on the perpetual preferred stocks of Freddie Mac and Fannie Mae when those companies were placed under conservatorship by the U.S. government.

During the first quarter of 2009, the Company recognized an “other-than-temporary” impairment loss on a fixed maturity security attributed to a bankruptcy filing made by Great Lakes Chemical Corporation, now known as Chemtura Corporation. At March 31, 2009, this security was trading at 26 percent of its par value, which was the amount established as the new cost basis (\$780,000) after recognition of a \$2,219,779 “other-than-temporary” impairment loss.

On April 1, 2009, the Company adopted updated guidance related to the Investments-Debt and Equity Securities Topic 310 of the FASB ASC (issued as FSP FAS 115-2 and FAS 124-2). This pronouncement required a cumulative effect adjustment from retained earnings to “accumulated other comprehensive income” for previously “other-than-temporarily” impaired fixed maturity securities that had a non-credit component of the loss as of the date of adoption. The only “other-than-temporarily” impaired fixed maturity security held by the Company as of the adoption date was the Chemtura Corporation securities. On the date of adoption the credit component of the loss amounted to \$1,229,779, which was measured as the difference between the present value of the estimated cash flows (\$1,770,000) and the original amortized cost basis (\$2,999,779). The non-credit component of the loss (\$990,000) was measured as the difference between the fair value (\$780,000) and the present value of the estimated cash flows (\$1,770,000). This non-credit component of the loss (\$643,000 after taxes) was treated as a change in accounting principle, and was reclassified from retained earnings to “accumulated other comprehensive income” as of April 1, 2009. This security was subsequently sold during the third quarter of 2009 for proceeds of \$2,617,500, resulting in a realized gain of \$847,500.

During 2009, in anticipation of an expected default and management’s intention to sell, the Company recognized an “other-than-temporary” impairment loss on US Freightways Corporation fixed maturity securities. Due to management’s intent to sell these securities, the impairment was not bifurcated between credit loss and non-credit loss components, and the entire impairment was recognized in earnings (\$350,000). This security was subsequently sold during the fourth quarter of 2009 for an additional loss of \$50,000. The Company also recognized an “other-than-temporary” impairment loss on a residential mortgage-backed security. The total impairment on this security was \$248,618, with \$87,315 determined as the credit loss component (recognized in earnings) and the remainder (\$161,303) recognized in other comprehensive income.

Following is a tabular roll forward of the amount of credit losses recognized in earnings from “other-than-temporary” impairments. Note that this table only includes the credit loss component of “other-than-temporary” impairments, and does not include the non-credit loss component (which is recognized through “other comprehensive income”) or impairments that are recognized through earnings in their entirety (not subject to bifurcation between credit and non-credit components).

<u>Year ended December 31, 2009</u>	<u>Credit losses recognized in earnings</u>
Balance at December 31, 2008	\$ -
Credit losses for which an "other-than-temporary" impairment loss was not previously recognized	1,317,094
Reduction for securities sold during the period	<u>(1,229,779)</u>
Balance at December 31, 2009	<u>\$ 87,315</u>

A summary of net investment income is as follows:

	Year ended December 31,		
	2009	2008	2007
Interest on fixed maturity securities	\$ 46,560,740	\$ 44,419,493	\$ 47,127,235
Dividends on equity securities	1,938,189	2,933,835	2,475,860
Interest on short-term investments	606,399	2,690,427	316,674
Interest on long-term investments	26,437	42,649	102,208
Fees from securities lending	104,786	166,926	160,560
Total investment income	49,236,551	50,253,330	50,182,537
Investment expenses	(1,477,245)	(1,849,957)	(1,700,550)
Net investment income	\$ 47,759,306	\$ 48,403,373	\$ 48,481,987

The large increase in interest income on short-term securities and the corresponding decline in interest on fixed maturity securities during 2008 is the result of a significant amount of call activity on U.S. government-sponsored agency securities due to the declining interest rate environment. The proceeds from these called securities were initially invested in short-term securities, until suitable long-term investment opportunities were later identified.

A summary of net changes in unrealized holding gains (losses) on securities available-for-sale is as follows:

	Year ended December 31,		
	2009	2008	2007
Fixed maturity securities	\$ 35,398,021	\$(27,332,178)	\$ 9,198,634
Deferred income tax expense (benefit)	12,389,307	(9,566,262)	3,219,523
Total fixed maturity securities	23,008,714	(17,765,916)	5,979,111
Equity securities	3,728,518	(28,233,640)	6,141,745
Deferred income tax expense (benefit)	1,304,982	(9,881,774)	2,149,610
Total equity securities	2,423,536	(18,351,866)	3,992,135
Total available-for-sale securities	\$ 25,432,250	\$(36,117,782)	\$ 9,971,246

10. INCOME TAXES

Temporary differences between the consolidated financial statement carrying amount and tax basis of assets and liabilities that give rise to significant portions of the deferred income tax asset at December 31, 2009 and 2008 are as follows:

	December 31,	
	2009	2008
Loss reserve discounting	\$ 19,949,865	\$ 20,473,247
Unearned premium reserve limitation	10,803,318	10,521,601
Retirement benefits	6,763,636	6,861,481
"Other-than-temporarily" impaired securities held	2,949,395	4,084,848
Other policyholders' funds payable	2,771,533	2,246,605
Other, net	1,292,761	1,832,351
Total deferred income tax asset	44,530,508	46,020,133
Net unrealized holding gains on investment securities	(15,421,445)	(1,727,156)
Deferred policy acquisition costs	(12,827,720)	(12,120,300)
Other, net	(1,236,986)	(1,353,085)
Total deferred income tax liability	(29,486,151)	(15,200,541)
Net deferred income tax asset	\$ 15,044,357	\$ 30,819,592

Based upon anticipated future taxable income and consideration of all other available evidence, management believes that it is "more likely than not" that the Company's net deferred income tax asset will be realized.

