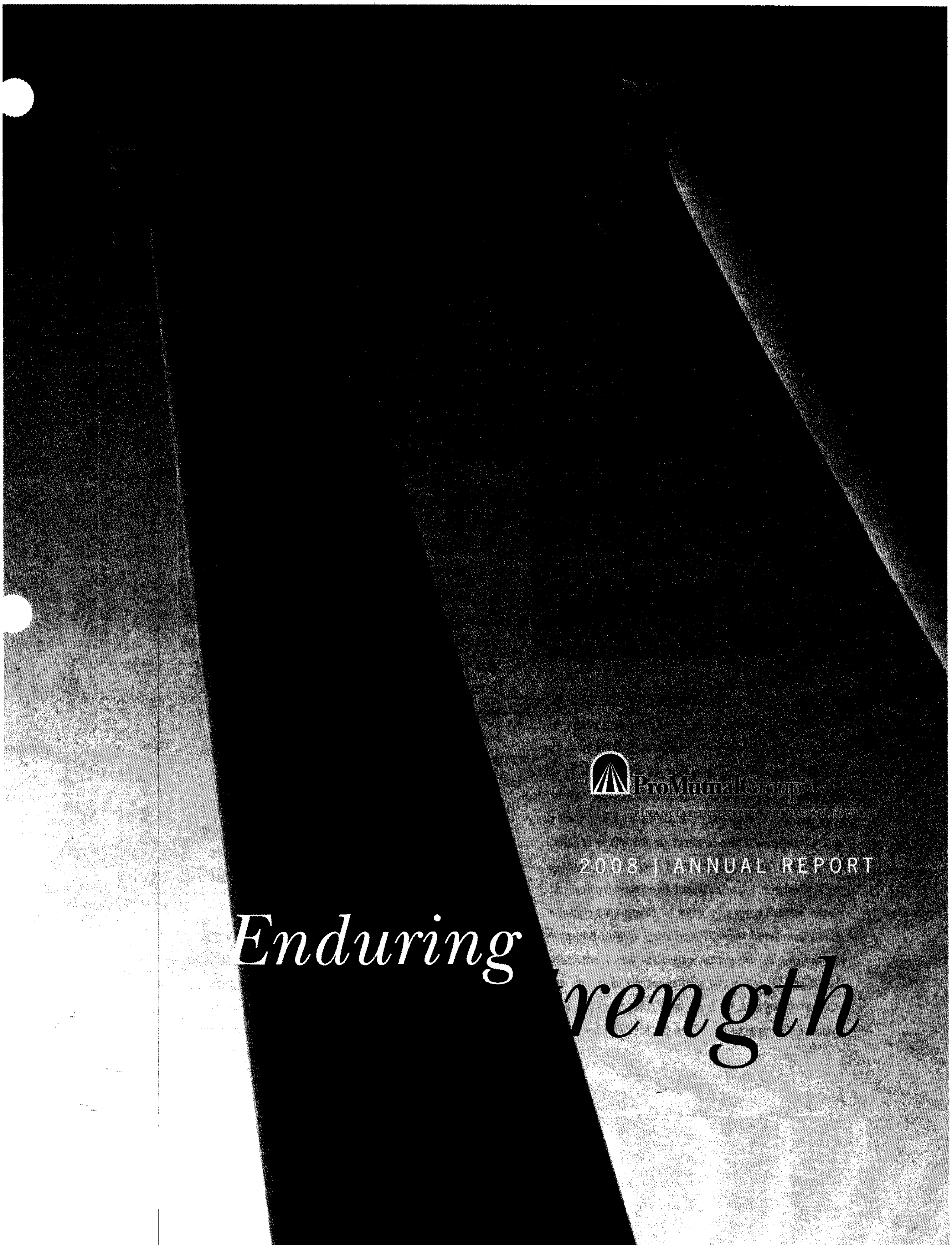


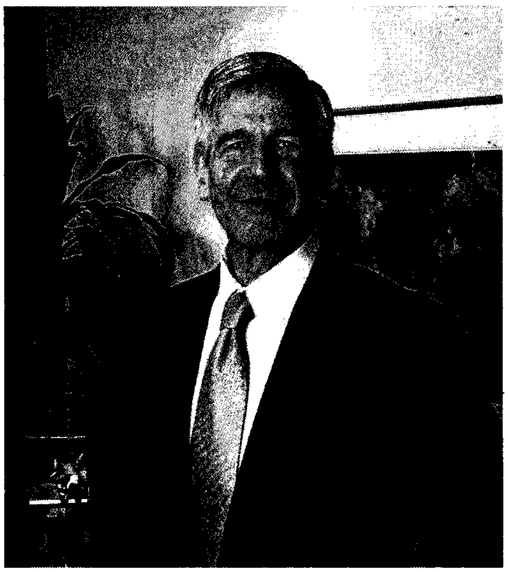
ProMutual Group

FINANCIAL INTEGRITY

2008 | ANNUAL REPORT

Enduring *rength*

Chairman's Letter



When it comes to medical liability insurance, endurance is critical, as your insurer needs to be there to protect you today and well into the future. That is why this line of insurance is often referred to as a "long-tail" business; for an action that occurs today may result in a claim that may not be reported for several years. As a fellow healthcare professional and ProMutual Group policyholder, I understand the importance of choosing a company that is going to be there when you need them. ProMutual Group has proven to be such a company, one that has maintained its financial strength and weathered many tough economic cycles to remain strong and be able to protect the practices of its policyholders.

This year's theme of *enduring strength* is fitting when describing a company like ProMutual Group, but perhaps is even more pertinent today given the tough economic conditions we are facing. With the uncertainty surrounding the financial markets, as well as challenges in the healthcare sector, it is more important than ever that you can rely on a company that can endure such tough market cycles. Our policyholders, while they hope that they never face a claim, understand that they can occur, and if they do, they rely on us to defend them. They need to know that we will be here in three years if a claim is filed and three years after that to defend them in court, if need be. And if their case is lost, that we will still be here and have the financial ability to pay the claim. If a company is well-managed, then reserves that are set aside today have to be sufficient to pay for claims that arise years from now. Once you contemplate the long-tail nature of our business, you have to think about strength and endurance. Such qualities are what have made ProMutual Group one of the leading medical liability providers in the country and the provider of choice for thousands of healthcare professionals.

In 2008, we continued our commitment to the defense of our policyholders. Our success in this regard is evidenced through our track record. Nearly 73 percent of claims were closed without an indemnity payment and we won more than 93 percent of those that went to a verdict at trial. On an industry-wide level, we have seen a decline in the frequency of claims while the severity of indemnity payments is trending moderately with inflation. The lower frequency may be attributed to a couple of factors. One is that plaintiff lawyers are being more selective in their choice of cases, choosing not to pursue less meritorious cases to keep their expenses down. More importantly, another factor which I believe has greatly attributed to the decline in frequency is that we are seeing the results of numerous patient safety initiatives. Although the results of these are hard to measure, I think their influence can be seen in the lower number of claims being filed.

At ProMutual Group, we continue to believe in the importance of clinical risk management which helps doctors practice safer medicine, improves physician-patient communication and helps prevent events that lead to claims from occurring in the first place. In 2008 we continued to further develop initiatives to enhance the resources we offer to our insureds in this regard and touch upon these further in this report.

As you will also read in this report, ProMutual Group managed to fare well financially even despite tough economic conditions. This speaks volumes to our conservative investment philosophy and disciplined financial management. In general, the medical liability market fared well last year, and ProMutual Group continued to be near the top of this group. We continue to be ranked in the top 10 medical liability insurance writers in the United States based on direct written premium, and we maintained our A.M. Best rating of A- (Excellent) which was reaffirmed for the thirteenth consecutive year.

