

Amtrust Financial Services, Inc.
Form 10-K
March 15, 2011

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

FORM 10-K

x

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended December 31, 2010

OR

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**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period from to .

Commission File Number: 001-33143

AMTRUST FINANCIAL SERVICES, INC.

(Exact Name of Registrant as Specified in Its Charter)

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Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

04-3106389
(IRS Employer
Identification No.)

59 Maiden Lane, 6th Floor
New York, New York
(Address of Principal Executive Offices)

10038
(Zip Code)

(212) 220-7120

(Registrant's Telephone Number, Including Area Code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Shares, \$0.01 par value per share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: **None**

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, and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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 Form 10-K or any amendment to this Form 10-K.

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

Large Accelerated Filer Accelerated Filer Smaller Reporting Company

Non-Accelerated Filer
(Do not check if a smaller
reporting company)

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

As of June 30, 2010, the last business day of the registrant's most recently completed second quarter, the aggregate market value of the common stock held by non-affiliates was \$289,010,074.

As of March 1, 2011, the number of common shares of the registrant outstanding was 59,613,713.

Documents incorporated by reference: Portions of the Proxy Statement for the 2011 Annual Meeting of Shareholders of the Registrant to be filed subsequently with the SEC are incorporated by reference into Part III of this report.

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PART I

Note on Forward-Looking Statement

This Form 10-K contains certain forward-looking statements that are intended to be covered by the safe harbors created by The Private Securities Litigation Reform Act of 1995. When we use words such as anticipate, intend, plan, believe, estimate, expect, or similar expressions, we do so to identify forward-looking statements.

Examples of forward-looking statements include the plans and objectives of management for future operations, including those relating to future growth of our business activities and availability of funds, and are based on current expectations that involve assumptions that are difficult or impossible to predict accurately and many of which are beyond our control. There can be no assurance that actual developments will be those anticipated by us. Actual results may differ materially from those expressed or implied in these statements as a result of significant risks and uncertainties, including, but not limited to, non-receipt of expected payments from insureds or reinsurers, changes in interest rates, a downgrade in the financial strength ratings of our insurance subsidiaries, the effect of the performance of financial markets on our investment portfolio, development of claims and the effect on loss reserves, accuracy in projecting loss reserves, the cost and availability of reinsurance coverage, the effects of emerging claim and coverage issues, changes in the demand for our products, successful integration of acquired businesses, the effect of general economic conditions, adverse state and federal legislation, regulations and regulatory investigations into industry practices, risks associated with conducting business outside the United States, developments relating to existing agreements, disruptions to our business relationships with Maiden Holdings, Ltd., American Capital Acquisition Corporation, or third party agencies and warranty administrators, difficulties with technology, heightened competition, changes in pricing environments, and changes in asset valuations. Additional information about these risks and uncertainties, as well as others that may cause actual results to differ materially from those projected, is contained in Item 1A. Risk Factors in this Annual Report on Form 10-K. The projections and statements in this report speak only as of the date of this report and we undertake no obligation to update or revise any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

Item 1. Business

Legal Organization

AmTrust Financial Services Inc. is a Delaware corporation formed in 1998 that began trading on the NASDAQ exchange on November 13, 2006. References to AmTrust, the Company, we, our, or us in this Annual Report on Form 10-K and in other statements and information publicly disseminated by AmTrust Financial Services, Inc., refer to the consolidated operations of the holding company.

Business Overview

AmTrust underwrites and provides property and casualty insurance in the United States and internationally to niche customer groups that we believe are generally underserved by larger insurance carriers within the broader insurance market.

Our business model reflects a balanced mix of businesses that we believe provides a broader level of diversity and financial stability through varying market cycles because our segments and customers are not all influenced in the

same manner by economic conditions and seasonality. We are largely focused on providing workers' compensation and property and casualty insurance products to small and middle market businesses in 50 states in the U.S. and extended warranty and related property and casualty insurance products for consumer and commercial goods throughout the U.S. and internationally. The majority of our products are sold through independent third party brokers, agents, retailers or administrators. Our portfolio is broadly diversified by both customer and geography, has a relatively low average policy size and short average life. Our business model is further differentiated through the use of our proprietary technology platform that, we believe, enables us to provide a higher level of service and better claims management experience in a more efficient and cost-effective manner. Additionally, our ability to maintain and analyze high volumes of loss data over a long historical period allows us to better manage and forecast the underlying risk inherent in the portfolio. Since our inception in 1998, we have grown both organically and through an opportunistic acquisition strategy. We believe we approach acquisitions conservatively and our strategy is to take relatively modest integration and

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balance sheet risk. Historically, most of our acquisition activity has involved asset purchases of renewal rights to established books of insurance portfolios, access to distribution networks and hiring established teams of underwriters with expertise in our specialty lines.

We are committed to driving long-term shareholder value and industry-leading returns on equity by continuing to execute on our lower risk, lower volatility business model, and leveraging technology to help maintain a more efficient cost structure, consistently generate solid underwriting profits and ensure strong customer service and retention rates. Additionally, we are focused on further enhancing our economies of scale by opportunistically expanding our geographic reach and product set, growing our network of agents and other distributors, developing new client relationships and executing our acquisition strategy. We are also focused on maintaining our disciplined approach to capital management while maximizing an appropriate risk-adjusted return on our growing investment portfolio. We continue to carefully monitor and maintain appropriate levels of reserves and seek to minimize our reinsurance recoverable exposure in order to maintain a strong balance sheet. We intend to expand our business and capital base to take advantage of profitable growth opportunities while maintaining or improving our A.M. Best ratings. Our principal operating subsidiaries are rated A (Excellent) by A.M. Best Company (A.M. Best), which rating is the third highest of 16 rating levels. Our consolidated results include the results for our holding company and eleven wholly-owned insurance company subsidiaries (collectively the Insurance Subsidiaries).

Competition

The insurance industry, in general, is highly competitive and there is significant competition in the commercial business insurance sector. Competition in the insurance business is based on many factors, including coverage availability, claims management, safety services, payment terms, premium rates, policy terms, types of insurance offered, overall financial strength, financial ratings assigned by independent rating organizations, such as A.M. Best, and reputation. Some of the insurers with which we compete have significantly greater financial, marketing and management resources and experience than we do. We may also compete with new market entrants in the future. Our competitors include other insurance companies, state insurance pools and self-insurance funds. We generally target niche sectors and clients where the market is not as developed as the broader market and where we have particular expertise and provide differentiated offerings versus our competitors.

More than one hundred insurance companies participate in the workers compensation market. The insurance companies with which we compete vary by state and by the industries we target. We believe our competitive advantages include our underwriting and claims management practices and systems and our A.M. Best rating of A (Excellent). In addition, we believe that our insurance is competitively priced and that our premium rates are typically lower than those for policyholders assigned to the state insurance pools, allowing us to provide a viable alternative for policyholders in those pools.

We believe that the Specialty Risk and Extended Warranty sector in which we do business is not as developed as most other insurance sectors (including workers compensation insurance). We believe that our Specialty Risk and Extended Warranty team is recognized for its expertise in this market. Nonetheless, we face significant competition, including several internationally well-known insurers that have significantly greater financial, marketing and management resources and experience than we have. We believe that our competitive advantages include the ability to provide technical assistance to warranty providers, experienced underwriting, resourceful claims management practices and good relations with warranty administrators in the European Union and in the U.S.

Our Specialty Program Business segment employs a niche strategy that helps differentiate its offerings versus competitors, as most competing carriers pursue larger transactions. We do not compete for high exposure business and

prefer to underwrite less volatile classes of business. We maintain the requisite A.M. Best rating and financial size to compete favorably for target business.

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We utilize our proprietary technology and extensive database of loss history in order to appropriately price and structure policies, maintain lower levels of loss, enhance our ability to accurately predict losses, and maintain lower claims costs than the industry as a whole. We believe a strong underwriting foundation is best accomplished through careful risk selection and continuous evaluation of underwriting guidelines relative to loss experience. We are committed to a consistent and thorough review of each new underwriting opportunity and our portfolio as a whole, and, where permissible and appropriate, we customize the terms, conditions and exclusions of our coverage in order to manage risk and enhance profitability. We believe that proactive and prompt claims management is essential to reducing losses and lowering loss adjustment expenses and enables us to more effectively and accurately measure reserves.

Business Segments

Historically, we managed our business through three primary segments, Small Commercial Business, Specialty Risk and Extended Warranty and Specialty Program Business, which are based on the products we provide and the markets we serve. In March 2010, we formed a fourth segment, Personal Lines Reinsurance, effective with our entry into an agreement to reinsure ten percent of GMAC's U.S. consumer property and casualty insurance business.

The following table provides our gross written premium by segment for the years ended December 31, 2010, 2009 and 2008:

(Amounts in Thousands)	2010	2009	2008
Small Commercial Business	\$ 465,951	\$ 469,627	\$ 458,842
Specialty Risk and Extended Warranty	748,525	461,338	415,921
Specialty Program Business	264,051	267,981	235,811
Personal Lines Reinsurance	82,295		
Total	\$ 1,560,822	\$ 1,198,946	\$ 1,110,574

Additional financial information regarding our segments is presented in Note 24 "Segments" of the notes to our 2010 audited consolidated financial statements appearing elsewhere in this Form 10-K.

Small Commercial Business

This segment provides workers' compensation to small businesses that operate in low and medium hazard classes, such as restaurants, retail stores and physicians and other professional offices and commercial package and other property and casualty insurance products to small businesses, with average annual premiums of approximately \$5,300. We are authorized to write our Small Commercial Business products in all 50 states. We distribute our policies through a network of over 7,000 select retail and wholesale agents who are paid commissions based on the annual policy premiums written. Workers' compensation insurance pricing and coverage options are generally mandated and regulated on a state by state basis and provide coverage for the statutory obligations of employers to pay medical care expenses and lost wages for employees who are injured in the course of their employment. Commercial package products provide a broad array of insurance to small businesses, including commercial property, general liability, inland marine, automobile, workers' compensation, umbrella and farm and ranch owners' coverage. As of December 31, 2010, we employed approximately 75 underwriters in this segment.

We believe the small business component of the workers' compensation market is generally less competitive than the broader insurance market because the smaller policy size and low average premiums needed by these types of policyholders generally does not fit the underwriting and profitability criteria of many of our competitors. Our highly customized and proprietary technology platform enables us to individually underwrite, manage and control losses in a cost-effective manner for a large number of small policies while still providing quality customer service and responsive claims management to our clients and the agents that distribute our products. We believe these factors have been key to our ability to achieve high retention and renewal rates. Our policy renewal rate on voluntary business (excluding assigned risk plans), which represented approximately 92% of the segment's gross written premiums in 2010, was 82%, 80%, and 83% in 2010, 2009 and 2008, respectively.

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Some of our commonly written small business risks include:

restaurants;
retail stores and strip malls;
physician and other professional offices;
building management-operations by owner or contractor;
private schools;
business traveler hotels/motels;
light manufacturing;
small grocery and specialty food stores;
light contracting, distributors;
laundry/dry cleaners.

We are focused on continuing to broaden our market share by enhancing our current agent relationships as well as developing new agent relationships. Our technology platform and application system permits agents and brokers to easily determine real-time if the risk and pricing parameters for a prospective workers compensation client meet our underwriting criteria and deliver an application for underwriting approval to us in a paperless environment. Our underwriting system will not allow business to be placed if it does not fit within our guidelines. We are currently introducing these same types of efficiencies for our commercial package product business. Our commercial package policies are delivered to our agents through our website, thereby reducing postage costs and enabling our agents to more readily track policy changes. Our system handles most clerical duties, so that our underwriters can focus on making decisions on risk submissions.

We administer all Small Commercial Business claims in house. Our claims management process is structured to provide prompt service and personal attention with a designated adjuster assigned to each case. Our system guides the insured and other involved parties through the claims adjudication process in an effort to allow them to return to normal business operations as soon as possible. We seek to limit the number of claim disputes with all parties through early intervention in the claims process. We use a proprietary system of internet-based tools and applications that enable our claims staff to concentrate on investigating submitted claims, to seek subrogation opportunities and to determine the actual amount of damages involved in each claim. This system allows the claims process to begin as soon as a claim is submitted.

Our workers compensation claims adjusters have an average of 20 years of experience and have teams located in ten different states. Each adjuster handles an average monthly pending caseload of approximately 214 cases. Supervision of the adjusters is performed by internal supervisors and a claims manager in each region.

In 2010, approximately 75.9% of our Small Commercial Business workers compensation claims were for medical expenses with 24.1% of claims for medical expenses and for lost wages compared with 74.6% and 25.4%, respectively, in 2009.

As of December 31, 2010, approximately 1.0% of the 7,611 Small Commercial Business workers compensation claims reported for accident year 2005 were open, 1.6% of the 9,462 claims reported for accident year 2006 were open, 2.3% of the 12,038 claims reported for accident year 2007 were open, 4.6% of the 11,894 claims reported for accident year 2008, 11.2% of the 16,048 claims reported for accident year 2009 were open and 39.4% of the 16,624 claims reported for accident year 2010 were open.

We maintain Small Commercial Business property and casualty claims operations in Texas and Oregon, and the commercial package claims operation is separated into four processing units; casualty, property, cost-containment/recovery and a fast-track physical damage unit. As of December 31, 2010, we employed 20 property

and casualty claims adjusters. This allows for the application of specific talents and claims knowledge to assist in the handling of losses. Overall, our property and casualty claims adjusters handle an average monthly pending caseload of approximately 105 claims.

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As of December 31, 2010, our Small Commercial Business property and casualty claims were approximately 47% automobile and 21% property and inland marine with the remaining 32% involving general liability and umbrella losses compared to 52%, 18% and 30%, respectively, in 2009. At the end of 2010, 17% of the 3,061 claims features reported in accident year 2010 remained open, while 3% and 4% of the 5,065 claims and 4,129 claims from 2009 and 2008, respectively, remained open.

Our Small Commercial Business adjusters have an average of 18 years of experience. Supervision of the adjusters is performed by our internal claims management, comprised of a staff that has an average of over 32 years of experience.

Increases in reserves over the authority of the claims adjuster must be approved by supervisors. Senior claims managers provide direct oversight on all claims with an incurred value of \$50,000 or more.

In addition to growing organically, we have further enhanced our marketing and customer liaison capabilities for small-business workers compensation and property and casualty insurance by acquiring distribution networks and renewal rights from companies that have long-standing, established agent relationships, underwriting and claims management expertise, and/or infrastructure to provide additional support to our platform. These transactions have also enabled us to further expand our geographic reach or offer additional products.

Specialty Risk and Extended Warranty

In our Specialty Risk and Extended Warranty segment we provide coverage for consumer and commercial goods and custom designed coverages, such as accidental damage plans and payment protection plans offered in connection with the sale of consumer and commercial goods, in the United States and Europe, and certain niche property, casualty and specialty liability risks in the United States and Europe, including general liability, employers liability and professional and medical liability. Our model is focused on developing coverage plans by evaluating and analyzing historical product and industry data to establish appropriate pricing and contract terms and enhancing the profitability of the plans by limiting the frequency and severity of losses while delivering superior customer service. We believe that our proprietary technology platform and strong industry expertise provide us a competitive advantage. We carefully select administrators with extensive industry knowledge and target industries and coverage plans that have demonstrated consistently favorable loss experience. Additionally, we utilize extensive historical claims data and detailed actuarial analysis to ensure our ability to more accurately forecast the frequency and severity of losses and draft restrictive, risk-specific coverage terms with clearly identified coverage restrictions to further reduce the level of losses. Our efficient and proactive claims management process enables us to ensure superior customer service, and if necessary, proactively adjust our premiums based on changes in actual loss experience. Our specialty risk business primarily covers the following risks:

- legal expenses in the event of unsuccessful litigation;
- property damage for residential properties;
- home emergency repairs caused by incidents affecting systems, such as plumbing, wiring or central heating;
- latent defects that materialize on real estate property after building or completion;
- creditor default to insureds if they become unable to meet financial obligations under finance contracts;
- guaranteed asset protection (GAP) to cover the difference between an insurer's settlement and the asset value in the event of a total loss; and
- general liability, employers liability, public liability, negligence of advisors and liability of health care providers and facilities.

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Our extended warranty business covers selected consumer and commercial goods and other risks, including:

personal computers;
consumer electronics, such as televisions and home theater components;
consumer appliances, such as refrigerators and washing machines;
automobiles (excluding liability coverage);
cellular telephones;
furniture; and
heavy equipment.

We also serve as a third party administrator to provide claims handling and call center services to the consumer products and automotive industries in the U.S. and Canada.

In connection with our extended warranty business, we issue policies to our clients that provide for payment or replacement of goods to meet our clients' contractual liabilities to the end purchasers of the warranty under contracts that have coverage terms with durations ranging from one month to 120 months depending on the type of product. The weighted average term of the portfolio is 25 months. In the event that the frequency or the severity of loss on the claims of a program exceeds original projections, we generally have the right to increase premium rates for the balance of the term of the contract and, in Europe, the right to cancel prior to the end of the term. We believe that the profitability of each coverage plan we underwrite is largely dependent upon our ability to accurately forecast the frequency and severity of claims and manage the claims process efficiently. We continuously collect and analyze claims data in order to forecast future claims trends. We also provide warranty administration services for a limited number of coverage plans in the United States.

We underwrite our specialty risk coverage on a coverage plan-level basis, which involves substantial data collection and actuarial analysis as well as analysis of applicable laws governing policy coverage language and exclusions. We prefer to apply a historical rating approach in which we analyze historical loss experience of the covered product or similar products rather than an approach that attempts to estimate our total exposure without such historical data. In addition, we believe that the quality of the marketing and claims administration service provided by the warranty administrator is a significant driver of the profitability of the product. Accordingly, a critical evaluation of the prospective warranty administrator is an important component of underwriting a plan. The results of our underwriting analysis are used to determine the premium we charge and drive the description of the plan coverage and exclusions. The underwriting process generally takes three months or more to complete.

We market our extended warranty and GAP products in the United States and internationally primarily through brokers and third party warranty administrators and through a direct marketing group. Third party administrators generally handle claims on our policies and provide monthly loss reports. We review the monthly reports and if the losses were unexpectedly high, we generally have the right under our policies to adjust our pricing or cease underwriting new business under the coverage plan. We routinely audit the claims paid by the administrators. We hire third party experts to validate certain types of claims. For example, we engage engineering consultants to validate claims made on coverage we provide on heavy machinery. We generally settle our extended warranty claims in-kind by repair or replacement rather than in cash. When possible, we negotiate volume fixed-fee repair or replacement agreements with third parties to reduce our loss exposure.

In 2010, approximately 72% of gross written premium was originated internationally with 28% originated in the United States.

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Specialty Program Business

Our Specialty Program Business segment provides workers compensation, package products, general liability, commercial auto liability and other specialty commercial property and casualty insurance to a narrowly defined, homogeneous, group of small and middle market companies whose business model and risk profile generally requires in-depth knowledge of a specific industry or sector focus in order to appropriately evaluate, price and manage the coverage risk. The type of risk covered by this segment is similar to the type of risk in Small Commercial Business but also covers, to a small extent, certain higher risk businesses. We partner with managing general agents and other wholesale agents and claims administrators who have a strong track record and history underwriting certain types of risk and who, subject to our underwriting standards, originate and assist in managing a book of business and generally share in the portfolio risk. Our products and underwriting criteria often entail customized coverage, loss control and claims services as well as risk sharing mechanisms. The coverage is offered through accounts with various agents to multiple insureds.

Policyholders in this segment primarily include the following types of industries:

retail;
wholesale;
service operations;
artisan contracting;
trucking;
light and medium manufacturing; and
habitational.

We establish the underwriting standards used with our agency partners by conducting detailed actuarial analysis using historical and industry data. Prior to entering into a relationship with an agency, we perform extensive due diligence on the agent including a review of underwriting, claims and financial control areas that generally takes three to nine months to complete. Additionally, once we have entered into a relationship with an agency, we carefully monitor the loss experience of the portfolio associated with each agent and conduct quarterly underwriting audits.

As of December 31, 2010, we underwrote 43 coverage plans through 26 independent wholesale and managing general agents. Workers compensation insurance comprised approximately 40% of this business in 2010, 38% in 2009 and 35% in 2008. The general liability and commercial auto lines combined comprised approximately 48%, 50% and 50% of this business in 2010, 2009 and 2008, respectively.