The actual income tax expense (benefit) for the years ended December 31, 2009, 2008 and 2007 differed from the "expected" income tax expense (benefit) for those years (computed by applying the United States federal corporate tax rate of 35 percent to income (loss) before income tax expense (benefit)) as follows:

	Year ended December 31,		
	2009	2008	2007
Computed "expected" income tax expense (benefit)	\$ 21,883,686	\$ (3,601,519)	\$ 20,621,541
Increases (decreases) in tax resulting from:			
Tax-exempt interest income	(5,139,443)	(5,012,548)	(4,277,856)
Dividends received deduction	(485,035)	(728,769)	(602,559)
Proration of tax-exempt interest and dividends received deduction	843,672	861,198	732,062
Other, net	51,323	(103,043)	(32,534)
Income tax expense (benefit)	\$ 17,154,203	\$ (8,584,681)	\$ 16,440,654

Comprehensive income tax expense (benefit) included in the consolidated financial statements for the years ended December 31, 2009, 2008 and 2007 is as follows:

	Year ended December 31,		
	2009	2008	2007
Income tax expense (benefit) on:			
Operations	\$ 17,154,203	\$ (8,584,681)	\$ 16,440,654
Change in unrealized holding gains (losses) on			
investment securities	14,040,789	(19,448,036)	5,369,133
Adjustment for retirement benefit plans:			
Pension plans	2,183,000	(8,196,274)	1,343,840
Postretirement benefit plans	(1,886,738)	(811,204)	2,993,875
Comprehensive income tax expense (benefit)	<u>31,491,254</u>	<u>(37,040,195)</u>	<u>26,147,502</u>
Adoption of ASC Topic 715 measurement date provision:			
Pension plans	-	11,321	-
Postretirement benefit plans	-	(36,121)	-
Income tax expense (benefit) reflected			
in accumulated other comprehensive			
income (loss)	<u>\$ 31,491,254</u>	<u>\$ (37,064,995)</u>	<u>\$ 26,147,502</u>

The Company had no provision for uncertain tax positions at December 31, 2009 or 2008. The Company did not recognize any interest or other penalties related to U.S. federal or state income taxes during 2009, 2008 or 2007. It is the Company's accounting policy to reflect income tax penalties as other expense, and interest as interest expense.

The Company files U.S. federal tax returns, along with various states income tax returns. The Company is no longer subject to U.S. federal and state income tax examinations by tax authorities for years before 2005.

11. SURPLUS NOTES

The Company's property and casualty insurance subsidiaries have \$25,000,000 of surplus notes issued to Employers Mutual. Effective February 1, 2008, the interest rate on these surplus notes was increased from 3.09 percent to 3.60 percent. Reviews of the interest rate will be conducted by the Inter-Company Committees of the Boards of Directors of the Company and Employers Mutual every five years. Payment of interest and repayment of principal can only be made out of the applicable subsidiary's statutory surplus and is subject to prior approval by the insurance commissioner of the respective state of domicile. The surplus notes are subordinate and junior in right of payment to all obligations or liabilities of the applicable insurance subsidiaries. Prior to December 31, 2007, the Company's reinsurance subsidiary had \$11,000,000 of surplus notes issued to Employers Mutual. These surplus notes were redeemed in the fourth quarter of 2007, along with accrued interest. Total interest expense incurred on these surplus notes was \$900,000, \$889,375 and \$1,111,469 in 2009, 2008 and 2007, respectively. At December 31, 2009, the Company's property and casualty insurance subsidiaries had received approval for the payment of interest accrued on the surplus notes during 2009.

12. EMPLOYEE RETIREMENT PLANS

Employers Mutual has various employee benefit plans, including a defined benefit retirement plan (pension) and a supplemental retirement plan. Employers Mutual also has two postretirement benefit plans that provide retiree healthcare and life insurance coverage.

Employers Mutual's pension plan covers substantially all of its employees. The plan is funded by employer contributions and provides benefits under two different formulas, depending on an employee's age and date of service. Benefits generally vest after three years of service or the attainment of 55 years of age. It is Employers Mutual's funding policy to make contributions that meet minimum regulatory funding requirements plus additional amounts as determined by management.

Employers Mutual's supplemental retirement plan provides retirement benefits for a select group of management and highly-compensated employees. This plan enables select employees to receive retirement benefits without the limit on compensation imposed on qualified defined benefit pension plans by the Internal Revenue Service (IRS) and to recognize compensation that has been deferred in the determination of retirement benefits. The plan is unfunded and benefits generally vest after three years of service.

Employers Mutual also offers postretirement benefit plans which provide certain health care and life insurance benefits for retired employees. Substantially all of its employees may become eligible for those benefits if they reach normal retirement age and have attained the required length of service while working for Employers Mutual. The health care postretirement plan requires contributions from participants and contains certain cost sharing provisions such as coinsurance and deductibles. The life insurance plan is noncontributory. The benefits provided under both plans are subject to change.

Employers Mutual maintains a Voluntary Employee Beneficiary Association (VEBA) trust which accumulates funds for the payment of postretirement health care and life insurance benefits. Contributions to the VEBA trust are used to fund the projected postretirement benefit obligation, as well as pay current year benefits.

Effective January 1, 2008, Employers Mutual increased the minimum retirement age and length of service requirements to receive the full employer contribution amount in the postretirement health care benefit plan. This change did not affect current retirees. The Company also increased the level of coverage and service requirements for its postretirement life insurance benefit plan.

The following table sets forth the funded status of Employers Mutual's pension and postretirement benefit plans as of December 31, 2009 and 2008, based upon measurement dates of December 31, 2009 and 2008, respectively. The 2009 projected benefit obligation for the postretirement benefit plans includes a significant actuarial loss, which is attributed to actual participant contributions being less than expected and several assumption changes. Effective January 1, 2008, the Company adopted the measurement date provision of FASB ASC Topic 715 and elected to apply the approach under which the Company's previous November 1, 2007 measurement date was used to obtain the adjustment for the two month transition period. As a result, the 2008 balances reflect fourteen months of activity.

	Pension plans		Postretirement benefit plans	
	2009	2008	2009	2008
Change in projected benefit obligation:				
Benefit obligation at beginning of year	\$ 171,276,329	\$ 163,554,814	\$ 69,835,445	\$ 65,414,972
Service cost	9,886,960	10,157,975	2,771,480	3,311,181
Interest cost	9,804,408	10,967,962	4,281,570	4,667,491
Actuarial (gain) loss	(1,411,417)	(2,654,902)	19,044,244	(1,443,827)
Benefits paid	(7,925,282)	(10,749,520)	(2,392,373)	(2,230,093)
Medicare subsidy reimbursements	-	-	227,703	115,721
Projected benefit obligation at end of year	181,630,998	171,276,329	93,768,069	69,835,445
Change in plan assets:				
Fair value of plan assets at beginning of year	134,613,308	195,015,332	39,430,673	34,225,479
Actual return on plan assets	23,192,301	(64,873,338)	3,628,541	(5,264,713)
Employer contributions	17,261,831	15,220,834	2,550,000	12,700,000
Benefits paid	(7,925,282)	(10,749,520)	(2,392,373)	(2,230,093)
Fair value of plan assets at end of year	167,142,158	134,613,308	43,216,841	39,430,673
Funded status	\$ (14,488,840)	\$ (36,663,021)	\$ (50,551,228)	\$ (30,404,772)

