

ATLANTIC AMERICAN CORP

Form 10-K

March 30, 2007

Table of Contents

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

Form 10-K

- þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2006**
- o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 0-3722

ATLANTIC AMERICAN CORPORATION
(Exact name of registrant as specified in its charter)

Georgia
*(State or other jurisdiction of
incorporation or organization)*
**4370 Peachtree Road, N.E.,
Atlanta, Georgia**
(Address of principal executive offices)

58-1027114
*(I.R.S. employer
identification no.)*

30319
(Zip code)

(Registrant's telephone number, including area code)
(404) 266-5500

Securities registered pursuant to section 12(b) of the Act:
None

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

Common Stock, \$1.00 par value
(Title of class)

Edgar Filing: ATLANTIC AMERICAN CORP - Form 10-K

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

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

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

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

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

The aggregate market value of voting and nonvoting common stock held by non-affiliates of the registrant as of June 30, 2006, the last business day of the registrant's most recently completed second fiscal quarter, was \$15,840,476. On March 16, 2007 there were 21,536,573 shares of the registrant's common stock, par value \$1.00 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders, to be held on May 1, 2007, have been incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III of this Form 10-K.

TABLE OF CONTENTS

	Page
<u>PART I</u>	
<u>Item 1.</u>	2
<u>Business</u>	2
<u>The Company</u>	2
<u>Marketing</u>	4
<u>Underwriting</u>	6
<u>Policyholder and Claims Services</u>	6
<u>Reserves</u>	8
<u>Reinsurance</u>	12
<u>Competition</u>	13
<u>Ratings</u>	14
<u>Regulation</u>	14
<u>NAIC Ratios</u>	15
<u>Risk-Based Capital</u>	15
<u>Investments</u>	16
<u>Employees</u>	17
<u>Financial Information by Industry Segment</u>	17
<u>Available Information</u>	17
<u>Executive Officers of the Registrant</u>	17
<u>Forward-Looking Statements</u>	18
<u>Item 1A.</u>	18
<u>Risk Factors</u>	18
<u>Item 1B.</u>	23
<u>Unresolved Staff Comments</u>	23
<u>Item 2.</u>	23
<u>Properties</u>	23
<u>Item 3.</u>	23
<u>Legal Proceedings</u>	23
<u>Item 4.</u>	24
<u>Submission of Matters to a Vote of Security Holders</u>	24
<u>PART II</u>	
<u>Item 5.</u>	24
<u>Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</u>	24
<u>Item 6.</u>	27
<u>Selected Financial Data</u>	27
<u>Item 7.</u>	28
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28
<u>Item 7A.</u>	46
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	46
<u>Item 8.</u>	47
<u>Financial Statements and Supplementary Data</u>	47
<u>Item 9.</u>	78
<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	78
<u>Item 9A.</u>	78
<u>Controls and Procedures</u>	78
<u>Item 9B.</u>	78
<u>Other Information</u>	78
<u>PART III</u>	
Item 10.	78
Directors and Executive Officers of the Registrant	78
Item 11.	78
Executive Compensation	78
Item 12.	78
Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters	78
Item 13.	78
Certain Relationships and Related Transactions	78
Item 14.	78
Principal Accountant Fees and Services	78

