

FIRST ACCEPTANCE CORP /DE/

Form 10-Q

May 10, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2010
Commission File Number: 001-12117
FIRST ACCEPTANCE CORPORATION
(Exact name of registrant as specified in its charter)**

Delaware
(State or other jurisdiction
of incorporation or organization)

75-1328153
(I.R.S. Employer
Identification No.)

**3813 Green Hills Village Drive
Nashville, Tennessee**
(Address of principal executive offices)

37215
(Zip Code)

(615) 844-2800

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See 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 Non-accelerated filer Smaller reporting company
(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

At May 10, 2010, there were 48,488,784 shares outstanding of the registrant's common stock, par value \$0.01 per share.

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FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2010
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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	March 31, 2010 (Unaudited)	June 30, 2009
ASSETS		
Fixed maturities, available-for-sale at fair value (amortized cost of \$183,013 and \$140,849, respectively)	\$ 188,145	\$ 140,311
Cash and cash equivalents	32,531	77,201
Premiums and fees receivable, net of allowance of \$376 and \$419	49,777	45,309
Other assets	8,905	11,866
Property and equipment, net	3,662	3,921
Deferred acquisition costs	4,255	3,896
Goodwill	70,092	70,092
Identifiable intangible assets	6,360	6,360
TOTAL ASSETS	\$ 363,727	\$ 358,956
LIABILITIES AND STOCKHOLDERS EQUITY		
Loss and loss adjustment expense reserves	\$ 76,183	\$ 83,973
Unearned premiums and fees	62,499	57,350
Debentures payable	41,240	41,240
Other liabilities	11,092	16,537
Total liabilities	191,014	199,100
Stockholders' equity:		
Preferred stock, \$.01 par value, 10,000 shares authorized		
Common stock, \$.01 par value, 75,000 shares authorized; 48,489 and 48,312 shares issued and outstanding, respectively	485	483
Additional paid-in capital	465,601	464,720
Accumulated other comprehensive income (loss)	5,132	(538)
Accumulated deficit	(298,505)	(304,809)
Total stockholders' equity	172,713	159,856
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 363,727	\$ 358,956

See notes to consolidated financial statements.

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Revenues:				
Premiums earned	\$ 46,651	\$ 54,845	\$ 140,317	\$ 171,506
Commission and fee income	7,471	8,115	21,391	24,033
Investment income	2,008	2,410	5,954	7,741
Net realized gains (losses) on fixed maturities, available-for-sale	(14)	1,727	(459)	486
	56,116	67,097	167,203	203,766
Costs and expenses:				
Losses and loss adjustment expenses	31,902	38,929	94,926	120,214
Insurance operating expenses	20,125	22,021	59,406	64,977
Other operating expenses	280	276	1,303	982
Litigation settlement	(35)	(67)	(314)	5,167
Stock-based compensation	198	523	853	1,532
Depreciation and amortization	483	455	1,447	1,379
Interest expense	970	969	2,951	3,159
	53,923	63,106	160,572	197,410
Income before income taxes	2,193	3,991	6,631	6,356
Provision for income taxes	124	1,597	327	3,124
Net income	\$ 2,069	\$ 2,394	\$ 6,304	\$ 3,232
Net income per share:				
Basic and diluted	\$ 0.04	\$ 0.05	\$ 0.13	\$ 0.07
Number of shares used to calculate net income per share:				
Basic	47,994	47,673	47,943	47,662
Diluted	48,637	48,865	48,699	49,030
Reconciliation of net income to comprehensive income (loss):				
Net income	\$ 2,069	\$ 2,394	\$ 6,304	\$ 3,232

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Net unrealized change in investments	2,123	(1,926)	5,670	(3,599)
Comprehensive income (loss)	\$ 4,192	\$ 468	\$ 11,974	\$ (367)
Detail of net realized gains (losses) on fixed maturities, available-for-sale:				
Net realized gains (losses) on sales	\$ (14)	\$ 2,449	\$ 300	\$ 2,473
Unrealized losses on fixed maturities with other-than-temporary impairment charges		(722)	(1,449)	(1,987)
Non-credit portion included in comprehensive income (loss)			(690)	
Other-than-temporary impairment charges recognized in income		(722)	(759)	(1,987)
Net realized gains (losses) on fixed maturities, available-for-sale	\$ (14)	\$ 1,727	\$ (459)	\$ 486

See notes to consolidated financial statements.

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(in thousands)

	Nine Months Ended	
	March 31,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 6,304	\$ 3,232
Adjustments to reconcile net income to cash used in operating activities:		
Depreciation and amortization	1,447	1,379
Stock-based compensation	853	1,532
Deferred income taxes		2,387
Other-than-temporary impairment on investment securities	759	1,987
Net realized gains on sales of investments	(300)	(2,473)
Other	432	103
Change in:		
Premiums and fees receivable	(4,511)	8,279
Loss and loss adjustment expense reserves	(7,790)	(8,660)
Unearned premiums and fees	5,149	(8,471)
Litigation settlement	91	(2,443)
Other	(2,865)	(1,087)
Net cash used in operating activities	(431)	(4,235)
Cash flows from investing activities:		
Purchases of fixed maturities, available-for-sale	(64,439)	(16,228)
Maturities and paydowns of fixed maturities, available-for-sale	9,867	19,285
Sales of fixed maturities, available-for-sale	11,566	42,786
Net change in receivable/payable for securities		(1,045)
Capital expenditures	(1,197)	(635)
Other	(22)	(103)
Net cash provided by (used in) investing activities	(44,225)	44,060
Cash flows from financing activities:		
Payments on borrowings	(47)	(3,996)
Net proceeds from issuance of common stock	33	37
Net cash used in financing activities	(14)	(3,959)
Net increase (decrease) in cash and cash equivalents	(44,670)	35,866
Cash and cash equivalents, beginning of period	77,201	38,646
Cash and cash equivalents, end of period	\$ 32,531	\$ 74,512

See notes to consolidated financial statements.

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**FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

1. General

The consolidated financial statements of First Acceptance Corporation and its subsidiaries (the Company) included herein have been prepared without audit pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted. In the opinion of management, the consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of the interim periods. Certain reclassifications have been made to the prior year's consolidated financial statements to conform with the current year presentation.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year. These consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements included in its Annual Report on Form 10-K for the fiscal year ended June 30, 2009.

2. Investments

Fair Value

Fair value is the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company holds available-for-sale fixed maturity investments, which are carried at fair value.

Fair value measurements are generally based upon observable and unobservable inputs. Observable inputs are based on market data from independent sources, while unobservable inputs reflect the Company's view of market assumptions in the absence of observable market information. All assets and liabilities that are carried at fair value are classified and disclosed in one of the following categories:

- Level 1 Quoted prices in active markets for identical assets or liabilities.

- Level 2 Quoted market prices for similar assets or liabilities in active markets; quoted prices by independent pricing services for identical or similar assets or liabilities in markets that are not active; and valuations, using models or other valuation techniques, that use observable market data. All significant inputs are observable, or derived from observable information in the marketplace, or are supported by observable levels at which transactions are executed in the market place.

- Level 3 Instruments that use non-binding broker quotes or model driven valuations that do not have observable market data.

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

The following table presents the fair-value measurements for each major category of assets that are measured on a recurring basis at March 31, 2010 (in thousands).

Description	Total	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fixed maturities, available-for-sale:				
U.S. government and agencies	\$ 28,924	\$ 28,924	\$	\$
State	7,825		7,825	
Political subdivisions	1,808		1,808	
Revenue and assessment	29,321		29,321	
Corporate bonds	77,419		77,419	
Collateralized mortgage obligations:				
Agency backed	29,175		29,175	
Non-agency backed residential	6,557		6,557	
Non-agency backed commercial	7,116		7,116	
Total fixed maturities, available-for-sale	188,145	28,924	159,221	
Cash and cash equivalents	32,531	32,531		
Total	\$ 220,676	\$ 61,455	\$ 159,221	\$

The fair values of the Company's fixed maturities are determined by management after taking into consideration available sources of data. All of the portfolio valuations classified as Level 1 or Level 2 in the above table are priced exclusively by utilizing the services of independent pricing sources using observable market data. The Level 2 classified security valuations are obtained from a single independent pricing service. There were no transfers between Level 1 and Level 2 for the three and nine months ended March 31, 2010. The Company's policy is to recognize transfers between levels at the end of the reporting period. The Company has not made any adjustments to the prices obtained from the independent pricing sources.

The Company has reviewed the pricing techniques and methodologies of the independent pricing sources and believes that their policies adequately consider market activity, either based on specific transactions for the security valued or based on modeling of securities with similar credit quality, duration, yield and structure that were recently traded. The Company monitored security-specific valuation trends and discussed material changes or the absence of expected changes with the pricing sources to understand the underlying factors and inputs and to validate the reasonableness of the pricing.

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Based on the above categorization, the following tables represent the quantitative disclosure for those assets included in category Level 3 during the periods presented (in thousands).

**Fair Value Measurements Using
Significant Unobservable Inputs (Level 3)
Collateralized mortgage
obligations**

	Corporate bonds	Non-agency backed residential	Non-agency backed commercial	Total
Three Months Ended March 31, 2010:				
Balance at January 1, 2010	\$ 3,974	\$ 2,600	\$	\$ 6,574
Total gains or losses (realized or unrealized):				
Included in net income				
Included in other comprehensive income (loss)	(14)	82		68
Transfers into Level 3				
Transfers out of Level 3 ^(a)	(3,960)	(2,682)		(6,642)
Balance at March 31, 2010	\$	\$	\$	\$

**Fair Value Measurements Using
Significant Unobservable Inputs (Level 3)
Collateralized mortgage
obligations**

	Corporate bonds	Non-agency backed residential	Non-agency backed commercial	Total
Nine Months Ended March 31, 2010:				
Balance at July 1, 2009	\$	\$ 1,930	\$ 707	\$ 2,637
Total gains or losses (realized or unrealized):				
Included in net income				
Included in other comprehensive income (loss)		353	189	542
Transfers into Level 3				
Transfers out of Level 3 ^(a)		(2,283)	(896)	(3,179)
Balance at March 31, 2010	\$	\$	\$	\$

(a) Transferred from Level 3 to Level 2 as observable market data became available during the periods presented due to

the increase in
market activity
for these
securities.

Investment Income and Net Realized Gains and Losses

The major categories of investment income follow (in thousands).

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Fixed maturities, available-for-sale	\$ 2,138	\$ 2,451	\$ 6,331	\$ 7,664
Cash and cash equivalents	3	38	26	324
Other	29	29	87	87
Investment expenses	(162)	(108)	(490)	(334)
	\$ 2,008	\$ 2,410	\$ 5,954	\$ 7,741

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

The components of net realized gains (losses) on fixed maturities, available-for-sale are as follows (in thousands).

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Gains	\$ 7	\$ 2,531	\$ 326	\$ 2,592
Losses	(21)	(82)	(26)	(119)
Other-than-temporary impairment		(722)	(759)	(1,987)
	\$ (14)	\$ 1,727	\$ (459)	\$ 486

Realized gains and losses on sales of securities are computed based on specific identification. The non-credit related portion of other-than-temporary impairment (OTTI) charges is included in other comprehensive income (loss). The amounts of such charges taken for securities still owned were \$1.3 million for non-agency backed residential collateralized mortgage obligations (CMOs) and \$0.6 million for non-agency backed commercial CMOs at March 31, 2010 and \$0.6 million for non-agency backed residential CMOs and \$0.6 million for non-agency backed commercial CMOs at June 30, 2009.

Fixed Maturities, Available-for-Sale

The following tables summarize the Company s fixed maturity securities (in thousands).

March 31, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agencies	\$ 28,281	\$ 643	\$	\$ 28,924
State	7,474	352	(1)	7,825
Political subdivisions	1,790	55	(37)	1,808
Revenue and assessment	28,485	966	(130)	29,321
Corporate bonds	74,533	3,265	(379)	77,419
Collateralized mortgage obligations:				
Agency backed	27,575	1,600		29,175
Non-agency backed residential	7,280	39	(762)	6,557
Non-agency backed commercial	7,595	122	(601)	7,116
	\$ 183,013	\$ 7,042	\$ (1,910)	\$ 188,145

June 30, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agencies	\$ 10,744	\$ 473	\$ (37)	\$ 11,180
State	8,238	344	(19)	8,563
Political subdivisions	1,834	52	(32)	1,854
Revenue and assessment	27,816	831	(166)	28,481
Corporate bonds	45,737	1,654	(665)	46,726
Collateralized mortgage obligations:				
Agency backed	30,656	1,270		31,926

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Non-agency backed	residential	8,178	1	(2,561)	5,618
Non-agency backed	commercial	7,646		(1,683)	5,963
		\$ 140,849	\$ 4,625	\$ (5,163)	\$ 140,311

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

The following table sets forth the scheduled maturities of our fixed maturity securities at March 31, 2010 based on their fair values (in thousands). Actual maturities may differ from contractual maturities because certain securities may be called or prepaid by the issuers.

	Securities with Gross Unrealized Gains	Securities with Gross Unrealized Losses	Securities with No Gross Unrealized Gains or Losses	All Fixed Maturity Securities
One year or less	\$ 5,546	\$ 500	\$	\$ 6,046
After one through five years	84,701	189		84,890
After five through ten years	36,250	745		36,995
After ten years	6,424	10,942		17,366
No single maturity date	34,802	8,046		42,848
	\$ 167,723	\$ 20,422	\$	\$ 188,145

The following table reflects the number of securities with gross unrealized gains and losses. Gross unrealized losses are further segregated by the length of time that individual securities have been in a continuous unrealized loss position.

	Gross Unrealized Losses		Gross Unrealized Gains
	Less than or equal to 12 months	Greater than 12 months	
At:			
March 31, 2010	6	22	153
June 30, 2009	3	37	133

The following tables reflect the fair value and gross unrealized losses of those securities in a continuous unrealized loss position for greater than 12 months. Gross unrealized losses are further segregated by the percentage of amortized cost (in thousands, except number of securities).

Gross Unrealized Losses at March 31, 2010:	Number of Securities	Fair Value	Gross Unrealized Losses
Less than 10%	13	\$ 8,688	\$ (499)
Greater than 10%	9	3,375	(1,326)
	22	\$ 12,063	\$ (1,825)

Gross Unrealized Losses at June 30, 2009:	Number of Securities	Fair Value	Gross Unrealized Losses
Less than 10%	17	\$ 15,368	\$ (766)
Greater than 10%	20	8,970	(4,348)
	37	\$ 24,338	\$ (5,114)

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

The following tables set forth the amount of gross unrealized losses by current severity (as compared to amortized cost) and length of time that individual securities have been in a continuous unrealized loss position (in thousands).

Length of Gross Unrealized Losses	Fair Value of Securities with Gross Unrealized Losses	Gross Unrealized Losses	Severity of Gross Unrealized Losses		
			Less than 5%	5% to 10%	Greater than 10%
at March 31, 2010:					
Less than or equal to:					
Three months	\$ 7,681	\$ (74)	\$ (74)	\$	\$
Six months	153	(1)	(1)		
Nine months	525	(10)	(10)		
Twelve months					
Greater than twelve months	12,063	(1,825)	(42)	(457)	(1,326)
Total	\$ 20,422	\$ (1,910)	\$ (127)	\$ (457)	\$ (1,326)

Length of Gross Unrealized Losses	Fair Value of Securities with Gross Unrealized Losses	Gross Unrealized Losses	Severity of Gross Unrealized Losses		
			Less than 5%	5% to 10%	Greater than 10%
at June 30, 2009:					
Less than or equal to:					
Three months	\$	\$	\$	\$	\$
Six months	1,011	(38)	(38)		
Nine months					
Twelve months	533	(11)	(11)		
Greater than twelve months	24,338	(5,114)	(249)	(517)	(4,348)
Total	\$ 25,882	\$ (5,163)	\$ (298)	\$ (517)	\$ (4,348)

Other-Than-Temporary Impairment

Effective April 1, 2009, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320-10-65, *Recognition and Presentation of Other-Than-Temporary Impairments* (Prior authoritative literature: FASB Staff Position No. FAS 115-2) (FASB ASC 320-10-65). Under this guidance, the Company separates OTTI into the following two components: (i) the amount related to credit losses, which is recognized in the consolidated statement of operations, and (ii) the amount related to all other factors, which is recorded in other comprehensive income (loss). The credit-related portion of an OTTI is measured by comparing a security's amortized cost to the present value of its current expected cash flows discounted at its effective yield at the

date of acquisition.

The determination of whether unrealized losses are other-than-temporary requires judgment based on subjective as well as objective factors. The Company routinely monitors its fixed maturity portfolio for changes in fair value that might indicate potential impairments and performs detailed reviews on such securities. Changes in fair value are evaluated to determine the extent to which such changes are attributable to (i) fundamental factors specific to the issuer or (ii) market-related factors such as interest rates or sector declines.

Securities with declines attributable to issuer-specific fundamentals are reviewed to identify all available evidence to estimate the potential for impairment. Resources used include historical financial data included in filings with the Securities and Exchange Commission for corporate bonds and performance data regarding the underlying loans for CMOs. Securities with declines attributable solely to market or sector declines where the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before the full recovery of its amortized cost basis are not deemed to be other-than-temporary.

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

The issuer-specific factors considered in reaching the conclusion that securities with declines are not other-than-temporary include (i) the extent and duration of the decline in fair value, including the duration of any significant decline in value, (ii) whether the security is current as to payments of principal and interest, (iii) a valuation of any underlying collateral, (iv) current and future conditions and trends for both the business and its industry, (v) changes in cash flow assumptions for CMOs and (vi) rating agency actions. Based on these factors, the Company makes a determination as to the probability of recovering principal and interest on the security.

The number and amount of securities for which the Company has recorded OTTI are presented in the following tables (in thousands, except for the number of securities).

	Three Months Ended March 31,		2010		2009	
	Number of Securities	OTTI	Number of Securities	OTTI		
Corporate bonds		\$	1	\$ (150)		
Collateralized mortgage obligations:						
Non-agency backed residential			2	(419)		
Non-agency backed commercial			1	(153)		
		\$	4	\$ (722)		

	Nine Months Ended March 31,		2010		2009	
	Number of Securities	OTTI	Number of Securities	OTTI		
Corporate bonds		\$	3	\$ (871)		
Collateralized mortgage obligations:						
Non-agency backed residential	8	(759)	4	(702)		
Non-agency backed commercial			3	(414)		
	8	\$ (759)	10	\$ (1,987)		

Since the adoption of FASB ASC 320-10-65, the following is a progression of the credit-related portion of OTTI on fixed maturity securities owned at March 31, 2010 (in thousands).

	Three Months Ended March 31, 2010	Nine Months Ended March 31, 2010
Beginning balance	\$ (3,077)	\$ (2,870)
Additional credit impairments on:		
Previously impaired securities		(270)
Securities without previous impairments		(489)
		(759)

Reductions for securities sold				552
Balance at March 31, 2010	\$	(3,077)	\$	(3,077)

On a quarterly basis, the Company reviews cash flow estimates for certain non-agency backed CMOs of lesser credit quality following the guidance of FASB ASC 325-40-65, *Amendments to the Impairment Guidance of EITF Issue No. 99-20 (Prior authoritative literature: FSP EITF 99-20-1) (FASB ASC 325-40-65)*. Accordingly, when changes in estimated cash flows from the cash flows previously estimated occur due to actual or estimated prepayment or credit loss experience, and the present value of the revised cash flows is less than the present value previously estimated, OTTI is deemed to have occurred. For non-agency backed CMOs not subject to FASB ASC 325-40-65, the Company prepares quarterly projected cash flow analyses and recognizes OTTI when it determines that a loss is probable. The Company has recognized OTTI related to certain non-agency backed CMOs as the underlying cash flows have been adversely impacted due to a reduction in prepayments from mortgage refinancing and an increase in actual and projected delinquencies in the underlying mortgages.

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

The Company's review of non-agency backed CMOs included an analysis of available information such as collateral quality, anticipated cash flows, credit enhancements, default rates, loss severities, the securities' relative position in their respective capital structures, and credit ratings from statistical rating agencies. The Company reviews quarterly projected cash flow analyses for each security utilizing current assumptions regarding (i) actual and anticipated delinquencies, (ii) delinquency transition-to-default rates, and (iii) loss severities. Based on its quarterly reviews, the Company determined that there had not been an adverse change in projected cash flows, except in the case of those securities for which OTTI charges have been recorded. The Company believes that the unrealized losses on these securities are not necessarily predictive of the ultimate performance of the underlying collateral. The Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell these securities before the recovery of their amortized cost basis.

The OTTI charges on corporate bonds for the nine months ended March 31, 2009 were recorded as these bonds were considered to be impaired based on the extent and duration of the declines in their fair values and issuer-specific fundamentals relating to (i) poor operating results and weakened financial conditions, (ii) negative industry trends further impacted by the recent economic decline, and (iii) a series of downgrades to their credit ratings. Based on the factors that existed at the time of impairment, the Company did not believe that these bonds would recover their unrealized losses in the near future.

The Company believes that the remaining securities having unrealized losses at March 31, 2010 were not other-than-temporarily impaired. The Company also does not intend to sell any of these securities and it is more likely than not that the Company will not be required to sell any of these securities before the recovery of their amortized cost basis.

3. Net Income Per Share

The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share data).

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Net income	\$ 2,069	\$ 2,394	\$ 6,304	\$ 3,232
Weighted average common basic shares	47,994	47,673	47,943	47,662
Weighted average effect of dilutive securities	643	1,192	756	1,368
Weighted average common dilutive shares	48,637	48,865	48,699	49,030
Basic and diluted net income per share	\$ 0.04	\$ 0.05	\$ 0.13	\$ 0.07

For the three months ended March 31, 2010, options to purchase approximately 4.6 million shares of common stock with a dilutive effect of approximately 0.1 million shares and 0.5 million shares of unvested restricted common stock were included in the computation of diluted income per share. For the three months ended March 31, 2009, options to purchase approximately 5.3 million shares of common stock with a dilutive effect of approximately 0.7 million shares and 0.6 million shares of unvested restricted common stock were included in the computation of diluted income per share.

For the nine months ended March 31, 2010, options to purchase approximately 4.6 million shares of common stock with a dilutive effect of approximately 0.3 million shares and 0.5 million shares of unvested restricted common stock were included in the computation of diluted income per share. For the nine months ended March 31, 2009, options to

purchase approximately 5.3 million shares of common stock with a dilutive effect of approximately 0.9 million shares and 0.6 million shares of unvested restricted common stock were included in the computation of diluted income per share.

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
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4. Income Taxes

The provision for income taxes consisted of the following (in thousands).

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Federal:				
Current	\$	\$ 553	\$	\$ 525
Deferred		953		2,105
		1,506		2,630
State:				
Current	124	3	327	212
Deferred		88		282
	124	91	327	494
	\$ 124	\$ 1,597	\$ 327	\$ 3,124

The provision for income taxes differs from the amounts computed by applying the statutory federal corporate tax rate of 35% to income before income taxes as a result of the following (in thousands).

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Provision for income taxes at statutory rate	\$ 768	\$ 1,397	\$ 2,321	\$ 2,225
Tax effect of:				
Tax-exempt investment income	(4)	(5)	(12)	(12)
Change in the beginning of the period balance of the valuation allowance for deferred tax assets allocated to income taxes	(602)		(2,031)	
State income taxes, net of federal income tax benefit	(67)	90	11	420
Other	29	115	38	491
	\$ 124	\$ 1,597	\$ 327	\$ 3,124

The Company had a valuation allowance of \$20.9 million and \$24.9 million at March 31, 2010 and June 30, 2009, respectively, to reduce net deferred tax assets to the amount that is more likely than not to be realized, which included all net deferred tax assets at March 31, 2010 and June 30, 2009. For the nine months ended March 31, 2010, the change in the valuation allowance included the unrealized change on investments of \$2.0 million included in other comprehensive income (loss).

In assessing the realization of deferred tax assets, management considered whether it was more likely than not that some portion or all of the deferred tax assets will not be realized. The Company is required to assess whether a

valuation allowance should be established against the Company's net deferred tax assets based on the consideration of all available evidence using a more likely than not standard. In making such judgments, significant weight is given to evidence that can be objectively verified. In assessing the Company's ability to support the realizability of its deferred tax assets, management considered both positive and negative evidence. The Company placed greater weight on historical results than on the Company's outlook for future profitability and established a deferred tax valuation allowance against all net deferred tax assets at March 31, 2010 and June 30, 2009. The deferred tax valuation allowance may be adjusted in future periods if management considers that it is more likely than not that some portion or all of the deferred tax assets will be realized. In the event the deferred tax valuation allowance is adjusted, the Company would record an income tax benefit for the adjustment.

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5. Goodwill and Identifiable Intangible Assets

Goodwill and other identifiable intangible assets are attributable to the Company's insurance operations and were initially recorded at their estimated fair values at the date of acquisition. Goodwill and other intangible assets having an indefinite useful life are not amortized for financial statement purposes. The Company performs required annual impairment tests of its goodwill and intangible assets as of the last day of the fourth quarter of each fiscal year. In the event that facts and circumstances indicate that the goodwill and other identifiable intangible assets may be impaired, an interim impairment test would be required. Intangible assets with finite lives have been fully amortized over their useful lives.

The goodwill impairment test is a two-step process that requires management to make judgments in determining what assumptions to use in the calculation. The first step of the process consists of estimating the fair value of each reporting unit based on valuation techniques, including a discounted cash flow model using revenue and profit forecasts, and comparing those estimated fair values with the carrying values of those assets and liabilities, which includes the allocated goodwill. If the estimated fair value is less than the carrying value, a second step is performed to compute the amount of the impairment, if any, by determining an implied fair value of goodwill. The determination of the implied fair value of goodwill of a reporting unit requires the Company to allocate the estimated fair value of the reporting unit to the assets and liabilities of the reporting unit. Any unallocated fair value represents the implied fair value of goodwill, which is compared to its corresponding carrying value.

As a result of the adverse impact of difficult economic conditions on the Company's customers and business and the resulting decline in its share price during the fourth quarter of fiscal year 2009, the Company estimated that a goodwill impairment was probable. Accordingly, the Company recognized an estimated non-cash, pre-tax goodwill impairment charge of \$68.0 million in the fourth quarter of fiscal year 2009. Due to the complexity of the fair value calculations involved, the analysis of the goodwill impairment charge recognized during the fourth quarter of fiscal year 2009 was finalized during the first quarter of fiscal year 2010 and the amount of the impairment did not differ from the initial estimate.

The Company's evaluation includes multiple assumptions, including estimated discounted cash flows and other estimates that may change over time. If future discounted cash flows become less than those projected by the Company, further impairment charges may become necessary that could have a materially adverse impact on the Company's results of operations and financial condition. As quoted market prices in active stock markets are relevant evidence of fair value, a significant decline in the Company's common stock trading price may indicate an impairment of goodwill.

6. Litigation

The Company is named as a defendant in various lawsuits, arising in the ordinary course of business, generally relating to its insurance operations. All legal actions relating to claims made under insurance policies are considered by the Company in establishing its loss and loss adjustment expense reserves. The Company also faces lawsuits that seek damages beyond policy limits, commonly known as bad faith claims, as well as class action and individual lawsuits that involve issues arising in the course of the Company's business. The Company continually evaluates potential liabilities and reserves for litigation of these types using the criteria established by FASB ASC 450-20, *Loss Contingencies (Prior authoritative literature: FASB Statement No. 5)* (FASB ASC 450-20). Pursuant to FASB ASC 450-20, reserves for a loss may only be recognized if the likelihood of occurrence is probable and the amount can be reasonably estimated. If a loss, while not probable, is judged to be reasonably possible, management will disclose, if it can be estimated, a possible range of loss or state that an estimate cannot be made. Management evaluates each legal action and records reserves for losses as warranted by establishing a reserve in its consolidated balance sheets in loss and loss adjustment expense reserves for bad faith claims and in other liabilities for other lawsuits. Amounts incurred are recorded in the Company's consolidated statements of operations in losses and loss adjustment expenses for bad faith claims and in insurance operating expenses for other lawsuits unless otherwise disclosed.

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The Company has established an accrual for losses related to the litigation settlements entered into during fiscal year 2009 related to litigation brought against the Company in Alabama and Georgia with respect to its sales practices, primarily the sale of ancillary motor club memberships currently or formerly sold in those states. Pursuant to the terms of the settlements, eligible class members are entitled to certain premium credits towards a future automobile insurance policy with the Company or a reimbursement certificate for future rental or towing expenses. Benefits to the Georgia and Alabama class members commenced January 1, 2009 and March 7, 2009, respectively. Any premium credits issued to class members as described above will be prorated over a twelve-month term not to extend beyond August 2011, and the class member will be entitled to the prorated premium credit only so long as their insurance premiums remain current during the twelve-month term.

At December 31, 2008, the Company accrued \$5.2 million for premium credits available to class members who were actively insured by the Company. The following is a progression of the activity associated with the estimated premium credit liability (in thousands).

Balance at December 31, 2008	\$ 5,227
Credits utilized	(1,338)
Credits forfeited	(904)
Balance at June 30, 2009	2,985
Credits utilized	(2,482)
Credits forfeited	(269)
Balance at March 31, 2010	\$ 234

The Company has not established an accrual for \$0.3 million in potential premium credits available to class members who were not actively insured by the Company upon commencement of the settlement due to the uncertainty associated with this group having to purchase a new automobile insurance policy. Based on experience to date, the Company does not expect any significant costs associated with the reimbursement certificates. The final costs of the settlements will depend on, among other factors, the rate of redemption and forfeiture of the premium credits and reimbursement certificates.

The litigation settlement costs are classified in the litigation settlement expenses line item in the Company's consolidated statements of operations. The litigation settlement accrual for those currently estimable costs associated with the utilization of premium credits is classified in other liabilities in the Company's consolidated balance sheets. Management intends to adjust the estimated accrual as necessary during future periods to account for the impact of the actual rate of redemption and forfeiture of the premium credits and reimbursement certificates.

The Company received \$2.95 million in July 2009 from its insurance carrier regarding coverage for the costs and expenses incurred by the Company relating to the settlement of the Georgia and Alabama litigation. The insurance recovery was accrued in fiscal year 2009 and is included in other assets in the Company's consolidated balance sheet at June 30, 2009.

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
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(Unaudited)

7. Fair Value of Financial Instruments

The carrying values and fair values of certain of the Company's financial instruments were as follows (in thousands).

	March 31, 2010		June 30, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Fixed maturities, available-for-sale	\$188,145	\$188,145	\$140,311	\$140,311
Cash and cash equivalents	32,531	32,531	77,201	77,201
Premiums and fees receivable, net	49,777	49,777	45,309	45,309
Liabilities:				
Debentures payable	41,240	21,673	41,240	15,568

The fair values as presented represent the Company's best estimates and may not be substantiated by comparisons to independent markets. The fair value of the debentures payable was based on current market rates offered for debt with similar risks and maturities. Certain financial instruments and all non-financial instruments are not required to be disclosed. Therefore, the aggregate fair values presented in the table do not purport to represent the Company's underlying value.

8. Segment Information

The Company operates in two business segments with its primary focus being the selling, servicing and underwriting of non-standard personal automobile insurance. The real estate and corporate segment consists of the activities related to the disposition of foreclosed real estate held for sale, interest expense associated with debt and other general corporate overhead expenses.

The following table presents selected financial data by business segment (in thousands).

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2010	2009	2010	2009
Revenues:				
Insurance	\$ 56,087	\$ 67,068	\$ 167,114	\$ 203,671
Real estate and corporate	29	29	89	95
Consolidated total	\$ 56,116	\$ 67,097	\$ 167,203	\$ 203,766
Income before income taxes:				
Insurance	\$ 3,609	\$ 5,729	\$ 11,645	\$ 11,930
Real estate and corporate	(1,416)	(1,738)	(5,014)	(5,574)
Consolidated total	\$ 2,193	\$ 3,991	\$ 6,631	\$ 6,356

	March 31, 2010	June 30, 2009
Total assets:		

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Insurance	\$ 351,636	\$ 348,801
Real estate and corporate	12,091	10,155
Consolidated total	\$ 363,727	\$ 358,956

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

9. Recent Accounting Pronouncements

In June 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-01, *Generally Accepted Accounting Principles (Topic 105)* (FASB ASU No. 2009-01), which established the FASB Accounting Standards Codification as the single source of authoritative accounting principles recognized by the FASB. This codification did not create new accounting and reporting standards but organized their structure and required the Company to update all existing U.S. generally accepted accounting principles references to the new codification references for all future filings. The Company adopted the provisions of FASB ASU No. 2009-01 in the quarter ended September 30, 2009.

In August 2009, the FASB issued ASU No. 2009-05, *Measuring Liabilities at Fair Value (Topic 820)* (FASB ASU No. 2009-05), which amends FASB ASC 820, *Fair Value Measurements and Disclosures (Prior authoritative literature: FASB SFAS No. 157)*, by clarifying that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using a valuation technique that uses either the quoted price of the identical liability when traded as an asset or quoted prices for similar liabilities when traded as assets. The Company adopted the provisions of FASB ASU No. 2009-05 upon issuance. The adoption did not have an impact on the Company's results of operations or financial condition.

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures about Fair Value Measurements (Topic 820)* (FASB ASU No. 2010-06), which amends FASB ASC 820, *Fair Value Measurements and Disclosures (Prior authoritative literature: FASB SFAS No. 157)*, to require additional disclosures regarding fair value measurements. The Company adopted the provisions of FASB ASU No. 2010-06 in the quarter ended March 31, 2010. The adoption did not have an impact on the Company's results of operations or financial condition.

Table of Contents**FIRST ACCEPTANCE CORPORATION 10-Q****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements which involve risks and uncertainties. Our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a difference include those discussed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended June 30, 2009. The following discussion should be read in conjunction with our consolidated financial statements included in this report and our consolidated financial statements and related Management's Discussion and Analysis of Financial Condition and Results of Operations for the fiscal year ended June 30, 2009 included in our Annual Report on Form 10-K.

General

At March 31, 2010, we leased and operated 405 retail locations (or stores) staffed by employee-agents who primarily sell non-standard private passenger automobile insurance products underwritten by us as well as certain commissionable ancillary products. In certain states, our employee-agents also sell other complementary insurance products underwritten by us. At March 31, 2010, we wrote non-standard personal automobile insurance in 12 states and were licensed in 13 additional states. See the discussion in Item 1. Business General in our Annual Report on Form 10-K for the fiscal year ended June 30, 2009 for additional information with respect to our business.

The following table shows the change in the number of our retail locations for the periods presented. Retail location counts are based upon the date that a location commenced or ceased writing business.

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Retail locations beginning of period	409	424	418	431
Opened				1
Closed	(4)	(5)	(13)	(13)
Retail locations end of period	405	419	405	419

The following table shows the number of our retail locations by state.

	March 31,		December 31,		June 30,	
	2010	2009	2009	2008	2009	2008
Alabama	25	25	25	25	25	25
Florida	34	39	34	39	39	40
Georgia	61	61	61	61	61	61
Illinois	75	80	76	81	78	80
Indiana	18	18	18	18	18	19
Mississippi	8	8	8	8	8	8
Missouri	12	12	12	12	12	14
Ohio	27	27	27	28	27	29
Pennsylvania	17	17	17	18	17	19
South Carolina	26	27	27	27	27	28
Tennessee	19	20	19	20	20	20
Texas	83	85	85	87	86	88
Total	405	419	409	424	418	431

Table of Contents**FIRST ACCEPTANCE CORPORATION 10-Q****Consolidated Results of Operations****Overview**

Our primary focus is the selling, servicing and underwriting of non-standard personal automobile insurance. Our real estate and corporate segment consists of activities related to the disposition of real estate held for sale, interest expense associated with debt, and other general corporate overhead expenses. Our insurance operations generate revenues from selling, servicing and underwriting non-standard personal automobile insurance policies in 12 states. We conduct our underwriting operations through three insurance company subsidiaries: First Acceptance Insurance Company, Inc., First Acceptance Insurance Company of Georgia, Inc. and First Acceptance Insurance Company of Tennessee, Inc. Our insurance revenues are primarily generated from:

premiums earned, including policy and renewal fees, from sales of policies written and assumed by our insurance company subsidiaries;

commission and fee income, including installment billing fees on policies written and assumed, agency fees and commissions and fees for other ancillary products and services; and

investment income earned on the invested assets of the insurance company subsidiaries.

The following table presents premiums earned by state (in thousands).

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Premiums earned:				
Georgia	\$ 9,918	\$ 12,273	\$ 30,780	\$ 38,045
Texas	6,233	6,459	17,858	19,593
Illinois	6,076	6,736	18,482	20,923
Florida	5,307	6,382	15,502	20,194
Alabama	4,727	5,845	14,645	18,305
Ohio	3,223	3,182	9,085	9,815
Tennessee	2,925	3,650	8,883	11,865
South Carolina	2,847	4,219	8,712	14,160
Pennsylvania	2,569	2,883	7,998	8,455
Indiana	1,266	1,359	3,699	4,221
Missouri	834	939	2,443	3,023
Mississippi	726	918	2,230	2,907
Total premiums earned	\$ 46,651	\$ 54,845	\$ 140,317	\$ 171,506

The following table presents the change in the total number of policies in force for the insurance operations. Policies in force increase as a result of new policies issued and decrease as a result of policies that are canceled or expire and are not renewed.

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Policies in force beginning of period	147,090	159,557	158,222	194,079
Net increase (decrease) during period	22,513	14,117	11,381	(20,405)
Policies in force end of period	169,603	173,674	169,603	173,674

Insurance companies present a combined ratio as a measure of their overall underwriting profitability. The components of the combined ratio are as follows.

Loss Ratio Loss ratio is the ratio (expressed as a percentage) of losses and loss adjustment expenses incurred to premiums earned and is a basic element of underwriting profitability. We calculate this ratio based on all direct and assumed premiums earned.

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Expense Ratio Expense ratio is the ratio (expressed as a percentage) of insurance operating expenses to premiums earned. Insurance operating expenses are reduced by commission and fee income from insureds. This is a measurement that illustrates relative management efficiency in administering our operations.

Combined Ratio Combined ratio is the sum of the loss ratio and the expense ratio. If the combined ratio is at or above 100%, an insurance company cannot be profitable without sufficient investment income.

The following table presents the loss, expense and combined ratios for our insurance operations.

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Loss and loss adjustment expense	68.4%	71.0%	67.6%	70.1%
Expense	27.1%	25.3%	27.1%	23.9%
Combined	95.5%	96.3%	94.7%	94.0%

The non-standard personal automobile insurance industry is cyclical in nature. Likewise, adverse economic conditions impact our customers and many will choose to reduce their coverage or go uninsured during a weak economy. In the past, the industry has been characterized by periods of price competition and excess capacity followed by periods of high premium rates and shortages of underwriting capacity. If new competitors enter this market, existing competitors may attempt to increase market share by lowering rates. Such conditions could lead to reduced prices, which would negatively impact our revenues and profitability.

Investments

We use the services of an independent investment manager to manage our fixed maturities investment portfolio. The investment manager conducts, in accordance with our investment policy, all of the investment purchases and sales for our insurance company subsidiaries. Our investment policy has been established by the Investment Committee of our Board of Directors and specifically addresses overall investment goals and objectives, authorized investments, prohibited securities, restrictions on sales by the investment manager and guidelines as to asset allocation, duration and credit quality. This policy currently does not allow investments in equity securities. Management and the Investment Committee meet regularly with our investment manager to review the performance of the portfolio and compliance with our investment guidelines.

The invested assets of the insurance company subsidiaries consist substantially of marketable, investment grade, U.S. government securities, municipal bonds, corporate bonds and collateralized mortgage obligations (CMOs). We also invest a portion of the portfolio in certain securities issued by political subdivisions, which enable our insurance company subsidiaries to obtain premium tax credits. Investment income is comprised primarily of interest earned on these securities, net of related investment expenses. Realized gains and losses may occur from time to time as changes are made to our holdings based upon changes in interest rates or the credit quality of specific securities.

The value of our consolidated investment portfolio was \$188.1 million at March 31, 2010 and consisted of fixed maturity securities, all carried at fair value with unrealized gains and losses reported as a separate component of stockholders' equity on an after-tax basis. At March 31, 2010, we had gross unrealized gains of \$7.0 million and gross unrealized losses of \$1.9 million.

At March 31, 2010, 94.7% of the fair value of our investment portfolio was rated investment grade (a credit rating of AAA to BBB) by nationally recognized rating organizations. The average credit rating of our fixed maturity portfolio was AA at March 31, 2010. Investment grade securities generally bear lower yields and have lower degrees of risk than those that are unrated or non-investment grade. We believe that a high quality investment portfolio is more likely to generate a stable and predictable investment return.

Investments in CMOs had a fair value of \$42.8 million at March 31, 2010 and represented 23% of our fixed maturity portfolio. At March 31, 2010, 93% of our CMOs were considered investment grade by the nationally recognized rating agencies. In addition, 83% of our CMOs were rated AAA and 68% of our CMOs were backed by

agencies of the United States government. Of the non-agency backed CMOs, 46% were rated AAA.

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The following table summarizes our fixed maturity securities at March 31, 2010 (in thousands).

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agencies	\$ 28,281	\$ 643	\$	\$ 28,924
State	7,474	352	(1)	7,825
Political subdivisions	1,790	55	(37)	1,808
Revenue and assessment	28,485	966	(130)	29,321
Corporate bonds	74,533	3,265	(379)	77,419
Collateralized mortgage obligations:				
Agency backed	27,575	1,600		29,175
Non-agency backed residential	7,280	39	(762)	6,557
Non-agency backed commercial	7,595	122	(601)	7,116
	\$ 183,013	\$ 7,042	\$ (1,910)	\$ 188,145

The following table sets forth the scheduled maturities of our fixed maturity securities at March 31, 2010 based on their fair values (in thousands). Actual maturities may differ from contractual maturities because certain securities may be called or prepaid by the issuers.

	Securities with Gross Unrealized Gains	Securities with Gross Unrealized Losses	Securities with No Gross Unrealized Gains or Losses	All Fixed Maturity Securities
One year or less	\$ 5,546	\$ 500	\$	\$ 6,046
After one through five years	84,701	189		84,890
After five through ten years	36,250	745		36,995
After ten years	6,424	10,942		17,366
No single maturity date	34,802	8,046		42,848
	\$ 167,723	\$ 20,422	\$	\$ 188,145

Other-Than-Temporary Impairment

Effective April 1, 2009, we adopted the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320-10-65, *Recognition and Presentation of Other-Than-Temporary Impairments* (Prior authoritative literature: FASB Staff Position No. FAS 115-2). Under this guidance, we separate other-than-temporary impairment (OTTI) into the following two components: (i) the amount related to credit losses, which is recognized in the consolidated statement of operations, and (ii) the amount related to all other factors, which is recorded in other comprehensive income (loss). The credit-related portion of an OTTI is measured by comparing a security's amortized cost to the present value of its current expected cash flows discounted at its effective yield at the date of acquisition.

The determination of whether unrealized losses are other-than-temporary requires judgment based on subjective as well as objective factors. We routinely monitor our fixed maturity portfolio for changes in fair value that might indicate potential impairments and perform detailed reviews on such securities. Changes in fair value are evaluated to

determine the extent to which such changes are attributable to (i) fundamental factors specific to the issuer or (ii) market-related factors such as interest rates or sector declines.

Securities with declines attributable to issuer-specific fundamentals are reviewed to identify all available evidence to estimate the potential for impairment. Resources used include historical financial data included in filings with the Securities and Exchange Commission for corporate bonds and performance data regarding the underlying loans for CMOs. Securities with declines attributable solely to market or sector declines where we do not intend to sell the security and it is more likely than not that we will not be required to sell the security before the full recovery of its amortized cost basis are not deemed to be other-than-temporary.

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The issuer-specific factors considered in reaching the conclusion that securities with declines are not other-than-temporary include (i) the extent and duration of the decline in fair value, including the duration of any significant decline in value, (ii) whether the security is current as to payments of principal and interest, (iii) a valuation of any underlying collateral, (iv) current and future conditions and trends for both the business and its industry, (v) changes in cash flow assumptions for CMOs and (vi) rating agency actions. Based on these factors, we make a determination as to the probability of recovering principal and interest on the security.

On a quarterly basis, we review cash flow estimates for certain non-agency backed CMOs of lesser credit quality following the guidance of FASB ASC 325-40-65, *Amendments to the Impairment Guidance of EITF Issue No. 99-20 (Prior authoritative literature: FSP EITF 99-20-1)* (FASB ASC 325-40-65). Accordingly, when changes in estimated cash flows from the cash flows previously estimated occur due to actual or estimated prepayment or credit loss experience, and the present value of the revised cash flows is less than the present value previously estimated, OTTI is deemed to have occurred. For non-agency backed CMOs not subject to FASB ASC 325-40-65, we prepare quarterly projected cash flow analyses and recognize OTTI when it is determined that a loss is probable. We have recognized OTTI related to certain non-agency backed CMOs as the underlying cash flows have been adversely impacted due to a reduction in prepayments from mortgage refinancing and an increase in actual and projected delinquencies in the underlying mortgages.

Our review of non-agency backed CMOs included an analysis of available information such as collateral quality, anticipated cash flows, credit enhancements, default rates, loss severities, the securities' relative position in their respective capital structures, and credit ratings from statistical rating agencies. We review quarterly projected cash flow analyses for each security utilizing current assumptions regarding (i) actual and anticipated delinquencies, (ii) delinquency transition-to-default rates, and (iii) loss severities. Based on our quarterly reviews, we determined that there had not been an adverse change in projected cash flows, except in the case of those securities previously discussed in Note 2 to our consolidated financial statements which incurred OTTI charges of \$0.8 million for the nine months ended March 31, 2010. We believe that the unrealized losses on these securities are not necessarily predictive of the ultimate performance of the underlying collateral. We do not intend to sell these securities and it is more likely than not that we will not be required to sell these securities before the recovery of their amortized cost basis.

The OTTI charges on corporate bonds for the nine months ended March 31, 2009 were recorded as these bonds were considered to be impaired based on the extent and duration of the declines in their fair values and issuer-specific fundamentals relating to (i) poor operating results and weakened financial conditions, (ii) negative industry trends further impacted by the recent economic decline, and (iii) a series of downgrades to their credit ratings. Based on the factors that existed at the time of impairment, we did not believe that these bonds would recover their unrealized losses in the near future.

We believe that the remaining securities having unrealized losses at March 31, 2010 were not other-than-temporarily impaired. We also do not intend to sell any of these securities and it is more likely than not that we will not be required to sell any of these securities before the recovery of their amortized cost basis.

Three and Nine Months Ended March 31, 2010 Compared with the Three and Nine Months Ended March 31, 2009

Consolidated Results

Revenues for the three months ended March 31, 2010 decreased 16% to \$56.1 million from \$67.1 million in the same period in the prior year. Income before income taxes for the three months ended March 31, 2010 was \$2.2 million, compared with \$4.0 million for the three months ended March 31, 2009. Net income for the three months ended March 31, 2010 was \$2.1 million, compared with \$2.4 million for the three months ended March 31, 2009. Basic and diluted net income per share was \$0.04 for the three months ended March 31, 2010, compared with \$0.05 for the three months ended March 31, 2009.

Revenues for the nine months ended March 31, 2010 decreased 18% to \$167.2 million from \$203.8 million in the same period in the prior year. Income before income taxes for the nine months ended March 31, 2010 was \$6.6 million, compared with \$6.4 million for the nine months ended March 31, 2009. Net income for the nine months ended March 31, 2010 was \$6.3 million, compared with \$3.2 million for the nine months ended March 31, 2009.

Basic and diluted net income per share was \$0.13 for the nine months ended March 31, 2010, compared with \$0.07 for the nine months ended March 31, 2009.

Table of Contents**FIRST ACCEPTANCE CORPORATION 10-Q*****Insurance Operations***

Revenues from insurance operations were \$56.1 million for the three months ended March 31, 2010, compared with \$67.1 million for the three months ended March 31, 2009. For the nine months ended March 31, 2010, revenues from insurance operations were \$167.1 million, compared with \$203.7 million for the nine months ended March 31, 2009.

Income before income taxes from insurance operations for the three months ended March 31, 2010 was \$3.6 million, compared with \$5.7 million for the three months ended March 31, 2009. Income before income taxes from insurance operations for the nine months ended March 31, 2010 was \$11.6 million, compared with \$11.9 million for the nine months ended March 31, 2009.

Premiums Earned

Premiums earned decreased by \$8.2 million, or 15%, to \$46.7 million for the three months ended March 31, 2010, from \$54.8 million for the three months ended March 31, 2009. For the nine months ended March 31, 2010, premiums earned decreased by \$31.2 million, or 18%, to \$140.3 million from \$171.5 million for the nine months ended March 31, 2009. The decreases in premiums earned were primarily due to the weak economic conditions, which have caused both a decline in the number of policies written, as well as an increase in the percentage of our customers purchasing liability-only coverage. The closure of underperforming stores also contributed to the decrease in policies written and premiums earned. Approximately 72% of the \$8.2 million decline in premiums earned for the three months ended March 31, 2010 and 68% of the \$31.2 million decline in premiums earned for the nine months ended March 31, 2010 were in our Alabama, Florida, Georgia and South Carolina markets.

The number of policies in force at March 31, 2010 decreased 2% over the same date in 2009 from 173,674 to 169,603, due to the factors noted above. At March 31, 2010, we operated 405 stores, compared with 419 stores at March 31, 2009.

Commission and Fee Income

Commission and fee income decreased 8% to \$7.5 million for the three months ended March 31, 2010, from \$8.1 million for the three months ended March 31, 2009. For the nine months ended March 31, 2010, commission and fee income decreased 11% to \$21.4 million from \$24.0 million for the nine months ended March 31, 2009. The decreases in commission and fee income were a result of the decrease in the number of policies in force, partially offset by higher fee income related to commissionable ancillary products sold through our retail locations.

Investment Income

Investment income decreased to \$2.0 million during the three months ended March 31, 2010 from \$2.4 million during the three months ended March 31, 2009. For the nine months ended March 31, 2010, investment income decreased to \$6.0 million from \$7.7 million during the nine months ended March 31, 2009. These decreases were primarily a result of the sale of fixed maturity investments in fiscal year 2009 to generate taxable income to utilize expiring net operating losses and the reduced yields obtained on reinvestment. At March 31, 2010 and 2009, the tax-equivalent book yield for our portfolio was 4.2% and 3.8%, respectively, with effective durations of 3.36 and 2.45 years, respectively.

Table of Contents**FIRST ACCEPTANCE CORPORATION 10-Q***Net realized gains (losses) on fixed maturities, available-for-sale*

Net realized losses on fixed maturities, available-for-sale during the three months ended March 31, 2010 consisted of net realized losses on sales of securities. For the three months ended March 31, 2009, net realized gains on fixed maturities, available-for-sale included \$2.4 million of net realized gains on sales of securities and \$0.7 million of charges related to OTTI.

For the nine months ended March 31, 2010, net realized losses on fixed maturities, available-for-sale included \$0.3 million in net realized gains on sales of securities and \$0.8 million of charges related to OTTI on certain non-agency backed CMOs. Net realized gains on fixed maturities, available-for-sale during the nine months ended March 31, 2009 included \$2.5 million of net realized gains on sales of securities and \$2.0 million of charges related to OTTI.

Loss and Loss Adjustment Expenses

The loss and loss adjustment expense ratio was 68.4% for the three months ended March 31, 2010, compared with 71.0% for the three months ended March 31, 2009. The loss and loss adjustment expense ratio was 67.6% for the nine months ended March 31, 2010, compared with 70.1% for the nine months ended March 31, 2009. For the three months ended March 31, 2010, we experienced favorable development related to prior periods of \$4.1 million, compared with \$2.7 million for the three months ended March 31, 2009. For the nine months ended March 31, 2010, we experienced favorable development related to prior periods of \$10.2 million, compared with \$6.9 million for the nine months ended March 31, 2009.

Excluding favorable development related to prior periods, the loss and loss adjustment expense ratios for the three months ended March 31, 2010 and 2009 were 77.2% and 75.9%, respectively, and the loss and loss adjustment expense ratios for the nine months ended March 31, 2010 and 2009 were 74.9% and 74.1%, respectively. The favorable development for the nine months ended March 31, 2010 and 2009 was due to lower than anticipated severity and frequency of accidents in addition to improvement in our claim handling practices.

Operating Expenses

Insurance operating expenses decreased 9% to \$20.1 million for the three months ended March 31, 2010 from \$22.0 million for the three months ended March 31, 2009. For the nine months ended March 31, 2010, insurance operating expenses decreased 9% to \$59.4 million from \$65.0 million for the nine months ended March 31, 2009. The decreases were primarily a result of a reduction in costs (such as employee-agent commissions and premium taxes) that varied along with the decrease in premiums earned as well as savings realized from the closure of underperforming stores.

The expense ratio increased from 25.3% for the three months ended March 31, 2009 to 27.1% for the same period in the current fiscal year. The expense ratio increased from 23.9% for the nine months ended March 31, 2009 to 27.1% for the same period in the current fiscal year. The year-over-year increase in the expense ratio was due to the decrease in premiums earned, which resulted in a higher percentage of fixed expenses in our retail operations (such as rent and base salary).

Overall, the combined ratio was 95.5% for the three months ended March 31, 2010, compared with 96.3% for the three months ended March 31, 2009. For the nine months ended March 31, 2010, the combined ratio was 94.7%, compared with 94.0% for the nine months ended March 31, 2009.

Litigation Settlement

Litigation settlement costs for the three months ended March 31, 2010 were \$(35) thousand, compared with \$(0.1) million for the same period in the prior fiscal year. For the nine months ended March 31, 2010, litigation settlement costs were \$(0.3) million, compared with \$5.2 million for the same period in the prior fiscal year. The reduction in expense during the three and nine months ended March 31, 2010 included the forfeiture of premium credits by Georgia and Alabama class members. The costs during the nine months ended March 31, 2009 were incurred in connection with our settlement and defense of the litigation as described further in Note 6 to our consolidated financial statements.

Table of Contents**FIRST ACCEPTANCE CORPORATION 10-Q**

Pursuant to the terms of the settlements, eligible class members are entitled to certain premium credits towards a future automobile insurance policy with the Company or a reimbursement certificate for future rental or towing expenses. Benefits to the Georgia and Alabama class members commenced January 1, 2009 and March 7, 2009, respectively. Any premium credits issued to class members as described above will be prorated over a twelve-month term not to extend beyond August 2011, and the class member will be entitled to the prorated premium credit only so long as their insurance premiums remain current during the twelve-month term.

At December 31, 2008, we accrued \$5.2 million for premium credits available to class members who were actively insured by the Company. The following is a progression of the activity associated with the estimated premium credit liability (in thousands).

Balance at December 31, 2008	\$ 5,227
Credits utilized	(1,338)
Credits forfeited	(904)
Balance at June 30, 2009	2,985
Credits utilized	(2,482)
Credits forfeited	(269)
Balance at March 31, 2010	\$ 234

We have not established an accrual for \$0.3 million in potential premium credits available to class members who were not actively insured by the Company upon commencement of the settlement due to the uncertainty associated with this group having to purchase a new automobile insurance policy. Based on experience to date, we do not expect any significant costs associated with the reimbursement certificates. The final costs of the settlements will depend on, among other factors, the rate of redemption and forfeiture of the premium credits and reimbursement certificates.

The litigation settlement costs are classified in the litigation settlement expenses line item in our consolidated statements of operations. The litigation settlement accrual for those currently estimable costs associated with the utilization of premium credits is classified in other liabilities in our consolidated balance sheets. We intend to adjust the estimated accrual as necessary during future periods to account for the impact of actual rate of redemption and forfeiture of the premium credits and reimbursement certificates. For additional information with respect to the litigation settlements, see Note 6 to our consolidated financial statements.

Provision for Income Taxes

The provision for income taxes for the three months ended March 31, 2010 was \$0.1 million, compared with \$1.6 million for the same period in the prior fiscal year. For the nine months ended March 31, 2010, the provision for income taxes was \$0.3 million, compared with \$3.1 million for the same period in the prior fiscal year. The provision for income taxes for the three and nine months ended March 31, 2010 related to current state income taxes for certain subsidiaries with taxable income. At March 31, 2010 and June 30, 2009, we established a full valuation allowance against all net deferred tax assets. In assessing our ability to support the realizability of our deferred tax assets, we considered both positive and negative evidence. We placed greater weight on historical results than on our outlook for future profitability. The deferred tax valuation allowance may be adjusted in future periods if we consider that it is more likely than not that some portion or all of the deferred tax assets will be realized. In the event the deferred tax valuation allowance is adjusted, we would record an income tax benefit for the adjustment.

Real Estate and Corporate

Loss before income taxes from real estate and corporate operations for the three months ended March 31, 2010 was \$1.4 million, compared with a loss before income taxes from real estate and corporate operations of \$1.7 million for the three months ended March 31, 2009. Loss before income taxes from real estate and corporate operations for the nine months ended March 31, 2010 was \$5.0 million, compared with a loss before income taxes from real estate and corporate operations of \$5.6 million for the nine months ended March 31, 2009. Segment losses consist of other

operating expenses not directly related to our insurance operations, interest expense and stock-based compensation offset by investment income on corporate invested assets.

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We incurred \$1.0 million and \$2.9 million, respectively, of interest expense during both the three and nine months ended March 31, 2010 and 2009 related to the debentures issued in June 2007. During the nine months ended March 31, 2009, we incurred \$0.2 million of interest expense in connection with borrowings under our former credit facility. The credit facility was repaid in full and terminated on October 31, 2008.

Liquidity and Capital Resources

Our primary sources of funds are premiums, fees and investment income from our insurance company subsidiaries and commissions and fee income from our non-insurance company subsidiaries. Our primary uses of funds are the payment of claims and operating expenses. Net cash used in operating activities for the nine months ended March 31, 2010 and 2009 was \$0.4 million and \$4.2 million, respectively. Net cash used in operating activities for both periods was primarily the result of a decrease in cash collected from premiums written. Net cash used in investing activities for the nine months ended March 31, 2010 was \$44.2 million, compared with net cash provided by investment activities of \$44.1 million for the same period in the prior fiscal year. The nine months ended March 31, 2010 included net additions in our investment portfolio of \$43.0 million, while the same period in the prior fiscal year included net reductions in our investment portfolio of \$45.8 million. The net additions in the current fiscal year were primarily the result of the reinvestment of the proceeds from the prior fiscal year sales of fixed maturity investments to generate taxable income to utilize expiring net operating losses. Financing activities for the nine months ended March 31, 2009 included principal prepayments made on our former credit facility of \$3.9 million.

Our holding company requires cash for general corporate overhead expenses and for debt service related to our debentures payable. The holding company's primary sources of unrestricted cash to meet its obligations are dividends from our insurance company subsidiaries and the sale of ancillary products to our insureds. The holding company also receives cash from operating activities as a result of investment income. Through an intercompany tax allocation arrangement, taxable losses of the holding company provide cash to the holding company to the extent that taxable income is generated by the insurance company subsidiaries. At March 31, 2010, we had \$8.4 million available in unrestricted cash and investments outside of the insurance company subsidiaries. These funds and the additional unrestricted cash from the sources noted above will be used to pay our future cash requirements outside of the insurance company subsidiaries.

The holding company has debt service requirements related to the debentures payable. The debentures are interest-only and mature in full in July 2037. Interest is fixed annually through July 2012 at \$3.9 million. The debentures pay a fixed rate of 9.277% until July 30, 2012, after which time the rate becomes variable (LIBOR plus 375 basis points).

State insurance laws limit the amount of dividends that may be paid from our insurance company subsidiaries. Based on our statutory capital and surplus, we believe our ordinary dividend capacity for the next twelve months will be approximately \$12 million.

The National Association of Insurance Commissioners Model Act for risk-based capital provides formulas to determine the amount of statutory capital and surplus that an insurance company needs to ensure that it has an acceptable expectation of not becoming financially impaired. There are statutory guidelines that suggest that on an annual calendar year basis, the insurance company subsidiaries should not exceed a ratio of net premiums written to statutory capital and surplus of 3-to-1. Based on our current forecast of statutory capital and surplus and net premiums written, we anticipate our ratio will be approximately 2-to-1 for the reasonably foreseeable future.

We believe that existing cash and investment balances, when combined with anticipated cash flows as noted above, will be adequate to meet our expected liquidity needs, for both the holding company and our insurance company subsidiaries, in both the short-term and the reasonably foreseeable future. Any future growth strategy may require external financing, and we may from time to time seek to obtain external financing. We cannot assure that additional sources of financing will be available to us on favorable terms, or at all, or that any such financing would not negatively impact our results of operations.

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Critical Accounting Estimates

There have been no significant changes to our critical accounting estimates during the nine months ended March 31, 2010 compared with those disclosed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2009.

Off-Balance Sheet Arrangements

We have not entered into any new off-balance sheet arrangements since June 30, 2009. For information with respect to our off-balance sheet arrangements at June 30, 2009, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Off-Balance Sheet Arrangements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2009.

Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). All statements made in this report, other than statements of historical fact, are forward-looking statements. You can identify these statements from our use of the words may, should, could, potential, continue, plan, forecast, estimate, intent, anticipate, expect, target, is likely, will, or the negative of these terms, and similar expressions. These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements may include, among other things:

statements and assumptions relating to future growth, income, income per share and other financial performance measures, as well as management's short-term and long-term performance goals;

statements relating to the anticipated effects on results of operations or financial condition from recent and expected developments or events;

statements relating to our business and growth strategies; and

any other statements or assumptions that are not historical facts.

We believe that our expectations are based on reasonable assumptions. However, these forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance or achievements, or industry results to differ materially from our expectations of future results, performance or achievements expressed or implied by these forward-looking statements. In addition, our past results of operations do not necessarily indicate our future results. We discuss these and other uncertainties in Item 1A. Risk Factors of our Annual Report on Form 10-K for the fiscal year ended June 30, 2009.

You should not place undue reliance on any forward-looking statements. These statements speak only as of the date of this report. Except as otherwise required by applicable laws, we undertake no obligation to publicly update or revise any forward-looking statements or the risk factors described in this report, whether as a result of new information, future events, changed circumstances or any other reason after the date of this report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the potential economic loss arising from adverse changes in the fair value of financial instruments. Our exposures to market risk relate primarily to our investment portfolio, which is exposed primarily to interest rate risk and credit risk. The fair value of our fixed maturity portfolio is directly impacted by changes in market interest rates; generally, the fair value of fixed-income investments moves inversely with movements in market interest rates. Our fixed maturity portfolio is comprised of substantially all fixed rate investments with primarily short-term and intermediate-term maturities. This portfolio composition allows flexibility in reacting to fluctuations of interest rates. The portfolios of our insurance company subsidiaries are managed to achieve an adequate risk-adjusted return while maintaining sufficient liquidity to meet policyholder obligations.

Table of Contents**FIRST ACCEPTANCE CORPORATION 10-Q****Interest Rate Risk**

The fair values of our fixed maturity investments fluctuate in response to changes in market interest rates. Increases and decreases in prevailing interest rates generally translate into decreases and increases, respectively, in the fair values of those instruments. Additionally, the fair values of interest rate sensitive instruments may be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, the liquidity of the instrument and other general market conditions.

The following table summarizes the estimated effects of hypothetical increases and decreases in interest rates resulting from parallel shifts in market yield curves on our fixed maturity portfolio (in thousands). It is assumed that the effects are realized immediately upon the change in interest rates. The hypothetical changes in market interest rates do not reflect what could be deemed best or worst case scenarios. Variations in market interest rates could produce significant changes in the timing of repayments due to prepayment options available. For these reasons, actual results might differ from those reflected in the table.

	Sensitivity to Instantaneous Interest Rate Changes (basis points)					
	(100)	(50)	0	50	100	200
Fair value of fixed maturity portfolio	\$ 195,416	\$ 191,786	\$ 188,145	\$ 184,544	\$ 181,018	\$ 174,240

The following table provides information about our fixed maturity investments at March 31, 2010 which are sensitive to interest rate risk. The table shows expected principal cash flows (at par value, which differs from amortized cost as a result of discounts at the time of purchase and OTTI) by expected maturity date for each of the five fiscal years and collectively for all fiscal years thereafter (in thousands). Callable bonds and notes are included based on call date or maturity date depending upon which date produces the most conservative yield. CMOs and sinking fund issues are included based on maturity year adjusted for expected payment patterns. Actual cash flows may differ from those expected.

Year Ended June 30,	Securities with Gross Unrealized Gains	Securities with Gross Unrealized Losses	Securities with No Gross Unrealized Gains or Losses	Amount
2010	\$ 1,263	\$ 549	\$	\$ 1,812
2011	13,094	1,223		14,317
2012	22,476	1,352		23,828
2013	27,373	671		28,044
2014	22,786	828		23,614
Thereafter	71,157	18,218		89,375
Total	\$ 158,149	\$ 22,841	\$	\$ 180,990
Fair value	\$ 167,723	\$ 20,422	\$	\$ 188,145

On June 15, 2007, our wholly-owned unconsolidated trust entity, First Acceptance Statutory Trust I, used the proceeds from its sale of trust preferred securities to purchase \$41.2 million of junior subordinated debentures. The debentures pay a fixed rate of 9.277% until July 30, 2012, after which the rate becomes variable (LIBOR plus 375

basis points).

Credit Risk

Credit risk is managed by diversifying the portfolio to avoid concentrations in any single industry group or issuer and by limiting investments in securities with lower credit ratings. The largest investment in any one fixed maturity security, excluding U.S. government and agency securities, is \$5.2 million, or 3% of the fixed maturity portfolio. The top five investments make up 14% of the fixed maturity portfolio. The average credit quality rating for our fixed maturity portfolio was AA at March 31, 2010. There are no fixed maturities in the portfolio that have not produced investment income during the previous twelve months.

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The following table presents the underlying ratings of our fixed maturity portfolio by nationally recognized securities rating organizations at March 31, 2010 (in thousands).

Comparable Rating	Amortized Cost	% of Amortized Cost	Fair Value	% of Fair Value
AAA	\$ 75,175	41.1%	\$ 78,029	41.5%
AA+, AA, AA-	34,742	19.0%	35,815	19.0%
A+, A, A-	51,871	28.3%	53,568	28.5%
BBB+, BBB, BBB-	10,679	5.8%	10,657	5.7%
Total investment grade	172,467	94.2%	178,069	94.7%
Not rated	5,018	2.8%	4,974	2.6%
BB+, BB, BB-	2,831	1.5%	2,746	1.4%
B+, B, B-	1,873	1.0%	1,733	0.9%
CCC+, CCC, CCC-	792	0.4%	570	0.3%
CC+, CC, CC-	32	0.1%	53	0.1%
Total non-investment grade	5,528	3.0%	5,102	2.7%
Total	\$ 183,013	100.0%	\$ 188,145	100.0%

The mortgage industry has experienced a rise in mortgage delinquencies and foreclosures, particularly among lower quality exposures (sub-prime and Alt-A). As a result of these increasing delinquencies and foreclosures, many CMOs with underlying sub-prime and Alt-A mortgages as collateral experienced significant declines in fair value. At March 31, 2010, our fixed maturity portfolio included three CMOs having sub-prime exposure with a fair value of \$0.8 million and no exposure to Alt-A investments.

Our investment portfolio consists of \$39.0 million of municipal bonds, of which \$24.6 million are insured. Of the insured bonds, 68% are insured with MBIA, 14% with AMBAC and 18% with XL Capital. These securities are paying their principal and periodic interest timely.

The following table presents the underlying ratings as of March 31, 2010, represented by the lower of either Standard and Poor's, Fitch's, or Moody's ratings, of the municipal bond portfolio (in thousands).

	Insured		Uninsured		Total	
	Fair Value	% of Fair Value	Fair Value	% of Fair Value	Fair Value	% of Fair Value
AAA	\$ 4,777		\$ 4,777	33%	\$ 4,777	12%
AA+, AA, AA-	11,806	48%	5,528	39%	17,334	45%
A+, A, A-	11,254	46%	4,015	28%	15,269	39%
BBB+, BBB, BBB-	1,574	6%			1,574	4%
Total	\$ 24,634	100%	\$ 14,320	100%	\$ 38,954	100%

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our chief executive officer and chief financial officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act as of March 31, 2010. Based on that evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures effectively ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

Changes in Internal Control Over Financial Reporting

During the period covered by this report, there has been no change in our internal control over financial reporting that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

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**FIRST ACCEPTANCE CORPORATION 10-Q
PART II OTHER INFORMATION**

Item 6. Exhibits

The following exhibits are attached to this report:

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a).
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a).
- 32.1 Chief Executive Officer's Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Chief Financial Officer's Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**FIRST ACCEPTANCE CORPORATION 10-Q
SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FIRST ACCEPTANCE CORPORATION

May 10, 2010

By: /s/ Kevin P. Cohn
Kevin P. Cohn
Senior Vice President and Chief Financial Officer
(Principal Financial Officer and Principal
Accounting Officer)

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