The following tables set forth the amounts recognized in the Company's financial statements as a result of the property and casualty insurance subsidiaries' aggregate 30 percent participation in the pooling agreement and amounts allocated to the reinsurance subsidiary as of December 31, 2009 and 2008:

Amounts recognized in the Company's consolidated balance sheets:

	Pension plans		Postretirement benefit plans	
	2009	2008	2009	2008
Liability for employee retirement plans ...	\$ 4,458,896	\$ 11,078,014	\$ 13,717,824	\$ 8,252,993

Amounts recognized in the Company's consolidated balance sheets under the caption "accumulated other comprehensive income":

	Pension plans		Postretirement benefit plans	
	2009	2008	2009	2008
Net actuarial loss	\$ (17,612,562)	\$ (23,714,219)	\$ (6,517,412)	\$ (1,706,642)
Prior service (cost) credit	(401,988)	(537,475)	5,166,602	5,746,510
Net amount recognized	\$ (18,014,550)	\$ (24,251,694)	\$ (1,350,810)	\$ 4,039,868

During 2010, the Company will amortize \$1,233,747 of net actuarial loss and \$138,957 of prior service cost associated with the pension plans into net periodic benefit cost. In addition, the Company will amortize \$619,217 of prior service credit and \$380,518 of net actuarial loss associated with the postretirement benefit plans into net periodic postretirement benefit cost in 2010.

Amounts recognized in the Company's consolidated statements of comprehensive income:

	Pension plans		Postretirement benefit plans	
	2009	2008	2009	2008
Net actuarial gain (loss)	\$ 6,101,657	\$ (23,552,243)	\$ (4,810,770)	\$ (1,679,502)
Prior service (cost) credit	135,487	134,316	(579,908)	(638,226)
Net amount recognized	<u>\$ 6,237,144</u>	<u>\$ (23,417,927)</u>	<u>\$ (5,390,678)</u>	<u>\$ (2,317,728)</u>

The following table sets forth the projected benefit obligation, accumulated benefit obligation and fair value of plan assets of Employers Mutual's defined benefit and supplemental retirement plans.

	Year ended December 31,	
	2009	2008
Projected benefit obligation	\$ 181,630,998	\$ 171,276,329
Accumulated benefit obligation	172,874,247	149,414,281
Fair value of plan assets	167,142,158	134,613,308

The components of net periodic benefit cost for Employers Mutual's pension and postretirement benefit plans is as follows:

	Year ended December 31,		
	2009	2008	2007
Pension plans:			
Service cost	\$ 9,886,960	\$ 8,723,908	\$ 8,519,444
Interest cost	9,804,408	9,422,592	8,685,931
Expected return on plan assets	(9,654,133)	(14,180,913)	(12,896,891)
Amortization of net actuarial loss	5,432,367	187,618	190,365
Amortization of prior service cost	452,297	454,561	439,727
Net periodic pension benefit cost	<u>\$ 15,921,899</u>	<u>\$ 4,607,766</u>	<u>\$ 4,938,576</u>
Postretirement benefit plans:			
Service cost	\$ 2,771,480	\$ 2,838,155	\$ 4,828,864
Interest cost	4,281,570	4,000,706	4,996,419
Expected return on plan assets	(2,412,020)	(2,029,308)	(1,923,728)
Amortization of net actuarial loss	98,054	-	-
Amortization of prior service credit	(2,131,256)	(2,131,256)	-
Net periodic postretirement benefit cost	<u>\$ 2,607,828</u>	<u>\$ 2,678,297</u>	<u>\$ 7,901,555</u>

Net periodic pension benefit cost allocated to the Company amounted to \$4,888,759, \$1,419,827 and \$1,514,136 in 2009, 2008 and 2007, respectively. Net periodic postretirement benefit cost allocated to the Company for the years ended December 31, 2009, 2008 and 2007 was \$732,969, \$752,309 and \$2,267,348, respectively.

The weighted-average assumptions used to measure the benefit obligations are as follows:

	Year ended December 31,	
	2009	2008
Pension plans:		
Discount rate	5.75%	6.25%
Rate of compensation increase:		
Defined benefit retirement plan	4.73%	4.73%
Supplemental retirement plan	4.68%	4.68%
Postretirement benefit plans:		
Discount rate	6.00%	6.25%

The weighted-average assumptions used to measure the net periodic benefit cost are as follows:

	Year ended December 31,		
	2009	2008	2007
Pension plans:			
Discount rate	6.25%	6.00%	5.75%
Expected long-term rate of return on plan assets	7.50%	7.50%	7.50%
Rate of compensation increase:			
Defined benefit retirement plan	4.73%	4.73%	4.73%
Supplemental retirement plan	4.68%	4.68%	4.73%
Postretirement benefit plans:			
Discount rate	6.25%	6.25%	5.75%
Expected long-term rate of return on plan assets	6.00%	6.00%	6.00%

The expected long-term rates of return on plan assets were developed considering actual historical results, current and expected market conditions, plan asset mix and management's investment strategy.

	Year ended December 31,	
	2009	2008
Assumed health care cost trend rate:		
Health care cost trend rate assumed for next year	9.00%	9.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2018	2012

The assumed health care cost trend rate has a significant effect on the service and interest cost components of the net periodic benefit cost and the benefit obligation reported for the postretirement benefit plans. A one-percentage-point change in assumed health care cost trend rate would have the following effects:

	One-percentage-point	
	Increase	Decrease
Effect on total of service and interest cost	\$ 1,188,825	\$ (945,865)
Effect on postretirement benefit obligation	\$ 13,496,551	\$(10,945,859)

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid from the plans over the next ten years:

	Pension benefits	Postretirement benefits		
		Gross	Medicare subsidy	Net
2010	\$ 15,436,041	\$ 3,467,105	\$ 389,583	\$ 3,077,522
2011	18,546,490	3,837,919	450,671	3,387,248
2012	22,372,663	4,294,327	541,046	3,753,281
2013	22,207,817	4,762,253	636,344	4,125,909
2014	19,935,749	5,260,045	727,268	4,532,777
2015 - 2019	101,725,853	32,519,571	5,223,577	27,295,994

Employers Mutual manages the VEBA trust assets internally. The trust is currently in the funding stage, with contributions sufficiently large enough to cover current year benefits, as well as establish a reserve to fund future benefits. As such, an emphasis is placed on asset accumulation, with current income generation secondary.