PART IV

Item 15. Exhibits and Financial Statement Schedules

79

EX-21.1 SUBSIDIARIES OF THE REGISTRANT

EX-23.1 CONSENT OF BDO SEIDMAN LLP

EX-31.1 SECTION 302, CERTIFICATION OF THE PEO

EX-31.2 SECTION 302, CERTIFICATION OF THE PFO

EX-32.1 SECTION 906 CERTIFICATIONS OF THE PEO AND PFO

1

Table of Contents

PART I

Item 1. *Business*

The Company

Atlantic American Corporation, a Georgia corporation incorporated in 1968 (the Parent or Company), is a holding company that operates through its subsidiaries in well-defined specialty markets of the life, health, property and casualty insurance industries. Atlantic American's principal subsidiaries are American Southern Insurance Company and American Safety Insurance Company (collectively known as American Southern), Association Casualty Insurance Company and Association Risk Management General Agency, Inc. (collectively known as Association Casualty), Georgia Casualty & Surety Company (Georgia Casualty) and Bankers Fidelity Life Insurance Company (Bankers Fidelity). Each subsidiary is managed separately based upon the geographic location or the type of products offered and is evaluated on its individual performance. Management has conformed information systems, policies and procedures, products, marketing and managerial responsibilities between Association Casualty and Georgia Casualty to create a southern regional property and casualty operation and increase efficiencies. The Parent has no significant business operations of its own and relies on fees, dividends and other distributions from its insurance companies as the principal source of cash flow to meet its obligations. Additional information regarding the cash flow and liquidity needs of the Parent may be found in the Liquidity and Capital Resources section of Management's Discussion and Analysis of Financial Condition and Results of Operations.

The Company's strategy is to focus on well-defined geographic, demographic and/or product niches within the insurance market place. Each of the Company's subsidiaries operate with relative autonomy, which allows for quick reaction to market opportunities. In addition, the Company seeks to develop and expand cross-selling opportunities and other synergies among its subsidiaries as they arise.

Property and Casualty Operations

The Company's property and casualty operations are composed of three distinct entities, American Southern, Association Casualty and Georgia Casualty. The primary products offered by the Company's property and casualty operations are described below, followed by an overview of each company.

Workers Compensation Insurance policies provide indemnity and medical benefits to insured workers for injuries sustained in the course of their employment.

Business Automobile Insurance policies provide bodily injury and/or property damage liability coverage, uninsured motorist coverage and physical damage coverage to commercial accounts.

General Liability Insurance policies cover bodily injury and property damage liability for both premises and completed operations exposures for general classes of business.

Property Insurance policies provide for payment of losses on real and personal property caused by fire or other multiple perils.

Personal Automobile Insurance policies provide bodily injury and/or property damage liability coverage, uninsured motorists coverage and physical damage coverage to individuals.

Surety Bonds are contracts under which one party, the insurance company issuing the surety bond, guarantees to a third party, that the primary party will fulfill an obligation in accordance with a contractual agreement. This obligation may involve meeting a contractual commitment, paying a debt or performing certain duties.

American Southern. American Southern provides tailored fleet automobile and long-haul physical damage insurance coverage, on a multi-year contract basis, to state governments, local municipalities and other large motor pools and fleets (block accounts) that can be specifically rated and underwritten. The size of the block accounts insured by American Southern are such that individual class experience generally can be determined, which allows for customized policy terms and rates. American Southern is licensed to do business

Table of Contents

in 29 states. While the majority of American Southern's premiums are derived from auto liability and auto physical damage, American Southern also offers both property and general liability coverage. Additionally, American Southern directly provides surety bond coverage for school bus transportation and subdivision construction, as well as performance and payment bonds. In recent years, American Southern has increased its premium writings in the general liability, primarily artisan and small contractors, and surety lines of business and expects such trends to continue.

The following table summarizes, for the periods indicated, the allocation of American Southern's net earned premiums from each of its principal product lines:

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands)				
Automobile liability	\$ 16,163	\$ 16,723	\$ 18,944	\$ 17,947	\$ 22,748
Automobile physical damage	9,698	11,002	11,187	9,451	9,829
General liability	11,394	11,767	10,102	5,777	3,647
Property	3,186	3,692	3,862	3,819	3,627
Surety	10,218	8,263	3,967	364	63
Total	\$ 50,659	\$ 51,447	\$ 48,062	\$ 37,358	\$ 39,914

Georgia Casualty. Georgia Casualty is a property-casualty insurance company providing workers' compensation, commercial property, general liability, commercial automobile, umbrella, inland marine and mechanical breakdown coverage to businesses throughout the Southeastern United States. Georgia Casualty's primary marketing focus is on accounts with low to moderate hazard grades, ranging from \$20,000 to \$250,000 in written premiums. In addition to the wide range of commercial products available, Georgia Casualty offers customized extension endorsements for various classes of business, including, but not limited to, light manufacturing, restaurants, country clubs and artisan contractors. These products, along with risk management and claims services, are offered through a network of independent agents. Georgia Casualty is licensed to do business in thirteen states. Its principal marketing territories include Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina and Tennessee.