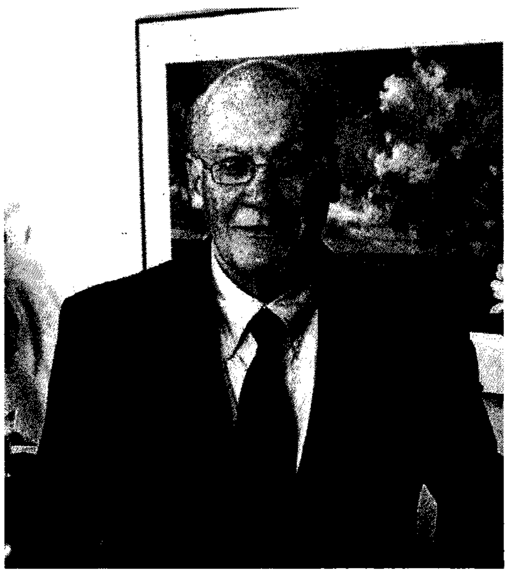
While the future of the economy and any effects it may have on our industry are yet to be determined, we can definitively say that ProMutual Group will remain fiscally responsible and focused on improving the practices of the healthcare professionals we insure.

Sincerely,

Kenneth A. Heisler, M.D.

KENNETH A. HEISLER, MD, FACS
Chairman of the Board

President's Letter



In recent years, our annual reports have focused on the qualities that make ProMutual Group one of the leading medical liability companies in the country. We know that such qualities – ***stability and commitment*** – are ones you look for when choosing a liability carrier. This year, we focus on the ***enduring strength*** we offer our policyholders, as this relates directly to the long-term nature of our business and underscores our ability to remain viable well into the future.

Our ability to endure is particularly relevant when given the circumstances of 2008. As you are all well aware, our economy experienced a significant downturn in the latter part of 2008. Such trouble in the economy affected nearly every business and segment of the market. No matter how careful or conservative a company may be, there was no way to avoid being affected in some manner or another. Most companies felt the impact as a result of their investments. This included ProMutual Group. However, we are fortunate that the effect on our overall investments was minimal.

Careful and diligent attention to the market and its warning signs allowed our company to avoid significant losses at the onset of economic difficulty. We constantly monitored the market and in the early part of 2008, as we saw what was unfolding, we made investment decisions in response to a changing investment climate. Such moves were the result of caution, not panic. More importantly, changes we did not make were of enormous benefit as our investment strategy was designed to withstand turbulence in the financial markets. Our main objective was to steer a steady course and this has served us well.

Overall, ProMutual Group fared well in 2008 given the economic conditions. We experienced an increase in policyholder surplus and achieved overall profitability. We ended 2008 with total assets in excess of $2.2 billion and surplus of $612 million. These results support our ability to pay any current and future claims against our policyholders. In addition we were able to generate a healthy amount of operating income, which helped to offset any losses we experienced in investments. Our strong operating results, as evidenced by our combined ratio of 72.7 percent and an expense ratio of 17.3 percent, are a result of our dedication to prudent fiscal management regardless of investment conditions.

Competition was also a factor for us in 2008 in all states where we do business, not only from other insurance companies but from the alternative insurance market. Despite increased competition, policy retention rate was very good and exceeded our own expectations. This is important to us not because we met or exceeded a numeric goal, but because it shows that we have been able to retain our customers. Customer loyalty, especially in tough times, is critical to being a strong company.

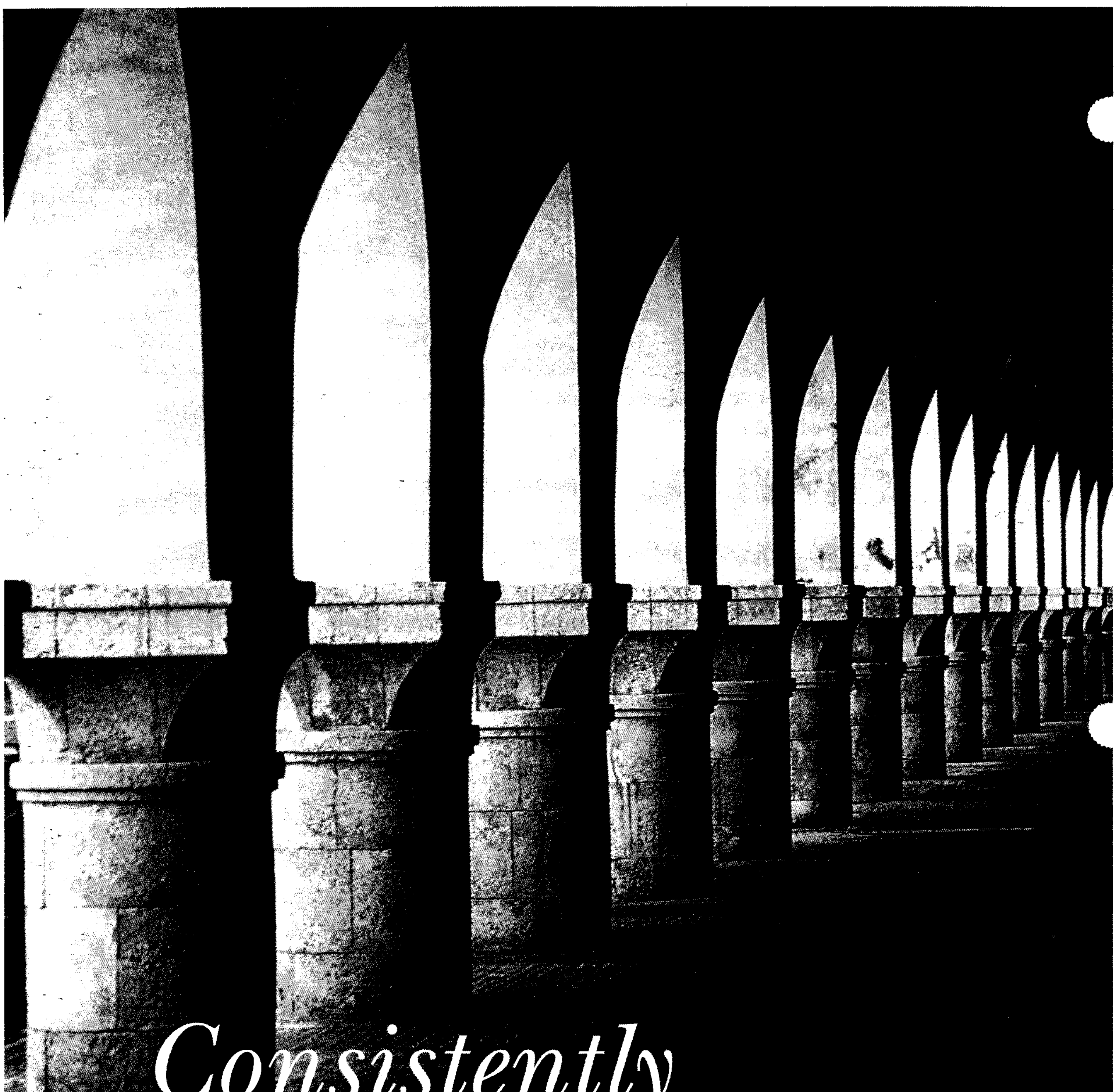
While there were certain actions we took in 2008 to better our overall financial position, the results we are seeing today are the culmination of a number of years of effort. Specifically, these excellent results can be attributed to the varied rate increases we instituted to ensure that we are charging the amount necessary to pay any future claims, our excellent claims defense record and cost control measures, and risk management strategies that helped to reduce losses for our policyholders. On the underwriting and marketing side, we were deliberate in our efforts to refrain from excessive growth if it made no sense. Instead, we maintained our business discipline and did not reduce prices to increase market share. Companies that have done this are often punished in the market. However, we were cautious and remained extremely disciplined in this regard.

Although 2008 had its difficulties, I would consider it a successful year because we exceeded nearly all our goals despite all the challenges. We proved we were strong enough to survive even the most turbulent of market cycles. We were able to add to policyholder surplus, we maintained our financial underpinnings, and we moved forward with a focused strategy for the future. As you will read in this report, we devised a strategic plan to take us through 2009 and beyond that builds upon our strengths and core competencies. This, combined with unswerving attention to our policyholders, will allow us to maintain our enduring strength.

Sincerely,

Richard W. Brewer

RICHARD W. BREWER
President & CEO



Consistently

2008. A YEAR THAT WILL FOREVER BE DEFINED BY AN UNPRECEDENTED, HEADLINE-MAKING ECONOMIC LANDSCAPE. DESPITE THESE VERY CHALLENGING CONDITIONS, WE STRENGTHENED OUR FINANCIAL POSITION AND DID NOT WAVER FROM LONG-HELD STANDARDS FOR UNDERWRITING. WE EXPLORED AND LEVERAGED OPPORTUNITIES FOR GROWTH THROUGH PURPOSEFUL, MEASURED PROCESSES. AND WE CONTINUED OUR LONG HISTORY OF DELIVERING EXCEPTIONAL SERVICE TO OUR POLICYHOLDERS AND AGGRESSIVELY DEFENDING GOOD MEDICINE.

Despite Challenging Conditions

In 2008, robust operating income and proactive adjustments to our investment portfolio allocations contributed to an increase in our policyholder surplus which was $612.1 million at year-end. This represents an increase of $9.3 million over 2007. Our combined ratio was 72.7, a reflection of the superior quality of business that we continue to write.

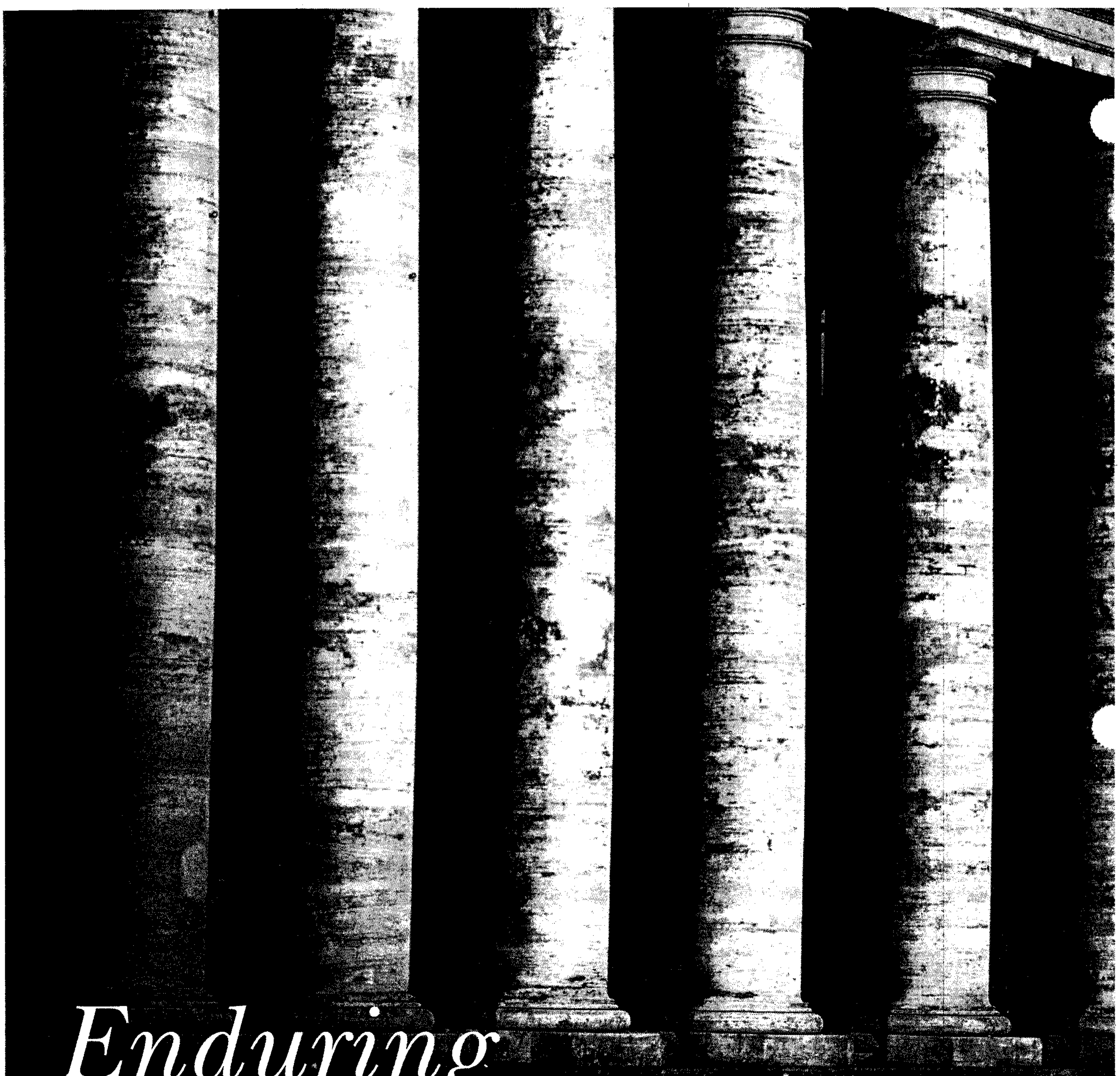
In acknowledgement of our financial strength and stability, our A.M. Best rating of A- (Excellent) was reaffirmed for the thirteenth year in a row.

The outstanding expertise and dedication of our underwriting, risk management, and claim services teams, in partnership with our network of independent insurance agents and brokers, resulted in an increase in our policyholder retention rate in 2008 to 95.1 percent, despite intense competition. We are gratified by the loyalty of our policyholders and their continued commitment to ProMutual Group.

We began offering medical liability insurance in the state of Pennsylvania in 2008. Our decision to enter Pennsylvania, as with any new territory, was made after an extensive review of conditions in the state. We evaluated a number of factors including how much premium is in the state, the legal climate, the distribution system, policy limits, attorneys, and the quality of competition. This process ensures that the solution offered by ProMutual Group will effectively address needs that we believe are currently underserved. As 2008 unfolded, we were pleased to see the conservative growth that we had predicted for the state being realized.

As strong advocates of proactive risk management, we believe that investment in this area can increase patient safety, improve patient care, and decrease the likelihood of claims. To this end, we further enhanced the support we provide to our policyholders by establishing a specialized department within our overall organization to focus exclusively on physician education.

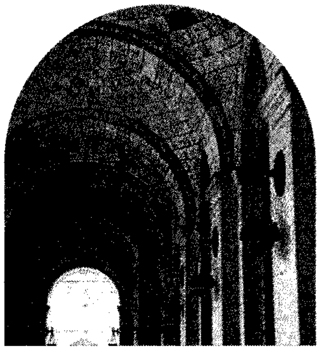
We launched our continuing medical education (CME) website in 2008 and made the website accessible to healthcare providers in all states, not just those in which we offer liability insurance. Expanded accessibility to these CME activities allows physicians from across the nation to enhance their skills and knowledge in the area of risk management.



Enduring

ENDURING STRENGTH. IT COMES FROM HAVING FORESIGHT, DISCIPLINE, AND A LONG-TERM VISION. IT REQUIRES CONSISTENT APPLICATION OF PRUDENT STRATEGIES AND GUIDING PRINCIPLES. WE DEFINE IT AS THE ABILITY TO ACHIEVE SUCCESS AND STABILITY OVER A LONG PERIOD OF TIME, WITH SOLID OPERATING RESULTS, AND HIGH CUSTOMER SATISFACTION. FOR OUR POLICYHOLDERS, ENDURING STRENGTH TRANSLATES INTO SECURITY AND PEACE OF MIND.

Throughout the Years



At ProMutual Group, we deliver on our commitment to financial stewardship by applying a conservative, grounded approach to growth and adhering to investment guidelines that seek to deliver steady returns through an appropriate balance of risk and reward. Through our own discretion and caution, and in conformity with regulatory requirements, our portfolio is consistently and heavily invested in the high quality bond market and therefore less subject to the vagaries of the stock market.

Throughout the years, we have maintained a high quality of business written through stringent underwriting standards. We closely examine the loss history of applicants and assess whether offices are well-managed, practicing good medicine, and implementing sound risk management techniques.

While we are diligent in our goal of insuring the best risks today, we also have the foresight to ensure that we have the ability to be here for our policyholders in the future. It was in this regard that in 2008 we engaged a consulting firm to review our overall direction and help formulate a long-term “measured growth plan.”

The timing of this important undertaking was driven by our strong capital position which we knew would allow us to consider and act upon the range of options that were to be identified in the plan.

The plan represents a sharply-focused vision and growth strategy that will guide ProMutual Group as we offer services to a broader and increased number of policyholders. We look forward to reporting on our activities in the coming years.

As we look ahead to 2009 and beyond, our mission remains clear: Remain financially strong so that we can effectively adjudicate and pay claims and minimize the possibility of litigation through comprehensive risk management programs and services. Because a claim may be separated from the circumstances that led to it by an extended period of time, we must consistently deliver on this mission, year after year, to support and protect our policyholders.

2008

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors of
Medical Professional Mutual Insurance Company, ProSelect Insurance Company and ProSelect National Insurance Company, Inc.

We have audited the accompanying statutory statements of admitted assets, liabilities and surplus of Medical Professional Mutual Insurance Company, ProSelect Insurance Company, and ProSelect National Insurance Company, Inc. ("ProMutual Group" or the "Companies") as of December 31, 2008 and 2007, and the related statutory statements of income and changes in surplus, and of cash flows for the years then ended. These financial statements are the responsibility of the Companies' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 combined 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.

As described in Note 2 to the combined financial statements, the Companies prepared these combined financial statements using accounting practices prescribed or permitted by the states in which the Companies are domiciled, which practices differ from accounting principles generally accepted in the United States of America. The effects on the combined financial statements of the variances between the statutory basis of accounting and accounting principles generally accepted in the United States of America are material; they are described in Note 2.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the combined financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Companies as of December 31, 2008 and 2007, or the results of its operations or its cash flows for the years then ended.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities and surplus of the Companies as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 2.

PricewaterhouseCoopers LLP

March 30, 2009

COMBINED STATEMENTS OF ADMITTED ASSETS, LIABILITIES, AND ACCUMULATED SURPLUS

(STATUTORY BASIS)

DECEMBER 31, 2008 AND 2007

(IN THOUSANDS)

	2008	2007
Admitted Assets		
Cash and investments		
Bonds, at carrying value	$ 1,871,756	$ 1,818,736
Common and preferred stocks, at carrying value	117,710	203,072
Cash and short-term investments	34,349	41,144
Other invested assets	4,132	4,132
Receivables for securities	46,718	-
Total cash and investments	2,074,665	2,067,084
Premiums receivable	91,799	95,577
Interest and dividends accrued	18,538	16,850
Federal income tax recoverable	14,150	-
Net deferred tax asset	18,803	19,075
Electronic data processing equipment, net	541	571
Reinsurance recoverable on paid losses and loss adjustment expenses	2,165	3,902
Equity in pool	25,468	26,472
Other assets	3,459	5,065
Total admitted assets	$ 2,249,588	$ 2,234,596
Liabilities and Accumulated Surplus		
Liabilities		
Loss and loss adjustment expense reserves	$ 1,328,795	$ 1,359,314
Unearned premiums	167,564	168,241
Advance premiums	6,223	6,502
Commissions payable and contingent commissions	5,758	5,655
Ceded reinsurance premiums payable, net of ceding commissions	2,155	2,271
Funds held by Company under reinsurance treaties	55,244	59,502
Policyholder dividends declared	3,063	1,229
Payable for securities purchased	51,122	960
Payable for securities lending agreements	2,863	-
Federal income tax payable	-	13,320
Other liabilities	14,696	14,787
Total liabilities	1,637,483	1,631,781
Accumulated surplus	612,105	602,815
Total liabilities and accumulated surplus	$ 2,249,588	$ 2,234,596

The accompanying notes are an integral part of the combined financial statements.

COMBINED STATEMENTS OF INCOME AND ACCUMULATED SURPLUS
(STATUTORY BASIS)
YEARS ENDED DECEMBER 31, 2008 AND 2007
(IN THOUSANDS)

	2008	2007
Premiums written	$ 297,548	$ 316,336
Decrease in unearned premiums	467	6,503
Premiums earned	298,015	322,839
Loss and loss adjustment expenses	165,076	217,549
Commissions	17,112	19,889
Taxes, licenses and fees	7,761	8,128
Other underwriting expenses	26,525	22,583
	216,474	268,149
Underwriting gain	81,541	54,690
Net investment income (Note 3)	92,629	91,979
Net realized (losses) gains (Note 3)	(68,095)	12,259
Finance and service charge income	2,044	2,102
Other expense	(6,466)	(6,842)
Dividends to policyholders (Note 11)	(8,253)	(2,831)
Income before federal income taxes	93,400	151,357
Federal income tax expense (Note 4)	46,112	40,972
Net income	$ 47,288	$ 110,385
Accumulated surplus at beginning of year	$ 602,815	$ 504,690
Net income	47,288	110,385
Net unrealized capital losses (Note 3)	(23,125)	(9,053)
Increase (decrease) in net deferred income tax	14,557	(1,355)
Increase in nonadmitted assets (Note 7)	(29,447)	(1,830)
Decrease (increase) in provision for reinsurance	17	(22)
Accumulated surplus at end of year	$ 612,105	$ 602,815

The accompanying notes are an integral part of the combined financial statements.

COMBINED STATEMENTS OF CASH FLOWS
(STATUTORY BASIS)
YEARS ENDED DECEMBER 31, 2008 AND 2007
(IN THOUSANDS)

	2008	2007
Operating activities		
Premiums collected, net of reinsurance	$ 301,138	$ 322,242
Investment income, net	94,956	90,677
Miscellaneous expenses	(4,421)	(4,169)
Benefits and loss related payments	(138,376)	(131,915)
Commissions and expenses paid	(105,750)	(105,168)
Dividends paid to policyholders	(6,419)	(1,603)
Federal income taxes paid	(62,996)	(34,259)
Net cash provided by operating activities	78,132	135,805
Investing activities		
Proceeds from bonds sold, matured or repaid	414,669	577,258
Proceeds from stocks sold	247,582	209,481
Proceeds from other invested assets	142	178
Total investment proceeds	662,393	786,917
Cost of bonds acquired	(497,862)	(779,719)
Cost of stocks acquired	(245,815)	(190,008)
Total investments acquired	(743,677)	(969,727)
Net cash used in investing activities	(81,284)	(182,810)
Total other cash applied	(3,643)	(3,160)
Net decrease in cash and short-term investments	(6,795)	(50,165)
Cash and short-term investments, beginning of year	41,144	91,309
Cash and short-term investments, end of year	$ 34,349	$ 41,144

The accompanying notes are an integral part of the combined financial statements.

NOTES TO COMBINED FINANCIAL STATEMENTS
DECEMBER 31, 2008 AND 2007
(IN THOUSANDS)

1. Business

The combined financial statements include the accounts of Medical Professional Mutual Insurance Company, ProSelect Insurance Company and ProSelect National Insurance Company, Inc. ("ProMutual Group" or the "Companies"). ProMutual Group is the largest writer of medical malpractice insurance in The Commonwealth of Massachusetts.

Medical Professional Mutual Insurance Company ("ProMutual") is licensed to write various lines of insurance in Massachusetts.

ProSelect Insurance Company ("ProSelect") is licensed to write various lines of insurance in the states of Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island and Vermont, and currently writes business in all but New York.

ProSelect National Insurance Company, Inc. ("ProSelect National") is licensed to write various property and casualty lines of insurance in twenty-seven states, but is not currently insuring risks.

2. Basis of Presentation and Significant Accounting Policies

Statutory Basis of Accounting

The combined financial statements of the Companies have been prepared on a statutory basis of accounting in accordance with accounting practices prescribed or permitted by The Division of Insurance of The Commonwealth of Massachusetts (Medical Professional Mutual Insurance Company and ProSelect Insurance Company) and the Arizona Department of Insurance (ProSelect National Insurance Company, Inc.). Intercompany amounts have been eliminated.

Statutory accounting practices include a variety of publications of the National Association of Insurance Commissioners ("NAIC"), as well as state laws, regulations and general administrative rules. Statutory accounting practices differ in some respects from accounting principles generally accepted in the United States of America (GAAP). Significant differences include:

a) Statutory accounting requires that policy acquisition costs (principally commissions and premium taxes) be charged to operations when incurred, and ceding commission received on reinsurance agreements related to the acquisition costs of the business ceded be recorded as income when written. Under GAAP, these items would be deferred and then recognized ratably over the policy period.

b) Under statutory accounting, certain assets designated as "nonadmitted assets" (principally premiums over three months past due, application software, prepaid expenses and office furniture and equipment) are charged directly to accumulated surplus. Under GAAP, the Companies would maintain a reserve for doubtful accounts based upon estimated collectibility, recognize an asset on the balance sheet

NOTES TO COMBINED FINANCIAL STATEMENTS
DECEMBER 31, 2008 AND 2007
(IN THOUSANDS)

for prepaid expenses, office furniture and equipment and software which would be recognized at net depreciated cost.

c) Ceded reinsurance balances relating to unpaid loss and loss adjustment expenses are presented as offsets to reserves; under GAAP, such amounts would be presented as reinsurance recoverable; moreover, under statutory accounting, a provision for reinsurance is established for unsecured recoverable balances from reinsurers that are not authorized which is not recognized under GAAP.

d) Statutory accounting requires that certain debt securities be stated at amortized cost. Bonds with ratings of 3 or lower are stated at the lower of amortized cost or NAIC market value. Under GAAP, debt securities are classified as trading or available for sale, which are valued at fair value, or as held to maturity and valued at amortized cost.

e) Under statutory accounting, classification of certain items on the statement of cash flows differs from GAAP. A reconciliation of indirect cash flows is not presented in the statutory basis cash flow statement, but would be required under GAAP.

f) Under statutory accounting, majority owned insurance and noninsurance subsidiaries are not consolidated. Under GAAP, such subsidiaries would be consolidated.

g) The Companies account for income taxes under the asset and liability method. Deferred federal income taxes are generally recognized when assets and liabilities have different values for financial statement carrying amounts and their respective tax bases. However, the realization on any resulting deferred tax asset is subject to certain criteria in accordance with SSAP 10, *Income Taxes.*

The following is a reconciliation of policyholders' surplus on a statutory basis to policyholders' surplus presented on a GAAP basis for the Companies:

	2008	2007
Policyholders' surplus, statutory basis	$ 612,105	$ 602,815
Valuation adjustments on investments	(51,869)	12,990
Deferred policy acquisition costs	18,273	18,678
Deferred federal income taxes	81,663	29,644
Other, net	2,650	2,450
Nonadmitted assets	5,065	4,551
Provision for reinsurance	3	22
Policyholders' surplus, GAAP	$ 667,890	$ 671,150

The net income for the Companies determined in accordance with GAAP for the years ended December 31, 2008 and 2007 was $54,860 and $108,913, respectively.

NOTES TO COMBINED FINANCIAL STATEMENTS
DECEMBER 31, 2008 AND 2007
(IN THOUSANDS)

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with statutory accounting practices requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value Measurements

Effective January 1, 2008, SFAS No. 157, Fair Value Measurement ("SFAS 157"), was issued and must be adopted prospectively for fiscal years beginning after November 15, 2007. The Statement provides a revised definition of fair value and guidance on methods used to measure fair value. The Statement also expands financial statement disclosure requirements for fair value information. The Statement establishes a hierarchy that distinguishes between inputs based on market data from independent sources ("observable inputs") and a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable ("unobservable inputs"). The fair value hierarchy in SFAS 157 prioritizes inputs with three levels. Quoted prices in active markets have the highest priority (Level 1) followed by observable inputs other than quoted prices (Level 2) and unobservable inputs having the lowest priority (Level 3). Included in the Companies' total cash and invested assets are certain investments carried at fair value on a recurring basis. Therefore, the disclosure principles required by SFAS 157 are included on these statutory basis financial statements. See Note 3 for further disclosure required pursuant to SFAS 157.

Cash and Short-Term Investments

For financial statement purposes, the Companies consider all cash and investments with maturities of less than one year at the time of their acquisition to be cash and short-term investments. Short-term investments, consisting primarily of money market funds, are stated at cost, which approximates fair value.

The Companies invest their excess short-term funds in repurchase agreements with reputable third party financial institutions. Funds are debited from the Companies' accounts on a nightly basis, earn a predetermined rate of interest, and are redeposited in full the following business day. The funds are fully collateralized, as required by the Companies' policy, by bank-owned government agency securities.

Investments

The Companies employ New England Asset Management, Inc., Wellington Management Co., L.L.P., Advent Capital Management, L.L.C. and NISA Investment Advisors L.L.C. ("NISA") to furnish investment management services. These investment fund managers, subject to the supervision of the Board of Directors, direct the investments of the Companies in accordance with established investment objectives, policies and limitations. For their services under their respective contracts, NISA receives a contractual flat annual fee and all other fund managers receive a monthly management fee calculated based on market values. During 2008 and 2007, the Companies incurred aggregate management fees of approximately $2,239 and $2,205, respectively.

NOTES TO COMBINED FINANCIAL STATEMENTS
DECEMBER 31, 2008 AND 2007
(IN THOUSANDS)

Valuation of investments is determined in accordance with the requirements, methods and values adopted by the NAIC, which provide that bonds, so qualified, be carried at amortized cost, preferred stock, so qualified, be carried at cost and other preferred and common stocks and other bonds at fair values established by the NAIC. The Companies have elected to use the retrospective method on loan-backed securities. The Companies use the scientific method for amortizing their debt securities.

The Companies value their investment in ProMutual Group, Inc. pursuant to the equity method using audited GAAP equity adjusted for statutory requirements, as is required under the rules promulgated by the NAIC.

Realized capital gains and losses on the sale of investments are included in net income and are determined on a specific identification basis. Where declines in securities' values are deemed other than temporary, the securities are reported at market value and the loss is reported as a component of net realized gains (losses). Unrealized capital gains and losses from the valuation of nonqualified bonds and equity investments at market are credited or charged directly to accumulated surplus.

The Companies participate in a securities lending program to maximize investment income. Certain investment securities are exchanged for collateral, consisting of cash or U.S. Government securities, equal to at least 102% of the fair value of the investment securities on loan. The fair value of the loaned investment securities is monitored on a daily basis, with additional collateral obtained or refunded as the fair value of the loaned investment securities fluctuates. The collateral is retained and invested by a custodian to generate additional investment income.

Reinsurance

In the normal course of business, the Companies seek to reduce the losses that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers. Amounts recoverable from reinsurers are estimated in a manner consistent with the associated claim liabilities.

Premiums Earned and Unearned

Premiums are recorded as earned on a daily pro rata basis over the terms of the policies. Unearned premiums represent the portion of premiums written applicable to the unexpired terms of the policies in force. A statutory premium deficiency reserve relating to insurance contracts is recognized if the sum of the expected loss and loss adjustment expenses, dividends to policyholders, and maintenance costs exceed the related unearned premiums. The Companies anticipate investment income in determining the need for a premium deficiency reserve.

Loss and Loss Adjustment Expense Reserves

Liabilities for losses and loss adjustment expenses represent the estimated ultimate net cost of all unpaid reported and unreported claims. These estimates are continuously reviewed and modified to reflect current conditions and any adjustments are reflected in current operating results. The Companies

NOTES TO COMBINED FINANCIAL STATEMENTS
DECEMBER 31, 2008 AND 2007
(IN THOUSANDS)

anticipate salvage and subrogation in recording their loss and loss adjustment expense reserves. The Companies do not discount their loss and loss adjustment expense reserves (Note 5).

Depreciation

The provision for depreciation on electronic data processing equipment is computed on the straight-line method over the assets' estimated useful lives of three years.

3. Investments

At December 31, 2008 and 2007, the amortized cost, NAIC market values and gross unrealized gains and losses of investments in securities are as follows:

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	NAIC Market Value
U.S. Treasury and obligations of U.S. Government and agencies	$ 210,801	$ 17,528	$ (2,449)	$ 225,880
Obligations of states and political subdivisions	740,052	8,496	(36,605)	711,943
Industrial and miscellaneous	317,483	3,719	(29,239)	291,963
Asset-backed securities	607,212	14,190	(34,269)	587,133
Total bonds	$ 1,875,548	$ 43,933	$ (102,562)	$1,816,919

	2008			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	NAIC Market Value
Preferred stock	$ 4,080	$ 252	$ (1,094)	$ 3,238
Common stock	101,760	13,349	(1,913)	113,196
Investment in subsidiary	4,090	-	(2,807)	1,283
Total stocks	$ 109,930	$ 13,601	$ (5,814)	$ 117,717

	2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	NAIC Market Value
U.S. Treasury and obligations of U.S. Government and agencies	$ 240,815	$ 10,630	$ (409)	$ 251,036
Obligations of states and political subdivisions	556,814	3,951	(5,617)	555,148
Industrial and miscellaneous	319,247	6,819	(7,390)	318,676
Asset-backed securities	701,852	3,923	(4,324)	701,451
Total bonds	$ 1,818,728	$ 25,323	$ (17,740)	$ 1,826,311

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	2007			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	NAIC Market Value
Preferred stock	$ 29,191	$ 1,925	$ (1,203)	$ 29,913
Common stock	131,397	44,923	(2,845)	173,475
Investment in subsidiary	4,090	-	(2,699)	1,391
Total stocks	$ 164,678	$ 46,848	$ (6,747)	$ 204,779

Other investments represent amounts invested in a LLC, accounted for under the cost method.

The amortized cost and NAIC market value of debt securities at December 31, 2008, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	2008	
	Amortized Cost	NAIC Market Value
Due in one year or less	$ 27,901	$ 28,283
Due after one year through five years	330,957	330,914
Due after five years through ten years	334,443	330,210
Due after ten years	575,035	540,379
Asset-backed securities	607,212	587,133
	$ 1,875,548	$ 1,816,919

At December 31, 2008 and 2007, the Companies held investments in certain bonds with an NAIC rating of 3 or lower. This resulted in a $9,559 and $2,582 reduction to the investment balance at December 31, 2008 and 2007, respectively, which was reflected as an unrealized loss for statutory reporting purposes. Additionally, $3,178 and $2,590 was recorded as unrealized gains on treasury inflation-protected securities in 2008 and 2007, respectively.

Management believes that the gross unrealized losses reflected on ProMutual Group's fixed income portfolio as of December 31, 2008 were primarily the result of increases in market interest rates from the time of acquisition to the current period. These decreases in value are viewed as being temporary as ProMutual Group has the intent and ability to retain such investments for a period of time sufficient to allow for any anticipated recovery in market value. The majority of the debt securities that are in an unrealized loss position are highly rated by the Securities Valuation Office (SVO) of the NAIC and are therefore not required to be written down under NAIC guidelines. An unrealized loss on equity securities of $2,807 relates to a wholly owned subsidiary, for which management has the ability and intent to hold for sufficient recovery. Management also believes that the remaining gross unrealized losses recorded on ProMutual Group's domestic equity portfolio as of December 31, 2008 were primarily the result of routine fluctuations in market prices as opposed to the issuer's financial condition. Therefore, these decreases in value are also viewed as being temporary. In compliance with statutory regulations, the Companies obtain market prices and NAIC designations from the SVO of the NAIC. All statutory unrealized losses have a direct impact on the Companies' policyholders' surplus.

(IN THOUSANDS)

December 31, 2008	**Under 12 Months**	**Over 12 Months**	**Totals**
Debt securities			
Number of positions	292	168	460
NAIC market value	$ 599,569	$ 255,616	$ 855,185
Amortized cost	656,639	301,108	957,747
Unrealized loss	$ (57,070)	$ (45,492)	$ (102,562)
Equity securities			
Number of positions	65	2	67
NAIC market value	$ 31,795	$ 1,570	$ 33,365
Cost	34,549	4,630	39,179
Unrealized loss	$ (2,754)	$ (3,060)	$ (5,814)
Total			
Number of positions	357	170	527
Carrying value	$ 631,364	$ 257,186	$ 888,550
Cost	691,188	305,738	996,926
Unrealized loss	$ (59,824)	$ (48,552)	$ (108,376)

Securities carried at other than amortized value were priced by the Securities Valuation Office of the National Association of Insurance Commissioners. Valuation techniques used to derive fair value of these securities are based on observable or unobservable inputs. Observable inputs reflect the assumptions market participants would use in pricing the asset based on market data obtained from sources independent of the Companies. Unobservable inputs are inputs that reflect the Companies' own assumptions about the assumptions market participants would use in pricing the asset based on the best information available.

	Quoted Prices in Active Markets for Identical Assets Level 1	**Significant Other Observable Inputs Level 2**	**Significant Unobservable Inputs Level 3**	**Carrying Value**
Industrial and miscellaneous	$ -	$ 30,935	$ -	$ 30,935
Asset-backed securities	-	2,374	-	2,374
Total bonds	$ -	$ 33,309	$ -	$ 33,309
Preferred stock	$ -	$ 3,231	$ -	$ 3,231
Common stock	113,196	-	-	113,196
Total equity securities	$ 113,196	$ 3,231	$ -	$ 116,427

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Proceeds from the sale of investments during 2008 and 2007 were $601,846 and $653,785, respectively. Gross gains of $8,192 and $11,516 and gross losses of $15,971 and $7,390 were realized on sales of debt securities during 2008 and 2007, respectively. Gross gains of $15,168 and $29,872 and gross losses of $63,528 and $12,419 were realized on sales of equity securities during 2008 and 2007, respectively. The calculation of the gain or loss on the sale of marketable securities is based on specific identification at the time of sale. In addition, the Companies realized losses of $22,684 and $1,038 in 2008 and 2007, respectively, due to other than temporary declines in securities' market value.

Net investment income for 2008 and 2007 consisted of the following:

	2008	2007
Interest and dividend income	$ 95,050	$ 94,350
Investment expenses	(2,421)	(2,371)
Net investment income	92,629	91,979
Net realized (losses) gains (less capital (losses) gains tax (benefit) expense of $(10,586) in 2008 and $8,460 in 2007)	(68,095)	12,259
Net investment gain	$ 24,534	$ 104,238

The Companies participate in a securities lending program where they loan certain investment securities in exchange for collateral, consisting of cash or U.S. government securities, equal to at least 102% of the fair value of the investment securities on loan. As of December 31, 2008 and 2007, investment securities with a fair value of $195,086 and $316,392, respectively, were on loan. Investment income earned on securities lending transactions for 2008 and 2007 was $1,622 and $433, respectively. The Companies incurred a collateral deficit of $2,817 and $0 during 2008 and 2007, respectively, and has recorded this as an unrealized loss in surplus, net of tax of $986 and $0, respectively.

4. Federal Income Taxes

The main components of the Companies' deferred tax asset and deferred tax liability as of December 31, 2008 and 2007 are as follows:

	2008	2007
Total of gross deferred tax assets	$ 95,835	$ 77,957
Total of deferred tax liabilities	4,130	14,915
Net deferred tax asset	91,705	63,042
Deferred tax asset nonadmitted	72,902	43,967
Net admitted deferred tax asset	18,803	19,075
Increase in nonadmitted asset	$ 28,935	$ 2,475

The Companies have no unrecognized deferred tax liabilities.

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Current income taxes incurred consist of the following major components:

	2008	2007
Current income tax expense on operations	$ 45,856	$ 40,923
Realized capital (losses) gains tax (benefit) expense	(9,725)	8,460
Prior year (overaccrual) underaccrual	(606)	49
Total income tax expense	$ 35,525	$ 49,432

Changes in the main components of the Companies' deferred tax asset ("DTA") and deferred tax liability ("DTL") are as follows:

	2008	2007	Change
Deferred tax assets			
Loss and LAE reserves	$ 55,323	$ 58,093	$ (2,770)
Unrealized capital losses	4,630	1,248	3,382
Impairments on investment securities	8,316	1,085	7,231
Unearned premium	11,729	11,777	(48)
Deferred compensation plans	1,107	1,503	(396)
Nonadmitted assets	1,772	1,639	133
Other	995	943	52
Alternative minimum tax credit	12	12	-
Loss carryforward	11,951	1,657	10,294
Total DTA	95,835	77,957	17,878
Nonadmitted DTA	72,902	(43,967)	28,935
Admitted DTA	22,933	33,990	(11,057)
Deferred tax liabilities			
Unrealized capital gains	4,003	14,727	(10,724)
Other	127	188	(61)
Total DTL	4,130	14,915	(10,785)
Net admitted DTA	$ 18,803	$ 19,075	$ (272)

The change in net deferred income taxes is comprised of the following:

	2008	2007	Change
Total deferred tax assets	$ 95,835	$ 77,957	$ 17,878
Total deferred tax liabilities	4,130	14,915	(10,785)
Net deferred tax asset	$ 91,705	$ 63,042	(28,663)
Tax effect on unrealized gains (losses)			(14,106)
Change in net deferred income tax			$ 14,557

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In accordance with SAAP 10, the Companies have nonadmitted that portion of the deferred tax asset that is not expected to be realized in the next year.

The provision for federal and foreign income taxes incurred is different from that which would be obtained by applying the statutory federal income tax rate to income before taxes. The significant items causing this difference are as follows:

	2008	Effective Tax Rate
Provision computed at statutory rate	$ 28,985	35.0%
Tax-exempt income	(8,231)	(9.9%)
Dividends received deduction	(1,813)	(2.2%)
Other	2,027	2.4%
	$ 20,968	25.3%
Federal and foreign income taxes incurred	$ 35,525	42.9%
Change in net deferred income taxes	(14,557)	(17.6%)
Total statutory income taxes	$ 20,968	25.3%

At December 31, 2008, the Companies had an operating loss carryforward originating in 2005 in the amount of $2,994, which will expire, if unused, in 2025. In addition, the Companies had capital loss carryforwards originating in 2005, 2007 and 2008 in the amounts of $701, $4 and $30,449, respectively, which will expire, if unused, in 2010, 2012 and 2013, respectively. The Companies also have AMT credits of $12 that do not expire.

The Companies have $45,856 and $41,178 income taxes incurred in the current or prior years, respectively, that are available for recoupment in the event of future net losses.

The Companies file a consolidated federal income tax return with their affiliates, which include ProMutual Group, Inc. and ProMutual Insurance Agency, Inc.

The method of allocation between the Companies is subject to written agreement, approved by the Board of Directors. The consolidated tax liability is allocated to the Member Companies in accordance with Reg. Section 1.1502-33 (d)(2)(ii) in conjunction with the method provided by Reg. Section 1.1552-1(a)(2) of the Internal Revenue Code whereby the tax is computed on an "as if separate return" basis. Intercompany tax balances are settled annually.

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5. Loss and Loss Adjustment Expense Reserves

The loss and loss adjustment expense reserves at December 31, 2008 and 2007 consisted of the following:

	2008	2007
Reported claims		
Losses	$ 525,246	$ 542,050
Loss adjustment expenses	116	305
	525,362	542,355
Claims incurred but not yet reported		
Losses	441,267	473,859
Loss adjustment expenses	362,166	343,100
	803,433	816,959
Loss and loss adjustment expense reserves	$ 1,328,795	$ 1,359,314

The activity in the liability for unpaid loss and loss adjustment expenses is summarized as follows:

	2008	2007
Balance at January 1	$ 1,359,314	$ 1,326,139
Payments made on claims existing at January 1	(190,791)	(180,279)
Decrease in liability on claims existing at January 1	(142,297)	(91,216)
Balance at December 31 on prior year claims	1,026,226	1,054,644
Estimated losses on new claims	307,373	308,764
Payments made on new claims	(4,804)	(4,094)
Balance at December 31 on current year claims	302,569	304,670
Total loss and loss adjustment expense reserves at December 31	$ 1,328,795	$ 1,359,314

These liabilities include estimates of expected trends in claim severity, frequency and other factors which could vary as the claims are ultimately settled. In establishing the reserve for losses and loss adjustment expenses, the Companies have relied upon their independent actuaries to review the reasonableness of management's best estimates. These recommendations are based principally upon the historical experience of the Companies in writing medical malpractice insurance. As a result of changes in estimates of insured events in prior years, the liability on claims existing at January 1, 2008 and 2007, respectively, decreased $142,297 and $91,216 for the years ended December 31, 2008 and 2007, respectively, primarily related to coverage years 2002 through 2007 predominantly in the physicians and surgeons line of business.

Claims in the medical malpractice line of insurance have traditionally been characterized by delayed discovery and reporting and, in many cases, the final payment of claims is dependent upon the outcome of litigation. As a result, the total of claims paid from the premiums earned in any policy year will not be known for many years.

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6. Leases

The Companies occupy office facilities under operating lease agreements which expire on November 30, 2013 and February 29, 2016. Total rent expense was $1,565 and $1,564 for 2008 and 2007, respectively.

Minimum annual rental commitments as of December 31, 2008 under the operating leases are as follows:

Fiscal Year	
2009	$ 1,653
2010	1,700
2011	1,748
2012	1,797
2013	1,841
Thereafter	4,045

7. Nonadmitted Assets

Certain assets, designated as nonadmitted by The Division of Insurance of The Commonwealth of Massachusetts and the Arizona Department of Insurance, were directly charged to accumulated surplus as follows:

	2008	2007
Premiums receivable over three months due	$ 628	$ 870
Funds held by reinsured companies	34	34
Nonadmitted deferred income tax	72,902	43,967
Equipment, furniture and application software	2,074	2,261
Accounts receivable	56	59
Notes receivable	978	-
Prepaid expenses and deposits	1,293	1,327
	$ 77,965	$ 48,518

8. Statutory Requirements

Regulatory limits restrict the amount of dividends that can be remitted to a company from its insurance subsidiaries without approval of state insurance regulators. The maximum amount of dividends which can be paid to shareholders by ProSelect without prior approval of the insurance commissioner is the greater of 10% of policyholder surplus as of the prior year-end or the net income for the twelve months ending the prior December 31. The maximum amount of dividends which can be paid to shareholders by ProSelect National without prior approval of the insurance commissioner is the lesser of 10% of policyholder surplus as of the prior year-end or the net investment income for the twelve months ending the prior December 31. No stockholder dividends were declared or paid in 2008.

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9. EDP Equipment

EDP equipment at December 31, 2008 and 2007 consisted of the following:

	2008	2007
EDP equipment	$ 2,479	$ 2,167
Less: Accumulated depreciation	(1,938)	(1,596)
	$ 541	$ 571

Depreciation expense was $343 and $332 during 2008 and 2007, respectively.

10. Employee Benefit Plans

The Companies' employees are covered by a qualified defined contribution pension plan sponsored by ProMutual. A contribution was made in 2008 in the amount of $785 for 2007 that was based on each employee's age and average salary over the most recent five years to meet a target benefit. A contribution of approximately $915 will be made for 2008 in 2009.

The Company sponsors a 401(k) Employee Savings Plan. Substantially all employees of the Companies are eligible to participate in the Companies' Employee Savings Plan under which a portion of employee contributions are matched by the Companies. The match by the Companies was $757 and $722 in 2008 and 2007, respectively.

The Companies' executives and members of their Board of Directors are also eligible to participate in a deferred compensation plan.

11. Dividends to Policyholders

On June 6, 2007, the Board of Directors of ProMutual voted to pay a dividend of $1,600 related to the experience of the dental line of business for calendar years 1986 through 1999 allocated to dentists based on their respective premiums earned by the Company during the period. The dividends were paid in September 2007.

On December 12, 2007, the Board of Directors of ProMutual voted to pay a dividend to physician and surgeon professional liability policyholders in The Commonwealth of Massachusetts on policies expiring between July 1, 2008, and June 30, 2009, in the amount of 5% of the premium paid by such policyholders. The amount accrued at December 31, 2007 was $1,613.

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On June 4, 2008, the Board of Directors of ProMutual voted to pay a dividend of $3,200 related to the experience of the dental line of business for calendar years 1986 through 1999 as well as 2003 and 2004, allocated to dentists based on their respective premiums earned by the Company during the period. The dividends were paid in November 2008.

On December 10, 2008, the Board of Directors of ProMutual voted to pay a dividend to physician and surgeon professional liability policyholders in The Commonwealth of Massachusetts on policies expiring between July 1, 2009 and June 30, 2010, in the amount of 6% of the premium paid by such policyholders. The amount accrued at December 31, 2008 was $1,450.

12. Reinsurance

Reinsurance is obtained to reduce exposure to large claims. Such ceded reinsurance includes quota share, excess of loss, and facultative contracts, on all lines of insurance. These reinsurance contracts do not relieve the Companies from their obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Companies.

The Companies purchased excess of loss agreements in 2007 and 2008, providing coverage of 95% of $8 million in excess of $2 million and 100% of $3 million in excess of $2 million along with 100% of $5 million in excess of $5 million, respectively. The principal reinsurers for these contracts are Axa Re, Platinum Underwriters Reinsurance, Inc., Max Re Ltd., Transatlantic Reinsurance Company, Paris Re, Aspen UK and various Lloyds syndicates.

The Companies participate in the Massachusetts Medical Malpractice Reinsurance Plan (MMMRP), a residual market pool. The Companies, as well as other insurance companies, cede policies into the pool on a facultative basis. The MMMRP assesses each participant an amount based on the profitability of the pool and their respective market share by policy year.

As of December 31, 2008 and 2007, a provision for reinsurance has been established in the amounts of $3 and $22, respectively, for unsecured recoverables from unauthorized reinsurers.

Irrespective of the protection afforded against claim exposure by the above reinsurance agreements, the Companies remain liable as the direct insurer to the insured.

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The amounts by which unearned premiums, loss reserves, loss adjustment expense reserves, premiums earned and loss and loss adjustment expenses incurred have been decreased for amounts ceded are as follows:

	2008	2007
Unearned premiums	$ 3,099	$ 2,867
Loss reserves	79,413	100,137
Loss adjustment expense reserves	21,477	27,562
Premiums earned	5,449	8,987
Loss and loss adjustment expenses incurred	(9,785)	(9,238)
Commission equity	737	683

The effect of assumed reinsurance from unaffiliated insurers is as follows:

	2008	2007
Unearned premiums	$ -	$ -
Loss reserves	50,690	61,327
Loss adjustment expense reserves	13,671	16,812
Premiums earned	(2,813)	2,764
Loss and loss adjustment expenses incurred	(17,521)	(5,500)
Commission equity	-	-

On January 3, 2008, ProMutual, as plaintiff, was successful in an arbitration ruling in a reinsurance dispute. The Companies recorded a surplus benefit of $6,460 for the rescission of the reinsurance contract.

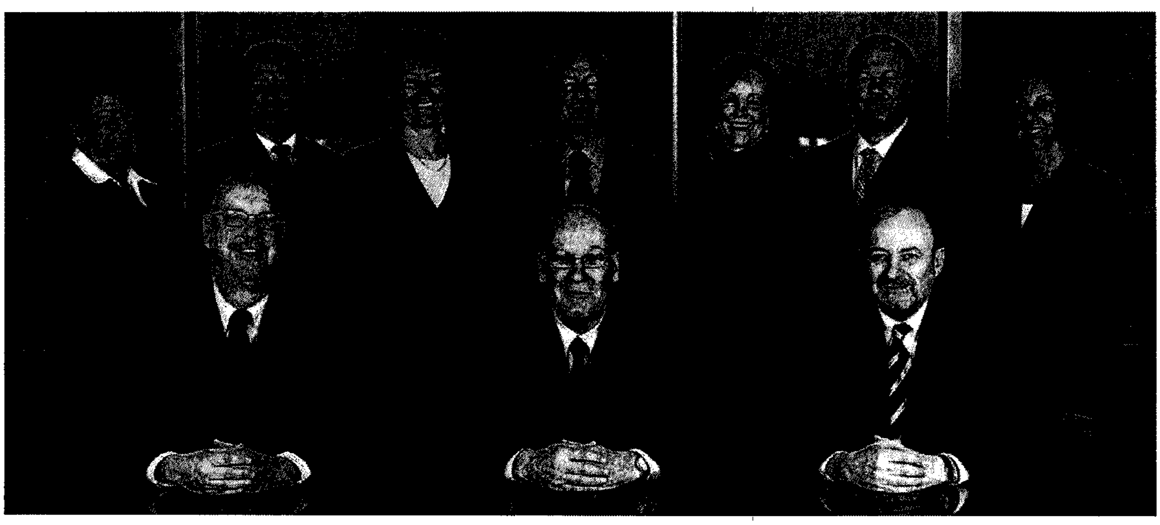
13. Commitments and Contingencies

Various legal claims arise from time to time in the ordinary course of business. In the opinion of management, these claims should not result in judgments or settlements which, in the aggregate, would have a material effect on the Companies' results of operations or financial condition.

Board of Directors

Pictured, front row, left to right: Maryanne C. Bombaugh, MD, MS, FACOG; Dwight Golann, Esq.; Brenda E. Richardson, MD, *Vice Chairwoman;* Kenneth A. Heisler, MD, FACS, *Chairman;* Erwin A. Stuebner, Jr., MD, *Secretary;* Deanna P. Ricker, MD. *Back row, left to right:* Paul A. Schnitman, DDS, MSD; Peter T. Robertson, Esq.; Robert P. Powers; Philip E. McCarthy, MD, FACS; Bruce S. Auerbach, MD, FACEP; John M. Crowe, MD; Richard J. Matteis.

Senior Staff



Pictured, front row, left to right: Gregg L. Hanson, *COO;* Richard W. Brewer, *President & CEO;* John J. Donehue, *Senior Vice President & CFO. Back row, left to right:* Maureen C. Mondor, *Vice President;* Almor M. Afonso, *Vice President;* Anne Huben-Kearney, *Vice President;* Theodore G. Kelley, *Vice President;* Janice W. Allegretto, *Vice President & General Counsel;* Michael R. Kubik, *Vice President;* Donna Miele-Cesario, *Vice President.*

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