Plan assets in Employers Mutual's VEBA trust are primarily invested in universal life insurance policies issued by EMC National Life Company, an affiliate of Employers Mutual. The assets supporting these universal life insurance policies are invested in S&P 500 mutual funds and debt securities and have a guaranteed interest rate of 4.5 percent.

Following is a description of the valuation methodologies used for the assets classes of Employers Mutual's VEBA trust that is used to fund the postretirement benefit plans.

- Money Market Fund: Valued at amortized cost, which approximates fair value. Under this method, investments purchased at a discount or premium are valued by accreting or amortizing the difference between the original purchase price and maturity value of the issue over the period to maturity. The net asset value of each share held by the plan at year-end was \$1.00.
- Mutual Funds: Valued at the net asset value of shares held by the Plan at year-end. For purposes of calculating the net asset value, portfolio securities and other assets for which market quotes are readily available are valued at fair value. Fair value is generally determined on the basis of last reported sales prices, or if no sales are reported, based on quotes obtained from a quotation reporting system, established market makers, or independent pricing services.
- Insurance Contract: Valued at the cash accumulation value, which approximates fair value.

The fair values of Employers Mutual's VEBA trust by asset category are as follows:

Description	Total	Fair value measurements at December 31, 2009 using		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Northern Institutional Money				
Market Government Select Fund	\$ 7,861,202	\$ 7,861,202	\$ -	\$ -
Vanguard Mutual Funds	23,236,722	23,236,722	-	-
EMC National Life Company				
Insurance Contracts	12,118,917	-	-	12,118,917
	<u>\$ 43,216,841</u>	<u>\$ 31,097,924</u>	<u>\$ -</u>	<u>\$ 12,118,917</u>

Presented in the table below is a reconciliation of the assets measured at fair value using significant unobservable inputs (Level 3) for the year ended December 31, 2009.

	Fair value measurements using significant unobservable inputs (Level 3)
	Insurance Contracts issued by EMC National Life Company
Balance at December 31, 2008	\$ 11,749,936
Actual return on plan assets:	
Increase in cash accumulation value	368,981
Balance at December 31, 2009	<u>\$ 12,118,917</u>

Employers Mutual uses Global Portfolio Strategies, Inc. to advise on asset allocation strategy for its pension plan. The asset allocation strategy and process of Global Portfolio Strategies, Inc. uses a diversified allocation of equity, debt and real estate exposures that is customized to the plan's payment risk and return targets.

Global Portfolio Strategies, Inc. reviews the plan's assets and liabilities in relation to expectations of long-term market and liability development to determine the appropriate asset allocation. The data for the contributions and emerging liabilities is provided from the plan's actuarial valuation, while the current assets and monthly benefit payment data is provided by the plan administrator.

Following is a description of the valuation methodologies used for the assets classes of Employers Mutual's defined benefit retirement plan.

- Pooled Separate Accounts: Each of the Prudential Retirement Insurance and Annuity Company (Prudential) funds held by the Plan is a pooled or commingled investment vehicle, each with many investors. The Plan asset is represented by a "unit of account" and a per unit value, much like a mutual fund, whose value is the result of the accumulated values of the underlying investments. As the sponsor of a fund, Prudential specifies the source(s) used for the underlying investment asset prices and the protocol used to value each fund. These underlying investments are valued in the following ways:
 - Short-Term Funds – these portfolios are comprised of short term securities. Securities in a Money Market Fund, such as the Prudential Short-Term Fund, are valued initially at cost and thereafter adjusted for amortization of any discount or premium.
 - U.S. Stock Funds – these are funds filled with domestic equities. Securities in these funds are priced using the closing price from the applicable exchange.
 - International Stock Funds – are comprised of international equities. Securities are priced using the closing price from the appropriate local stock exchange(s). Prudential also uses Interactive Data's Fair Value Evaluation Service, which seeks to update prices in the event there are material market movements between local stock exchange closing time and portfolio valuation time.
 - U.S. Bond Funds – are portfolios that contain domestic fixed-income securities. Securities are priced by Interactive Data using inputs such as benchmark yields, reported trades, broker/dealer quotes, and issuer spreads. Interactive Data also monitors market indices and industry and economic events. Prices are reviewed to ensure comfort and can be challenged with Interactive Data and/or overridden if Prudential believes the price would be more reflective of fair value.

- First American Funds – Real Estate Securities Fund: Valued at the net asset value of shares held by the Plan at year-end. For purposes of calculating the net asset value, portfolio securities and other assets for which market quotes are readily available are valued at fair value. Fair value is generally determined on the basis of last reported sales prices, or if no sales are reported, based on quotes obtained from a quotation reporting system, established market makers, or independent pricing services.
- Principal Money Market Separate Account: Invests mainly in short-term securities such as commercial paper. Valued by an independent pricing service.
- Principal Bond and Mortgage Separate Account: Invests mainly in fixed securities such as asset backed securities, residential mortgage-backed securities, commercial mortgage-backed securities and corporate bonds. Securities are priced by Interactive Data using inputs such as benchmark yields, reported trades, broker/dealer quotes, and issuer spreads. Interactive Data also monitors market indices and industry and economic events.

The fair values of Employers Mutual's defined benefit retirement plan by asset category are as follows:

	Fair value measurements at December 31, 2009 using			
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Description				
Principal Financial Group:				
Money Market Separate Account	\$ 2,019,808	\$ -	\$ 2,019,808	\$ -
Bond and Mortgage Separate Account	27,520,387	-	27,520,387	-
Prudential Retirement Insurance and Annuity Co. pooled separate accounts:				
U.S. stock funds	79,414,339	-	79,414,339	-
International stock funds	18,509,742	-	18,509,742	-
U.S. bond funds	29,447,314	-	29,447,314	-
Short-term funds	7,341,906	-	7,341,906	-
First American funds - Real Estate securities fund	2,888,662	2,888,662	-	-
	\$ 167,142,158	\$ 2,888,662	\$ 164,253,496	\$ -

Employers Mutual plans to contribute approximately \$25,000,000 to the pension plan and \$2,750,000 to the VEBA trust in 2010.

The Company participates in other retirement plans sponsored by Employers Mutual, including its 401(k) Plan and Board and Executive Non-Qualified Excess Plan. The Company's share of expenses for these plans amounted to \$1,293,676, \$1,085,173 and \$1,262,512 in 2009, 2008 and 2007, respectively.

13. STOCK PLANS

The Company has no stock-based compensation plans of its own; however, Employers Mutual has several stock plans which utilize the common stock of the Company. Employers Mutual can provide the common stock required under its plans by: 1) using shares of common stock that it currently owns; 2) purchasing common stock on the open market; or 3) directly purchasing common stock from the Company at the current fair value. Employers Mutual has historically purchased common stock from the Company for use in its stock option plans and its non-employee director stock purchase plan. Employers Mutual generally purchases common stock on the open market to fulfill its obligations under its employee stock purchase plan.

Stock Option Plans

Employers Mutual maintains three separate stock option plans for the benefit of officers and key employees of Employers Mutual and its subsidiaries. A total of 1,000,000 shares of the Company's common stock have been reserved for issuance under the 1993 Employers Mutual Casualty Company Incentive Stock Option Plan (1993 Plan), a total of 1,500,000 shares have been reserved for issuance under the 2003 Employers Mutual Casualty Company Incentive Stock Option Plan (2003 Plan) and a total of 2,000,000 shares have been reserved for issuance under the 2007 Employers Mutual Casualty Company Stock Incentive Plan (2007 Plan).

The 1993 Plan and the 2003 Plan provide for awards of incentive stock options only, while the 2007 Plan provides for the awarding of performance shares, performance units, and other stock-based awards, in addition to qualified (incentive) and non-qualified stock options, stock appreciation rights, restricted stock and restricted stock units. All three plans provide for a ten-year time limit for granting awards. Options can no longer be granted under the 1993 Plan and no additional options will be granted under the 2003 Plan now that Employers Mutual is utilizing the 2007 Plan. Options granted under the plans generally have a vesting period of five years, with options becoming exercisable in equal annual cumulative increments commencing on the first anniversary of the option grant. Option prices cannot be less than the fair value of the common stock on the date of grant.

The Senior Executive Compensation and Stock Option Committee (the "Committee") of Employers Mutual's Board of Directors (the "Board") grants the awards and is the administrator of the plans. The Company's Compensation Committee must consider and approve all awards granted to the Company's senior executive officers.

The Company recognized compensation expense from these plans of \$282,528 (\$237,605 net of tax), \$232,318 (\$226,624 net of tax) and \$200,941 (gross and net of tax) in 2009, 2008 and 2007, respectively.

During 2009, 304,400 non-qualified options were granted under the 2007 Plan to eligible participants at a price of \$18.865 and 37,271 options were exercised under the plans at prices ranging from \$9.25 to \$19.35. A summary of the activity under Employers Mutual's stock option plans for 2009, 2008 and 2007 is as follows:

	Year ended December 31,					
	2009		2008		2007	
	Number of options	Weighted- average exercise price	Number of options	Weighted- average exercise price	Number of options	Weighted- average exercise price
Outstanding, beginning of year	929,716	\$ 21.57	817,268	\$ 20.37	741,718	\$ 19.23
Granted	304,400	18.87	221,875	23.47	119,250	25.46
Exercised	(37,271)	17.10	(93,415)	15.38	(40,825)	14.25
Expired	(12,430)	23.86	(13,887)	22.80	(2,875)	24.71
Forfeited	(9,125)	22.91	(2,125)	22.08	-	-
Surrendered	(2,676)	25.46	-	-	-	-
Outstanding, end of year	<u>1,172,614</u>	\$ 20.96	<u>929,716</u>	\$ 21.57	<u>817,268</u>	\$ 20.37
Exercisable, end of year	<u>537,786</u>	\$ 20.48	<u>405,731</u>	\$ 19.39	<u>360,064</u>	\$ 17.49

The weighted average fair value of options granted in 2009, 2008 and 2007 amounted to \$2.30, \$2.77 and \$3.82, respectively. Employers Mutual estimated the fair value of each option grant on the date of grant using the Black-Scholes-Merton option-pricing model and the following weighted-average assumptions:

	Year ended December 31,		
	2009	2008	2007
Dividend yield	3.82%	3.07%	2.67%
Expected volatility	22.7% - 43.8%	21.0% - 30.1%	22.2% - 31.4%
Weighted-average volatility	35.24%	26.09%	25.64%
Risk-free interest rate	0.38% - 2.81%	1.45% - 3.17%	4.32% - 5.01%
Expected term (years)	0.25 - 6.30	0.25 - 6.25	0.25 - 6.25

The expected term of the options granted in 2009 was estimated using historical data that was adjusted to remove the effect of option exercises prior to the normal vesting period due to the retirement of the option holder. The expected term of options granted to individuals who are, or will be, eligible to retire prior to the completion of the normal vesting period has been adjusted to reflect the potential accelerated vesting period. This produced a weighted-average expected term of 2.6 years.

The expected volatility in the price of the underlying shares for the 2009 option grant was computed by using the historical average high and low monthly prices of the Company's common stock for a period covering 6.3 years, which approximates the average term of the options and produced an expected volatility of 22.7 percent. The expected volatility of options granted to individuals who are, or will be, eligible to retire prior to the completion of the normal vesting period was computed by using the historical average high and low daily, weekly, or monthly prices for the period approximating the expected term of those options. This produced expected volatility ranging from 23.4 percent to 43.8 percent.

At December 31, 2009, the Company's portion of the unrecognized compensation cost associated with option awards issued under Employers Mutual's stock option plans that are not currently vested was \$247,634, with a 1.5 year weighted-average period over which the compensation expense is expected to be recognized. A summary of non-vested option activity under Employers Mutual's stock option plans for 2009, 2008 and 2007 is as follows:

	Year ended December 31,					
	2009		2008		2007	
	Number of options	Weighted- average grant-date fair value	Number of options	Weighted- average grant-date fair value	Number of options	Weighted- average grant-date fair value
Non-vested, beginning of year	523,985	\$ 3.55	457,204	\$ 4.09	478,578	\$ 4.13
Granted	304,400	2.30	221,875	2.77	119,250	3.82
Vested	(189,006)	3.70	(155,094)	4.03	(140,624)	3.99
Forfeited	(1,875)	2.30	-	-	-	-
Surrendered	(2,676)	3.82	-	-	-	-
Non-vested, end of year	<u>634,828</u>	<u>\$ 2.91</u>	<u>523,985</u>	<u>\$ 3.55</u>	<u>457,204</u>	<u>\$ 4.09</u>