The following table summarizes, for the periods indicated, the allocation of Georgia Casualty's net earned premiums from each of its principal product lines:

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands)				
Workers' compensation	\$ 8,363	\$ 12,909	\$ 11,608	\$ 11,071	\$ 10,592
Business automobile	4,322	11,026	9,470	8,767	7,388
General liability	2,001	434	351	2,272	1,761
Property	6,532	14,901	13,246	12,209	10,003
Total	\$ 21,218	\$ 39,270	\$ 34,675	\$ 34,319	\$ 29,744

Association Casualty. Association Casualty is a property-casualty insurance company that offers workers compensation, commercial property, commercial automobile, general liability, umbrella and inland marine coverages throughout Texas and surrounding states. Association Casualty has adopted a strategy consistent with that of Georgia Casualty and is focused on small to middle market accounts with low to moderate hazard grades, ranging from \$15,000 to \$250,000 in written premiums. In addition to a wide range of products, customized extension endorsements are also offered to various classes of business, including restaurants, light manufacturing and country clubs. These particular products can be coupled with specialized loss control and claims services and are offered through a network of independent agents. Association Casualty is licensed to do business in nine states and Texas is its principal marketing territory.

Table of Contents

The following table summarizes, for the periods indicated, the allocation of Association Casualty's net earned premiums from each of its principal product lines.

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands)				
Workers compensation	\$ 8,374	\$ 9,613	\$ 11,357	\$ 13,196	\$ 18,950
Business automobile	4,899	4,265	4,119	2,307	1,811
General liability	1,027	350	558	385	221
Property	8,608	6,744	6,647	4,464	3,080
Other					182
Total	\$ 22,908	\$ 20,972	\$ 22,681	\$ 20,352	\$ 24,244

Life and Health Operations

Bankers Fidelity. Bankers Fidelity constitutes the life and health operations of the Company and offers a variety of life and supplemental health products with a focus on the senior markets. Products offered by Bankers Fidelity include ordinary and term life insurance, Medicare supplement, cancer, and other supplemental health insurance products. Health business, primarily Medicare supplement, accounted for 81.4% of Bankers Fidelity's net earned premiums in 2006. Life insurance, including both whole and term life insurance policies, accounted for 18.6% of Bankers Fidelity's premiums in 2006. In terms of the number of policies written in 2006, 23% were life insurance policies and 77% were health policies.

The following table summarizes, for the periods indicated, the allocation of Bankers Fidelity's net earned premiums from each of its principal product lines followed by a brief description of the principal products:

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands)				
Life insurance	\$ 10,960	\$ 11,600	\$ 12,934	\$ 13,541	\$ 15,421
Medicare supplement	44,919	51,414	49,575	46,190	42,298
Cancer, accident and other health	3,041	2,890	2,933	2,952	2,878
Total health	47,960	54,304	52,508	49,142	45,176
Total	\$ 58,920	\$ 65,904	\$ 65,442	\$ 62,683	\$ 60,597

Life Insurance products include non-participating individual term and whole life insurance policies with a variety of riders and options.

Medicare Supplement Insurance includes 7 of the 13 standardized Medicare supplement policies created under the Omnibus Budget Reconciliation Act of 1990 (OBRA 1990), which are designed to provide insurance coverage for certain expenses not covered by the Medicare program, including copayments and deductibles.

Cancer, Accident & Other Health Insurance coverages include several policies providing for the payment of benefits in connection with the treatment of diagnosed cancer, as well as a number of other policies including facility care, accident expense, hospital/surgical and disability.

Marketing

Property and Casualty Operations

American Southern. A portion of American Southern's business is marketed through a small number of specialized, experienced independent agents. Most of American Southern's agents are paid an up-front commission with the potential for additional commissions by participating in a profit sharing arrangement that is directly linked to the profitability of the business generated. American Southern also solicits business from

Table of Contents

governmental entities. As an experienced writer for certain governmental programs, the company actively pursues this market on a direct basis. Much of this business is priced by means of competitive bid situations and there can be no assurance that the company can retain such business at the time of a specific contract renewal. During 1998, American Southern formed American Auto Club Insurance Agency, LLC in a 50/50 joint venture with AAA Carolinas to market personal automobile insurance to the members of the automobile club. This program produced gross written premiums of approximately \$2.6 million and \$8.6 million during 2006 and 2005, respectively. Effective October 1, 2005, this joint venture was terminated due to unfavorable underwriting results.