The Company's portion of the total intrinsic value of options exercised under Employers Mutual's stock option plans was \$51,461, \$310,210 and \$176,344 in 2009, 2008 and 2007, respectively. Under the terms of the pooling and quota share agreements, these amounts were paid to Employers Mutual. The Company received the full fair value for all shares issued under these plans. The Company's portion of the total fair value of options that vested in 2009, 2008 and 2007 was \$282,528, \$232,318 and \$200,941, respectively. Additional information relating to options outstanding and options vested (exercisable) at December 31, 2009 is as follows:

	December 31, 2009			
	Number of options	Weighted- average exercise price	Aggregate intrinsic value	Weighted- average remaining term
Options outstanding	1,172,614	\$ 20.96	\$ 2,114,913	6.66
Options exercisable	537,786	\$ 20.48	\$ 1,202,402	4.94

The 1993 Plan and 2003 Plan do not generally generate tax deductions for the Company because only incentive stock options could be issued under these plans. The Company did receive a deferred tax benefit for the March 2009 grant and a portion of the March 2008 grant made under the 2007 Plan because non-qualified options were issued. The Company's portion of the current tax deduction realized from exercises of stock options was \$1,970 in 2009 (no realized tax deduction prior to 2009). No cash flow effects have resulted from share-based payment arrangements. The income tax benefit that results from disqualifying dispositions of stock purchased through incentive stock options is deemed immaterial.

Employee Stock Purchase Plan

A total of 500,000 shares of the Company's common stock have been reserved for issuance under the Employers Mutual Casualty Company 1993 Employee Stock Purchase Plan. Any eligible employee who is employed by Employers Mutual on the first day of the month immediately preceding any option period is eligible to participate in the plan. Participants pay 85 percent of the fair market value of the stock on the date of purchase. The plan is administered by the Board of Employers Mutual and the Board has the right to amend or terminate the plan at any time; however, no such amendment or termination shall adversely affect the rights and privileges of participants with unexercised options. This plan was replaced by a new plan during 2008 and the 217,862 shares that were unused as of December 31, 2008 were de-registered in 2009.

On May 30, 2008, the Company registered 500,000 shares of the Company's common stock for use in the Employers Mutual Casualty Company 2008 Employee Stock Purchase Plan (2008 Plan). The 2008 Plan provides for any eligible employee to participate in the plan by delivering, during the first twenty days of the calendar month preceding the first day of an election period, a payroll deduction authorization to the plan administrator; or making a cash contribution. Participants pay 85 percent of the fair market value of the stock on the date of purchase. The plan is administered by the Board of Employers Mutual and the Board has the right to amend or terminate the plan at any time; however, no such amendment or termination shall adversely affect the rights and privileges of participants with unexercised options. Expenses allocated to the Company in connection with these plans totaled \$25,892, \$9,695 and \$22,643 in 2009, 2008 and 2007, respectively.

During 2009, a total of 23,397 options were exercised at prices ranging from \$17.84 to \$18.39. Activity under the plans was as follows:

	Year ended December 31,		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
Shares available for purchase, beginning of year	709,381	229,163	248,449
Shares registered for use in the 2008 plan	-	500,000	-
Shares deregistered under the 1993 plan	(217,862)	-	-
Shares purchased under the plans	(23,397)	(19,782)	(19,286)
Shares available for purchase, end of year	<u>468,122</u>	<u>709,381</u>	<u>229,163</u>

Non-Employee Director Stock Option Plan

A total of 200,000 shares of the Company's common stock have been reserved for issuance under the 2003 Employers Mutual Casualty Company Non-Employee Director Stock Option Plan. All non-employee directors of Employers Mutual and its subsidiaries and affiliates who are not serving on the "Disinterested Director Committee" of the Board of Employers Mutual as of the beginning of an option period are eligible to participate in the plan. Each eligible director can purchase shares of common stock at 75 percent of the fair value of the stock on the option exercise date in an amount equal to a minimum of 25 percent and a maximum of 100 percent of their annual cash retainer. The plan will continue through the option period for options granted at the 2012 annual meetings. The plan is administered by the Disinterested Director Committee of the Board. The Board may amend or terminate the plan at any time; however, no such amendment or termination shall adversely affect the rights and privileges of participants with unexercised options. Expenses allocated to the Company in connection with these plans totaled \$15,326, \$27,121 and \$18,173 in 2009, 2008 and 2007, respectively.

During 2009, a total of 3,878 options were exercised at prices ranging from \$14.15 to \$16.35. Activity under the plan was as follows:

	Year ended December 31,		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
Shares available for purchase, beginning of year	176,508	181,668	186,510
Shares purchased under the plan	(3,878)	(5,160)	(4,842)
Shares available for purchase, end of year	<u>172,630</u>	<u>176,508</u>	<u>181,668</u>

Dividend Reinvestment Plan

The Company maintains a dividend reinvestment and common stock purchase plan which provides stockholders with the option of reinvesting cash dividends in additional shares of the Company's common stock. Participants may also purchase additional shares of common stock without incurring broker commissions by making optional cash contributions to the plan, and may sell shares of common stock through the plan. Employers Mutual did not participate in this plan in 2009, 2008 or 2007. Activity under the plan was as follows:

	Year ended December 31,		
	2009	2008	2007
Shares available for purchase, beginning of year	182,141	188,973	195,626
Shares purchased under the plan	(6,532)	(6,832)	(6,653)
Shares available for purchase, end of year	175,609	182,141	188,973
Range of purchase prices	\$ 20.44	\$ 20.93	\$ 23.53
	to	to	to
	\$ 22.62	\$ 29.75	\$ 32.75

Stock Appreciation Right (SAR) agreement

On October 19, 2006, Employers Mutual entered into a stock appreciation rights (SAR) agreement with the Company's Executive Vice President and Chief Operating Officer (Mr. Murray). This SAR agreement is a substitute for an incentive stock option grant Mr. Murray was initially authorized to receive as part of his 2006 compensation arrangement, but was not issued to him due to certain limitations contained in Employers Mutual's incentive stock option plan. The grant-date fair value of this award was \$546,300. Because the SAR agreement will be settled in cash, it is considered to be a liability-classified award under ASC Topic 718. As a result, the value of this agreement must be re-measured at fair value at each financial statement reporting date, subject to a minimum fair value of \$318,825 stipulated in the SAR agreement. The fair value of this agreement at December 31, 2009, 2008 and 2007 was \$318,825 (\$95,648 as the Company's portion from the pool). The full value of this agreement was expensed in 2006 because Mr. Murray is currently eligible for retirement and is entitled to keep the award at retirement. As a result, the award does not have any subsequent service requirements. Subsequent changes in the fair value of this agreement will be reflected as compensation expense until the agreement is ultimately settled in 2016. During 2009 and 2008, the Company did not recognize any compensation expense related to this award as the fair value of the award did not change. During 2007, the Company recognized negative compensation expense of \$103,207 (\$67,085 net of tax) related to this award.

Stock Repurchase Plan

On March 10, 2008, the Company's Board of Directors authorized a \$15,000,000 stock repurchase program. On October 31, 2008, the Company's Board of Directors announced an extension of the stock repurchase program, authorizing an additional \$10,000,000. This program became effective immediately and does not have an expiration date. The timing and terms of the purchases are determined by management based on market conditions and are conducted in accordance with the applicable rules of the Securities and Exchange Commission. Common stock purchased under this program is being retired by the Company. As of December 31, 2009, 736,133 shares of common stock had been repurchased at a cost of \$17,851,898.

Stock Purchase Plan

During the second quarter of 2005, Employers Mutual initiated a \$15,000,000 stock purchase program under which Employers Mutual will purchase shares of the Company's common stock in the open market. This purchase program does not have an expiration date, however, this program is currently dormant and will remain so while the Company's repurchase program is active. The timing and terms of the purchases are determined by management based on market conditions and are conducted in accordance with the applicable rules of the Securities and Exchange Commission. During 2007, Employers Mutual purchased 65,501 shares of the Company's common stock under this program at an average cost of \$24.02 per share. No purchases were made during 2009 and 2008. As of December 31, 2009, \$4,490,561 remained available under this plan for additional purchases.

14. LEASES, COMMITMENTS AND CONTINGENT LIABILITIES

One of the Company's property and casualty insurance subsidiaries leases office facilities in Bismarck, North Dakota with lease terms expiring in 2014. Employers Mutual has entered into various leases for branch and service office facilities with lease terms expiring through 2021. All lease costs are included as expenses under the pooling agreement, after allocation of a portion of these expenses to the subsidiaries that do not participate in the pooling agreement. The following table reflects the lease commitments of the Company as of December 31, 2009.

	Payments due by period				
	Total	Less than 1 year	1 - 3 years	4 - 5 years	More than 5 years
<u>Lease commitments</u>					
Real estate operating leases	\$ 7,517,281	\$ 1,226,388	\$ 2,108,370	\$ 1,661,676	\$ 2,520,847

The participants in the pooling agreement are subject to guaranty fund assessments by states in which they write business. Guaranty fund assessments are used by states to pay policyholder liabilities of insolvent insurers domiciled in those states. Many states allow assessments to be recovered through premium tax offsets. Estimated guaranty fund assessments of \$1,236,315 and \$1,505,808 and related premium tax offsets of \$692,233 and \$935,822 have been accrued as of December 31, 2009 and 2008, respectively. The guaranty fund assessments are expected to be paid over the next two years and the premium tax offsets are expected to be realized within ten years of the payments. The participants in the pooling agreement are also subject to second-injury fund assessments which are designed to encourage employers to employ a worker with a pre-existing disability. Estimated second-injury fund assessments of \$1,709,015 and \$1,575,905 have been accrued as of December 31, 2009 and 2008, respectively. The second-injury fund assessment accruals are based on projected loss payments. The periods over which the assessments will be paid is not known.

The participants in the pooling agreement have purchased annuities from life insurance companies, under which the claimant is payee, to fund future payments that are fixed pursuant to specific claim settlement provisions. The Company's share of case loss reserves eliminated by the purchase of these annuities was \$1,711,614 at December 31, 2009. The Company has a contingent liability of \$1,711,614 at December 31, 2009 should the issuers of these annuities fail to perform. The probability of a material loss due to failure of performance by the issuers of these annuities is considered remote. The Company's share of the amount due from any one life insurance company does not equal or exceed one percent of its subsidiaries' aggregate policyholders' surplus.

The Company and Employers Mutual and its other subsidiaries are parties to numerous lawsuits arising in the normal course of the insurance business. The Company believes that the resolution of these lawsuits will not have a material adverse effect on its financial condition or its results of operations. The companies involved have established reserves which are believed adequate to cover any potential liabilities arising out of all such pending or threatened proceedings.

15. UNAUDITED INTERIM FINANCIAL INFORMATION

	Three months ended,			
	March 31	June 30	September 30	December 31
<u>2009</u>				
Total revenues	\$ 96,292,459	\$ 108,374,063	\$ 111,683,128	\$ 134,098,006
Income before income				
tax expense	\$ 6,927,018	\$ 8,890,941	\$ 6,470,929	\$ 40,235,929
Income tax expense	1,123,155	1,923,809	1,420,154	12,687,085
Net income	\$ 5,803,863	\$ 6,967,132	\$ 5,050,775	\$ 27,548,844
Net income per share				
- basic and diluted*	\$ 0.44	\$ 0.53	\$ 0.38	\$ 2.10
<u>2008</u>				
Total revenues	\$ 104,153,368	\$ 109,148,591	\$ 94,755,051	\$ 105,835,121
Income (loss) before income				
tax expense (benefit)	\$ 11,059,558	\$ (3,579,851)	\$ (16,389,055)	\$ (1,380,706)
Income tax expense (benefit)	2,840,572	(2,639,521)	(6,931,486)	(1,854,246)
Net income (loss)	\$ 8,218,986	\$ (940,330)	\$ (9,457,569)	\$ 473,540
Net income (loss) per share				
- basic and diluted*	\$ 0.60	\$ (0.07)	\$ (0.70)	\$ 0.04
<u>2007</u>				
Total revenues	\$ 107,910,669	\$ 111,521,132	\$ 108,897,554	\$ 117,480,240
Income before income				
tax expense	\$ 20,887,106	\$ 19,976,217	\$ 8,787,875	\$ 9,267,491
Income tax expense	6,185,705	5,985,790	2,059,838	2,209,321
Net income	\$ 14,701,401	\$ 13,990,427	\$ 6,728,037	\$ 7,058,170
Net income per share				
- basic and diluted*	\$ 1.07	\$ 1.02	\$ 0.49	\$ 0.51

* Since the weighted-average number of shares outstanding for the quarters are calculated independently of the weighted-average number of shares outstanding for the year, quarterly net income (loss) per share may not total to annual net income (loss) per share.

GLOSSARY

Assumed Reinsurance - When one or more insurers, in exchange for a share of the premium, accepts responsibility to indemnify risk underwritten by another as reinsurance. See “Reinsurance.”

Catastrophe and Storm Losses - Losses from the occurrence of an earthquake, hurricane, explosion, flood, hail storm or other similar event which results in substantial loss.

Ceded Reinsurance - The transfer of all or part of the risk of insurance loss from an insurer to another as reinsurance. See “Reinsurance.”

Combined Ratio - A measure of property/casualty underwriting results. It is the ratio of claims, settlement and underwriting expenses to insurance premiums. When the combined ratio is under 100%, underwriting results are generally profitable; when the ratio is over 100%, underwriting results are generally unprofitable. Underwriting results do not include net investment income, which may make a significant contribution to overall profitability.

Deferred Policy Acquisition Costs - The capitalization of commissions, premium taxes and other expenses related to the production of insurance business. These costs are deferred and amortized in proportion to related premium revenue.

Excess of Loss Reinsurance - Coverage for the portion of losses which exceed predetermined retention limits.

Generally Accepted Accounting Principles (GAAP) - The set of practices and procedures that provides the framework for financial statement measurement and presentation. Financial statements in this report were prepared in accordance with U.S. GAAP.

Incurred But Not Reported (IBNR) – An estimate of liability for losses that have occurred but not yet been reported to the insurer. For reinsurance business IBNR may also include anticipated increases in reserves for claims that have previously been reported.

Incurred Losses and Settlement Expenses - Claims and settlement expenses paid or unpaid for which the Company has become liable for during a given reporting period.

Loss Reserve Development - A measure of how the latest estimate of an insurance company's claim obligations compares to an earlier projection. This is also referred to as the increase or decrease in the provision for insured events of prior years.

Net Investment Income - Dividends and interest earned during a specified period from cash and invested assets, reduced by related investment expenses.

Net Investment Yield - Net investment income divided by average invested assets.

Other-Than-Temporary Investment Impairment Loss – A realized investment loss that is recognized when an investment's fair value declines below its carrying value and the decline is deemed to be other-than-temporary.

Pooling Agreement - A joint underwriting operation in which the participants assume a predetermined and fixed interest in the premiums, losses, expenses and profits of insurance business.

Premiums - Amounts paid by policyholders to purchase insurance coverages.

Earned Premium - The recognition of the portion of written premiums directly related to the expired portion of an insurance policy for a given reporting period.

Net Written Premiums - Premiums written during a given reporting period, net of assumed and ceded reinsurance, which correlate directly to the insurance coverage provided.

Unearned Premium - The portion of written premium which would be returned to a policyholder upon cancellation.

Written Premium - The cost of insurance coverage. Written premiums refer to premiums for all policies sold during a specified accounting period.

Quota Share Reinsurance Agreement – A form of reinsurance in which the reinsurer assumes a stated percentage of all premiums, losses and related expenses in a given class of business.

Realized Investment Gains/Losses - The amount of net gains/losses realized when an investment is sold at a price higher or lower than its original cost or carrying amount. Also the amount of loss recognized when an investment's carrying value is reduced to fair value due to a other-than-temporary impairment in the fair value of that investment.

Reinsurance - The contractual arrangement by which one or more insurers, called reinsurers, in exchange for premium payments, agree to assume all or part of a risk originally undertaken by another insurer. Reinsurance "spreads risk" among insurance enterprises, allowing individual companies to reduce exposure to losses and provide additional capacity to write insurance.

Reserves - The provision for the estimated future cost of all unpaid claims. The total includes known claims as well as amounts for claims that have occurred but have not been reported to the insurer (IBNR).

Return on Equity (ROE) - Net income divided by average stockholders' equity.

Risk-Based Capital - A model developed by the National Association of Insurance Commissioners which attempts to measure the minimum statutory capital needs of property and casualty insurance companies based upon the risks in a company's mix of products and investment portfolio.

Settlement Expenses - Expenses incurred in the process of investigating and settling claims.

Statutory Accounting - Accounting practices used by insurance companies to prepare financial statements submitted to state regulatory authorities. Statutory accounting differs from GAAP in that it stresses insurance company solvency rather than the matching of revenues and expenses.

Underwriting Gain/Loss - Represents insurance premium income less insurance claims, settlement and underwriting expenses.

Unrealized Holding Gains/Losses on Investments - Represents the difference between the current market value of investments and the basis at the end of a reporting period.

STOCKHOLDER INFORMATION

STOCK PRICES AND DIVIDENDS PAID

(by quarter as reported by NASDAQ OMX)

	2009			2008		
	HIGH	LOW	DIVIDEND	HIGH	LOW	DIVIDEND
1st Quarter	\$25.17	\$18.01	\$ 0.18	\$29.46	\$21.40	\$0.18
2nd Quarter	\$22.86	\$20.07	\$ 0.18	\$30.95	\$24.03	\$0.18
3rd Quarter	\$25.12	\$20.04	\$ 0.18	\$31.65	\$20.11	\$0.18
4th Quarter	\$23.60	\$20.03	\$ 0.18	\$30.74	\$16.36	\$0.18
Close on Dec. 31	\$21.51			\$25.65		

Common Stock

EMC Insurance Group Inc.'s common stock trades on the NASDAQ OMX Global Select Market tier of the NASDAQ OMX Stock Market under the symbol EMCI. As of February 28, 2010, the number of registered stockholders was 962.

There are certain regulatory restrictions relating to the payment of dividends by the Company's insurance subsidiaries. (See note 6 of Notes to Consolidated Financial Statements.) It is the present intention of the Company's Board of Directors to declare quarterly cash dividends, but the amount and timing thereof, if any, are determined by the Board of Directors at its discretion.

Dividend Reinvestment and Common Stock Purchase Plan

A dividend reinvestment and common stock purchase plan provides stockholders with the option of receiving additional shares of common stock instead of cash dividends. Participants may also purchase additional shares of common stock without incurring broker commissions by making optional cash contributions to the plan and may sell shares of common stock through the plan. (See note 13 of Notes to Consolidated Financial Statements.) More information about the plan can be obtained by calling American Stock Transfer & Trust Company, LLC, the Company's stock transfer agent and plan administrator.

STOCKHOLDER SERVICES

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SEC Counsel

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and Fairgrave P.C.
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Independent Registered Public Accounting Firm

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Annual Meeting

We welcome attendance at our annual meeting on May 25, 2010, at 1:30 p.m. CDT. EMC Insurance Companies
700 Walnut Street
Des Moines, IA 50309

Information Availability

Interested parties can request news releases, annual reports, Forms 10-Q and 10-K, quarterly financial brochures and other information at no cost by contacting:

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