Association Casualty. Association Casualty was represented by a field force of 68 independent agencies with 87 locations in Texas for the sale and distribution of its insurance products at December 31, 2006. Each agency is a party to a standard agency contract that sets forth the commission structure and other terms. Association Casualty also offers a contingent profit sharing arrangement that allows agents to earn additional commissions when specific loss experience and premium growth goals are achieved. Marketing efforts are handled by an experienced staff of insurance professionals, and complemented by the assistance of Association Casualty's underwriting, loss control and claims staffs.

Georgia Casualty. Georgia Casualty was represented by a field force of 58 independent agencies with 90 locations in eight states for the sale and distribution of its insurance products at December 31, 2006. Each agency is a party to a standard agency contract that sets forth the commission structure and other terms. Georgia Casualty also offers a contingent profit-sharing arrangement that allows agents to earn additional commissions when specific loss experience and premium growth goals are achieved. Marketing efforts, directed by experienced marketing professionals, are complemented by the underwriting, risk management, and audit staffs of Georgia Casualty, who are available to assist agents in the presentation of all insurance products and services to their insureds.

Life and Health Operations

Bankers Fidelity. Bankers Fidelity markets its policies through commissioned, independent agents. In general, Bankers Fidelity enters contractual arrangements with various general agents, responsible for marketing and other activities, who also, in turn, contract with independent agents. The standard agreements set forth the commission arrangements and are terminable by either party upon thirty days' written notice. General agents receive an override commission on sales made by agents contracted by them. Management believes utilizing experienced agents, as well as independent general agents who recruit and train their own agents, is cost effective. All independent agents are compensated on a pure commission basis. Using independent agents also enables Bankers Fidelity to expand or contract its sales forces at any time without incurring significant additional expense.

Bankers Fidelity has implemented a selective agent qualification process and had 1,900 licensed agents as of December 31, 2006. The agents concentrate their sales activities in either the accident and health or life insurance product lines, although the company is currently promoting greater cross selling initiatives through property and casualty agencies, association groups and worksite marketing agencies. During 2006, approximately 500 agents wrote policies on behalf of Bankers Fidelity.

Products of Bankers Fidelity compete directly with products offered by other insurance companies, and agents may represent several insurance companies. Bankers Fidelity, in an effort to motivate agents to market its products, offers the following agency services: a unique lead system, competitive products and commission structures, efficient claims service, prompt payment of commissions that immediately vest, simplified policy issue procedures, periodic sales incentive programs and, in some cases, protected sales territories determined based on specific counties and/or zip codes.

Bankers Fidelity utilizes multiple distribution sales systems including agency business which is centered around a lead generation plan that rewards qualified agents with leads in accordance with monthly production goals. In addition, a protected territory is established for each qualified agent, which entitles them to all leads produced within that territory. The territories are zip code or county based and encompass sufficient geographic territory to produce a minimum senior population of 25,000. Bankers Fidelity also recruits at a

Table of Contents

general agent level as well as at a managing general agent level in an effort to use more than one distribution system to lower expenses.

The Company believes these distribution systems solve an agent's most important dilemma—prospecting—and allows Bankers Fidelity to build long-term relationships with agents who view Bankers Fidelity as their primary company. In addition, management believes that Bankers Fidelity's product line is less sensitive to competitor pricing and commissions because of the perceived value of the protected territory and the lead generation plan. In protected geographical areas, production per agent compares favorably to unprotected areas served by the general brokerage division.

Underwriting

Property and Casualty Operations

American Southern specializes in underwriting various risks that are sufficiently large enough to establish separate class experience, relying upon the underwriting expertise of its agents. In contrast, Georgia Casualty and Association Casualty internally underwrite all of their individual accounts.

During the course of the policy year, extensive use is made of risk management representatives to assist commercial underwriters in identifying and correcting potential loss exposures and to pre-inspect a majority of the new underwritten accounts. The results of each product line are reviewed on a stand-alone basis periodically. When the results are below expectations, management takes appropriate corrective action which may include adjusting rates, reviewing underwriting standards, reducing commissions paid to agents, altering or declining to renew accounts at expiration, and/or terminating agencies with an unprofitable book of business.

Life and Health Operations

Bankers Fidelity issues a variety of products for both life and health, which include senior life products typically with small face amounts of between \$1,000 and \$30,000 and Medicare supplement. The majority of its products are Yes or No applications that are underwritten on a non-medical basis. Bankers Fidelity offers products to all age groups; however, its primary focus is the senior market. For life products other than the senior market, Bankers Fidelity may require medical information such as medical examinations subject to age and face amount based on published guidelines. Approximately 95% of the net premiums earned for both life and health insurance sold during 2006 were derived from insurance written below Bankers Fidelity's medical limits. For the senior market, Bankers Fidelity issues products primarily on an accept-or-reject basis with face amounts up to \$30,000 for ages 45-70, \$20,000 for ages 71-80 and \$10,000 for ages 81-85. Bankers Fidelity retains a maximum amount of \$50,000 with respect to any individual life policy (see Reinsurance).

Applications for insurance are reviewed to determine the face amount, age, and medical history. Depending upon information obtained from the insured, the Medical Information Bureau (M.I.B.) report, paramedical testing, and/or medical records, special testing may be ordered. If deemed necessary, Bankers Fidelity may use investigative services to supplement and substantiate information. For certain limited coverages, Bankers Fidelity has adopted simplified policy issue procedures by which an application containing a variety of Yes/No health related questions is submitted. For these plans, a M.I.B. report is ordered, however, paramedical testing and medical records are not ordered in most cases. All applications for individuals age 60 and above are verified by telephone interview.

Policyholder and Claims Services

The Company believes that prompt, efficient policyholder and claims services are essential to its continued success in marketing its insurance products (see Competition). Additionally, the Company believes that its insureds are particularly sensitive to claims processing time and to the accessibility of qualified staff to answer inquiries. Accordingly, the Company's policyholder and claims services seek to offer expeditious disposition of service requests by providing toll-free access for all customers, 24-hour claim reporting services, and direct computer links with some of its largest accounts. The Company also utilizes a state-of-the-art

Table of Contents

automatic call distribution system to ensure that inbound calls to customer service support groups are processed efficiently. Operational data generated from this system allows management to further refine ongoing client service programs and service representative training modules.

The Company supports a Customer Awareness Program as the basis for its customer service philosophy. All personnel are required to attend customer service classes. Customer service hours of operation have been expanded in all service areas to serve customers and agents in all domestic time zones.

Property and Casualty Operations

American Southern, Association Casualty, and Georgia Casualty control their claims costs by utilizing an in-house staff of claims supervisors to investigate, verify, negotiate and settle claims. Upon notification of an occurrence purportedly giving rise to a claim, a claim file is established. The claims department then conducts a preliminary investigation, determines whether an insurable event has occurred and, if so, updates the file for the findings and any required reserve adjustments. The property and casualty companies frequently utilize independent adjusters and appraisers to service claims which require on-site inspections.

Life and Health Operations

Insureds may obtain claim forms by calling the claims department customer service group or through Bankers Fidelity's website. To shorten claim processing time, a letter detailing all supporting documents that are required to complete a claim for a particular policy is sent to the customer along with the correct claim form. With respect to life policies, the claim is entered into Bankers Fidelity's claims system when the proper documentation is received. Properly documented claims are generally paid within three to nine business days of receipt. With regard to Medicare supplement policies, the claim is either directly billed to Bankers Fidelity by the provider or sent electronically through a Medicare clearing house.

Table of Contents**Reserves**

The following table sets forth information concerning the Company's reserves for losses and claims and reserves for loss adjustment expenses (LAE) for the periods indicated:

	Year Ended December 31,		
	2006	2005	2004
	(In thousands)		
Balance at January 1	\$ 168,617	\$ 167,133	\$ 150,092
Less: Reinsurance recoverables	(53,352)	(57,429)	(41,752)
Net balance at January 1	115,265	109,704	108,340

Incurred related to: