

FIRST ACCEPTANCE CORP /DE/

Form 10-Q

May 09, 2011

Table of Contents

**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, 2011

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)

Not applicable

(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 9, 2011, there were 48,473,718 shares outstanding of the registrant's common stock, par value \$0.01 per share.

FIRST ACCEPTANCE CORPORATION
FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2011

INDEX

PART I FINANCIAL INFORMATION

<u>Item 1. Financial Statements</u>	1
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	26
<u>Item 4. Controls and Procedures</u>	28

PART II OTHER INFORMATION

<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	29
<u>Item 6. Exhibits</u>	29

SIGNATURES

EX-31.1
EX-31.2
EX-32.1
EX-32.2

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	March 31, 2011 (Unaudited)	June 30, 2010
ASSETS		
Investments, available-for-sale at fair value (amortized cost of \$175,735 and \$187,907, respectively)	\$ 184,281	\$ 196,550
Cash and cash equivalents	34,073	26,184
Premiums and fees receivable, net of allowance of \$354 and \$418	49,369	41,276
Other assets	8,219	8,733
Property and equipment, net	2,636	3,524
Deferred acquisition costs	4,062	3,623
Goodwill	70,092	70,092
Identifiable intangible assets	6,360	6,360
TOTAL ASSETS	\$ 359,092	\$ 356,342
LIABILITIES AND STOCKHOLDERS' EQUITY		
Loss and loss adjustment expense reserves	\$ 69,429	\$ 73,198
Unearned premiums and fees	61,064	52,563
Debentures payable	41,240	41,240
Other liabilities	12,728	12,151
Total liabilities	184,461	179,152
Stockholders' equity:		
Preferred stock, \$.01 par value, 10,000 shares authorized		
Common stock, \$.01 par value, 75,000 shares authorized; 48,477 and 48,509 shares issued and outstanding, respectively	485	485
Additional paid-in capital	466,675	465,831
Accumulated other comprehensive income	8,546	8,643
Accumulated deficit	(301,075)	(297,769)
Total stockholders' equity	174,631	177,190
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 359,092	\$ 356,342

See notes to consolidated financial statements.

Table of Contents

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Revenues:				
Premiums earned	\$ 43,444	\$ 46,651	\$ 129,898	\$ 140,317
Commission and fee income	7,443	7,471	21,784	21,391
Investment income	1,991	2,008	6,252	5,954
Net realized losses on investments, available-for-sale	(78)	(14)	(334)	(459)
	52,800	56,116	157,600	167,203
Costs and expenses:				
Losses and loss adjustment expenses	31,586	31,902	96,981	94,926
Insurance operating expenses	20,963	20,125	57,864	59,406
Other operating expenses	307	280	985	1,303
Litigation settlement	(1)	(35)	(6)	(314)
Stock-based compensation	549	198	914	853
Depreciation and amortization	338	483	1,279	1,447
Interest expense	968	970	2,950	2,951
	54,710	53,923	160,967	160,572
Income (loss) before income taxes	(1,910)	2,193	(3,367)	6,631
Provision (benefit) for income taxes	(302)	124	(61)	327
Net income (loss)	\$ (1,608)	\$ 2,069	\$ (3,306)	\$ 6,304
Net income (loss) per share:				
Basic and diluted	\$ (0.03)	\$ 0.04	\$ (0.07)	\$ 0.13
Number of shares used to calculate net income (loss) per share:				
Basic	48,192	47,994	48,125	47,943
Diluted	48,192	48,489	48,125	48,395
Reconciliation of net income (loss) to comprehensive income (loss):				
Net income (loss)	\$ (1,608)	\$ 2,069	\$ (3,306)	\$ 6,304
Net unrealized change in investments	(379)	2,123	(97)	5,670

Comprehensive income (loss)	\$ (1,987)	\$ 4,192	\$ (3,403)	\$ 11,974
-----------------------------	------------	----------	------------	-----------

Detail of net realized losses on investments,
available-for-sale:

Net realized gains (losses) on sales	\$ (1)	\$ (14)	\$ 79	\$ 300
--------------------------------------	--------	---------	-------	--------

Unrealized losses on investments with other-than-temporary impairment charges	(77)		(415)	(1,449)
--	------	--	-------	---------

Non-credit portion included in comprehensive income (loss)			2	(690)
---	--	--	---	-------

Other-than-temporary impairment charges recognized in income (loss)	(77)		(413)	(759)
--	------	--	-------	-------

Net realized losses on investments, available-for-sale	\$ (78)	\$ (14)	\$ (334)	\$ (459)
--	---------	---------	----------	----------

See notes to consolidated financial statements.

2

Table of Contents

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

	Nine Months Ended March 31,	
	2011	2010
Cash flows from operating activities:		
Net income (loss)	\$ (3,306)	\$ 6,304
Adjustments to reconcile net income (loss) to cash used in operating activities:		
Depreciation and amortization	1,279	1,447
Stock-based compensation	914	853
Other-than-temporary impairment on investment securities	413	759
Net realized losses on sales of investments	(79)	(300)
Other	370	432
Change in:		
Premiums and fees receivable	(8,157)	(4,511)
Loss and loss adjustment expense reserves	(3,769)	(7,790)
Unearned premiums and fees	8,501	5,149
Litigation settlement	(42)	91
Other	755	(2,865)
Net cash used in operating activities	(3,121)	(431)
Cash flows from investing activities:		
Purchases of investments, available-for-sale	(3,283)	(64,439)
Maturities and paydowns of investments, available-for-sale	14,718	9,867
Sales of investments, available-for-sale		11,566
Capital expenditures	(396)	(1,197)
Other	(2)	(22)
Net cash provided by (used in) investing activities	11,037	(44,225)
Cash flows from financing activities:		
Payments on borrowings	(59)	(47)
Net proceeds from issuance of common stock	32	33
Net cash used in financing activities	(27)	(14)
Net increase (decrease) in cash and cash equivalents	7,889	(44,670)
Cash and cash equivalents, beginning of period	26,184	77,201
Cash and cash equivalents, end of period	\$ 34,073	\$ 32,531

See notes to consolidated financial statements.

Table of Contents

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

1. General

The consolidated financial statements of First Acceptance Corporation (the Company) included herein have been prepared without audit pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). 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, 2010.

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 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.

Table of Contents

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

The following tables present the fair-value measurements for each major category of assets that are measured on a recurring basis (in thousands).

		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)
March 31, 2011	Total			
Fixed maturities, available-for-sale:				
U.S. government and agencies	\$ 27,708	\$ 27,708	\$	\$
State	7,691		7,691	
Political subdivisions	1,808		1,808	
Revenue and assessment	26,942		26,942	
Corporate bonds	76,361		76,361	
Collateralized mortgage obligations:				
Agency backed	22,559		22,559	
Non-agency backed residential	5,918		5,918	
Non-agency backed commercial	7,061		7,061	
Redeemable preferred stock	172	172		
Total fixed maturities, available-for-sale	176,220	27,880	148,340	
Investment in mutual fund, available-for-sale	8,061	8,061		
Total investments, available-for-sale	184,281	35,941	148,340	
Cash and cash equivalents	34,073	34,073		
Total	\$ 218,354	\$ 70,014	\$ 148,340	\$

		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)
June 30, 2010	Total			

Edgar Filing: FIRST ACCEPTANCE CORP /DE/ - Form 10-Q

Fixed maturities, available-for-sale:				
U.S. government and agencies	\$ 29,499	\$ 29,499	\$	\$
State	7,848		7,848	
Political subdivisions	1,830		1,830	
Revenue and assessment	29,286		29,286	
Corporate bonds	78,803		78,803	
Collateralized mortgage obligations:				
Agency backed	28,036		28,036	
Non-agency backed residential	6,612		6,612	
Non-agency backed commercial	7,180		7,180	
Total fixed maturities, available-for-sale	189,094	29,499	159,595	
Investment in mutual fund, available-for-sale	7,456	7,456		
Total investments, available-for-sale	196,550	36,955	159,595	
Cash and cash equivalents	26,184	26,184		
Total	\$ 222,734	\$ 63,139	\$ 159,595	\$

Table of Contents

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

The fair values of the Company's investments 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 tables 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, 2011 and 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 Level 2 independent pricing service 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 has made inquiries with the pricing service about material changes or the absence of expected changes to understand the underlying factors and inputs and to validate the reasonableness of the pricing.

Based on the above categorization, there were no Level 3 classified security valuations at March 31, 2011 and June 30, 2010. The following tables represent the quantitative disclosure for those assets classified as Level 3 during the three and nine months ended March 31, 2010 (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 (loss)				
Included in other comprehensive income (loss)	(14)	82		68
Purchases, sales, issuances and settlements				
Transfers in to Level 3				
Transfers out of Level 3	(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 (loss)				
Included in other comprehensive income (loss)		353	189	542

Purchases, sales, issuances and settlements

Transfers in to Level 3

Transfers out of Level 3		(2,283)	(896)	(3,179)
--------------------------	--	---------	-------	---------

Balance at March 31, 2010	\$	\$	\$	\$
---------------------------	----	----	----	----

6

Table of Contents

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

Investment Income and Net Realized Gains and Losses

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Fixed maturities, available-for-sale	\$ 1,975	\$ 2,138	\$ 6,177	\$ 6,331
Investment in mutual fund, available-for-sale	151		474	
Cash and cash equivalents	1	3	7	26
Other	29	29	87	87
Investment expenses	(165)	(162)	(493)	(490)
	\$ 1,991	\$ 2,008	\$ 6,252	\$ 5,954

The components of net realized losses on investments, available-for-sale follow (in thousands).

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Gains	\$	\$ 7	\$ 81	\$ 326
Losses	(1)	(21)	(2)	(26)
Other-than-temporary impairment	(77)		(413)	(759)
	\$ (78)	\$ (14)	\$ (334)	\$ (459)

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). At March 31, 2011, the amounts of such charges taken for securities still owned was \$0.1 million related to non-agency backed residential collateralized mortgage obligations (CMOs). At June 30, 2010, the amount of such charges taken for securities still owned was \$0.6 million related to non-agency backed residential CMOs and \$0.3 million related to non-agency backed commercial CMOs.

Investments, Available-for-Sale

The following tables summarize the Company's investment securities (in thousands).

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2011				
U.S. government and agencies	\$ 26,686	\$ 1,022	\$	\$ 27,708
State	7,410	281		7,691
Political subdivisions	1,797	26	(15)	1,808
Revenue and assessment	26,203	967	(228)	26,942
Corporate bonds	72,456	4,202	(297)	76,361
Collateralized mortgage obligations:				
Agency backed	21,132	1,427		22,559
Non-agency backed residential	5,819	239	(140)	5,918
Non-agency backed commercial	6,555	506		7,061

Redeemable preferred stock	176		(4)	172
Total fixed maturities, available-for-sale	168,234	8,670	(684)	176,220
Investment in mutual fund, available-for-sale	7,501	560		8,061
	\$ 175,735	\$ 9,230	\$ (684)	\$ 184,281

7

Table of Contents

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

June 30, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agencies	\$ 28,263	\$ 1,236	\$	\$ 29,499
State	7,461	387		7,848
Political subdivisions	1,792	52	(14)	1,830
Revenue and assessment	28,209	1,217	(140)	29,286
Corporate bonds	73,868	5,181	(246)	78,803
Collateralized mortgage obligations:				
Agency backed	26,262	1,774		28,036
Non-agency backed residential	7,189	56	(633)	6,612
Non-agency backed commercial	7,363	158	(341)	7,180
Total fixed maturities, available-for-sale	180,407	10,061	(1,374)	189,094
Investment in mutual fund, available-for-sale	7,500		(44)	7,456
	\$ 187,907	\$ 10,061	\$ (1,418)	\$ 196,550

The following tables set forth the scheduled maturities of the Company's fixed maturity securities 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.

March 31, 2011	Securities with Unrealized Gains	Securities with Unrealized Losses	Securities with No Unrealized Gains or Losses	All Fixed Maturity Securities
One year or less	\$ 16,201	\$	\$	\$ 16,201
After one through five years	72,948			72,948
After five through ten years	34,744			34,744
After ten years	10,733	6,056		16,789
No single maturity date	33,852	1,686		35,538
	\$ 168,478	\$ 7,742	\$	\$ 176,220

June 30, 2010	Securities with Unrealized Gains	Securities with Unrealized Losses	Securities with No Unrealized Gains or Losses	All Fixed Maturity Securities
One year or less	\$ 9,137	\$	\$	\$ 9,137
After one through five years	82,250	642		82,892
After five through ten years	39,567			39,567

After ten years	8,607	7,063		15,670
No single maturity date	33,676	8,085	67	41,828
	\$ 173,237	\$ 15,790	\$ 67	\$ 189,094

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		
At:	Less than or equal to 12 months	Greater than 12 months	Gross Unrealized Gains
March 31, 2011	4	4	160
June 30, 2010	6	18	153

Table of Contents

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

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, 2011:	Number of Securities	Fair Value	Gross Unrealized Losses
Less than or equal to 10%	2	\$ 1,469	\$ (78)
Greater than 10%	2	1,839	(413)
	4	\$ 3,308	\$ (491)

Gross Unrealized Losses at June 30, 2010:	Number of Securities	Fair Value	Gross Unrealized Losses
Less than or equal to 10%	11	\$ 7,931	\$ (276)
Greater than 10%	7	3,366	(965)
	18	\$ 11,297	\$ (1,241)

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, 2011:					
Less than or equal to:					
Three months	\$ 3,022	\$ (154)	\$ (4)	\$ (150)	\$
Six months	1,412	(39)	(39)		
Nine months					
Twelve months					
Greater than twelve months	3,308	(491)		(78)	(413)
Total	\$ 7,742	\$ (684)	\$ (43)	\$ (228)	\$ (413)

Fair Value of Securities with	Severity of Gross Unrealized Losses
--	--

Length of Gross Unrealized Losses	Gross Unrealized Losses	Gross Unrealized Losses	Less than 5%	5% to 10%	Greater than 10%
at June 30, 2010:					
Less than or equal to:					
Three months	\$ 11,291	\$ (170)	\$ (145)	\$ (25)	\$
Six months					
Nine months	152	(2)	(2)		
Twelve months	505	(5)	(5)		
Greater than twelve months	11,297	(1,241)	(153)	(123)	(965)
Total	\$ 23,245	\$ (1,418)	\$ (305)	\$ (148)	\$ (965)

Table of Contents

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

Other-Than-Temporary Impairment

In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320-10-65, *Recognition and Presentation of Other-Than-Temporary Impairments* (FASB ASC 320-10-65), 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 prior to the impairment charge.

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 investment 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 SEC 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.

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 recognized OTTI charges in net income (loss) are presented in the following tables (in thousands, except for the number of securities).

	Three Months Ended March 31, 2011		2010	
	Number of Securities	OTTI	Number of Securities	OTTI
Collateralized mortgage obligations:				
Non-agency backed residential	3	\$ (77)		\$
Non-agency backed commercial				
	3	(77)		
Portion of loss recognized in accumulated other comprehensive income				
Net OTTI recognized in net income (loss)		\$ (77)		\$

Table of Contents

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

	Nine Months Ended March 31, 2011		2010	
	Number of Securities	OTTI	Number of Securities	OTTI
Collateralized mortgage obligations:				
Non-agency backed residential	5	\$ (119)	8	\$ (1,449)
Non-agency backed commercial	5	(296)		
	10	(415)	8	(1,449)
Portion of loss recognized in accumulated other comprehensive income		2		690
Net OTTI recognized in net income (loss)		\$ (413)		\$ (759)

Since the adoption of FASB ASC 320-10-65, the following is a progression of the credit-related portion of OTTI on investments owned at March 31, 2011 and 2010 (in thousands).

	Three Months Ended March 31, 2011		Nine Months Ended March 31, 2011	
	2011	2010	2011	2010
Beginning balance	\$ (3,590)	\$ (3,077)	\$ (3,301)	\$ (2,870)
Additional credit impairments on:				
Previously impaired securities	(77)		(413)	(270)
Securities without previous impairments				(489)
	(77)		(413)	(759)
Reductions for securities sold (realized)	192		239	552
	\$ (3,475)	\$ (3,077)	\$ (3,475)	\$ (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* (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 reviews 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.

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 the remaining non-agency backed CMOs for which OTTI charges have not been recorded 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 Company believes that the remaining securities having unrealized losses at March 31, 2011 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.

Table of Contents

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

3. Net Income (Loss) Per Share

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Net income (loss)	\$ (1,608)	\$ 2,069	\$ (3,306)	\$ 6,304
Weighted average common basic shares	48,192	47,994	48,125	47,943
Effect of dilutive securities		495		452
Weighted average common dilutive shares	48,192	48,489	48,125	48,395
Basic and diluted net income (loss) per share	\$ (0.03)	\$ 0.04	\$ (0.07)	\$ 0.13

For both the three and nine months ended March 31, 2011, the computation of diluted net loss per share did not include 0.2 million shares of unvested restricted common stock as their inclusion would have been anti-dilutive. For both the three and nine months ended March 31, 2010, the computation of diluted net income per share included 0.5 million shares of unvested restricted common stock. Options to purchase 4.5 million and 4.6 million shares for both the three and nine months ended March 31, 2011 and 2010, respectively, were not included in the computation of diluted net income (loss) per share as their exercise prices were in excess of the average stock prices for the periods presented.

4. Income Taxes

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Federal:				
Current	\$	\$	\$	\$
Deferred				
State:				
Current	(204)	124	37	327
Deferred	(98)		(98)	
	(302)	124	(61)	327
	\$ (302)	\$ 124	\$ (61)	\$ 327

Table of Contents

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

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Provision (benefit) for income taxes at statutory rate	\$ (669)	\$ 768	\$ (1,178)	\$ 2,321
Tax effect of:				
Tax-exempt investment income	(4)	(4)	(12)	(12)
Change in the beginning of the period balance of the valuation allowance for deferred tax assets allocated to income taxes	556	(602)	985	(2,031)
Restricted stock	136		217	
State income taxes, net of federal income tax benefit	(302)	(67)	(61)	11
Other	(19)	29	(12)	38
	\$ (302)	\$ 124	\$ (61)	\$ 327

The Company had a valuation allowance of \$18.0 million and \$16.9 million at March 31, 2011 and June 30, 2010, respectively, to reduce deferred tax assets to the amount that is more likely than not to be realized, which included all federal and substantially all state net deferred tax assets at March 31, 2011 and June 30, 2010. The change in the total valuation allowance for the nine months ended March 31, 2011 was an increase of \$1.1 million. For the nine months ended March 31, 2011, the change in the valuation allowance included a reduction of \$0.2 million related to deferred state income taxes.

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 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 federal and substantially all state net deferred tax assets at March 31, 2011 and June 30, 2010. The deferred tax valuation allowance may be adjusted in future periods if management determines 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.

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, primarily comprised of trade names, 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 during 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.

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.

Table of Contents

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

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, 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. Fair Value of Financial Instruments

The carrying values and fair values of certain of the Company's financial instruments at March 31, 2011 and June 30, 2010 were as follows (in thousands).

	March 31, 2011		June 30, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Investments, available-for-sale	\$ 184,281	\$ 184,281	\$ 196,550	\$ 196,550
Liabilities:				
Debentures payable	41,240	18,323	41,240	19,701

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. Carrying values of certain financial instruments, such as cash and cash equivalents and premiums and fees receivable, approximate fair value due to the short-term nature of the instruments and are not required to be disclosed. Therefore, the aggregate of the fair values presented in the table does not purport to represent the Company's underlying value.

7. Severance

During March 2011, certain executive officers resigned from the Company. Under the terms of their employment agreements, the former officers will receive severance and related benefits for the period from March 2011 through March 2012, as well as accelerated vesting of certain outstanding stock options and all restricted common stock held by the former officers. Accordingly, the Company incurred a charge of \$1.7 million, comprised of \$1.3 million in accrued severance and benefits and a \$0.4 million non-cash charge related to the vesting of certain unvested stock options and all unvested restricted common stock. The severance and benefit accrual is classified within other liabilities on the Company's consolidated balance sheet. The severance and benefits charge is included in insurance operating expenses and the non-cash charge related to the vesting of certain unvested stock options and all unvested restricted common stock is included within stock-based compensation expense in the consolidated statements of operations. The insurance operations segment includes the accrued severance and benefits charge, and the real estate and corporate segment includes the accelerated vesting charge.

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 all debt and other general corporate overhead expenses.

Table of Contents

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

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Revenues:				
Insurance	\$ 52,771	\$ 56,087	\$ 157,512	\$ 167,114
Real estate and corporate	29	29	88	89
Consolidated total	\$ 52,800	\$ 56,116	\$ 157,600	\$ 167,203
Income (loss) before income taxes:				
Insurance	\$ (115)	\$ 3,609	\$ 1,389	\$ 11,645
Real estate and corporate	(1,795)	(1,416)	(4,756)	(5,014)
Consolidated total	\$ (1,910)	\$ 2,193	\$ (3,367)	\$ 6,631
			March 31,	June 30,
			2011	2010
Total assets:				
Insurance			\$ 345,703	\$ 343,499
Real estate and corporate			13,389	12,843
Consolidated total			\$ 359,092	\$ 356,342

9. Recent Accounting Pronouncements

In December 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-17, *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities (Topic 810)* (FASB ASU No. 2009-17), which amends FASB ASC 810-10, *Variable Interest Entities*. FASB ASU No. 2009-17 amends the evaluation criteria to identify the primary beneficiary of a variable interest entity and requires ongoing reassessment of whether an enterprise is the primary beneficiary of the variable interest entity. The Company adopted the provisions of FASB ASU No. 2009-17 in the quarter ended September 30, 2010. The adoption did not have an impact on the Company's results of operations or financial condition.

In October 2010, the FASB issued ASU No. 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (a consensus of the FASB Emerging Issues Task Force) (Topic 944)* (FASB ASU No. 2010-26), which amends FASB ASC 944-340, *Other Assets and Deferred Costs*. FASB ASU No. 2010-26 clarifies what costs should be deferred by insurance companies when issuing or renewing insurance contracts. FASB ASU 2010-26 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2011. The Company is currently evaluating the impact that the adoption of FASB ASU 2010-26 will have on its future consolidated financial statements.

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, 2010. The following discussion should be read in conjunction with our consolidated financial statements included with 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, 2010 included in our Annual Report on Form 10-K.

General

At March 31, 2011, we leased and operated 385 retail locations (or stores) staffed by employee-agents who primarily sell non-standard personal 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, 2011, 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, 2010 for additional information with respect to our business.

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Retail locations beginning of period	393	409	394	418
Opened			1	
Closed	(8)	(4)	(10)	(13)
Retail locations end of period	385	405	385	405

The following tables show the number of our retail locations by state.

	March 31,		December 31,		June 30,	
	2011	2010	2010	2009	2010	2009
Alabama	24	25	25	25	25	25
Florida	31	34	31	34	31	39
Georgia	60	61	60	61	60	61
Illinois	68	75	73	76	74	78
Indiana	17	18	17	18	17	18
Mississippi	8	8	8	8	8	8
Missouri	12	12	12	12	12	12
Ohio	27	27	27	27	27	27
Pennsylvania	16	17	16	17	16	17
South Carolina	26	26	26	27	26	27
Tennessee	20	19	20	19	19	20
Texas	76	83	78	85	79	86
Total	385	405	393	409	394	418

Developments during the Quarter

On March 1, 2011, we announced the resignation of Edward L. Pierce as President and Kevin P. Cohn as Senior Vice President and Chief Financial Officer. In light of these resignations, the Board of Directors of the Company elected Mark A. Kelly and Michael J. Bodayle as interim President and interim Chief Financial Officer, respectively. For a more detailed description of these management changes, see the Current Report on Form 8-K and Current Report on Form 8-K/A (Amendment No. 1) filed with the Securities and Exchange Commission (SEC) on March 2, 2011 and April 1, 2011, respectively.

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 interest expense associated with debt, general corporate overhead expenses and the disposition of real estate held for sale. 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, 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 March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Premiums earned:				
Georgia	\$ 9,440	\$ 9,918	\$ 28,376	\$ 30,780
Texas	5,891	6,233	17,508	17,858
Illinois	5,707	6,076	17,287	18,482
Florida	4,824	5,307	14,270	15,502
Alabama	4,174	4,727	12,686	14,645
Ohio	3,472	3,223	9,962	9,085
Tennessee	2,700	2,925	7,994	8,883
South Carolina	2,469	2,847	7,320	8,712
Pennsylvania	2,248	2,569	6,967	7,998
Indiana	1,144	1,266	3,410	3,699
Missouri	724	834	2,146	2,443
Mississippi	651	726	1,972	2,230
Total premiums earned	\$ 43,444	\$ 46,651	\$ 129,898	\$ 140,317

The following table presents the change in the total number of policies in force (PIF) for the insurance operations. PIF 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 March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Policies in force beginning of period	144,582	147,090	154,655	158,222
Net increase during period	16,006	22,513	5,933	11,381
Policies in force end of period	160,588	169,603	160,588	169,603

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

The following tables present total PIF for the insurance operations segregated by policies that were sold through our open and closed retail locations as well as our independent agents. For our retail locations, PIF are further segregated by (i) new and renewal and (ii) liability-only or full coverage. New policies are defined as those policies issued to both first-time customers and customers who have reinstated a lapsed or cancelled policy. Renewal policies are those policies which renewed after completing their full uninterrupted policy term. Liability-only policies are defined as those policies including only bodily injury (or no-fault) and property damage coverages, which are the required coverages in most states. For comparative purposes, the PIF data with respect to closed retail locations for each of the periods presented below includes all retail locations closed as of March 31, 2011.

	March 31,	
	2011	2010
Retail locations:		
Open retail locations:		
New	78,931	83,074
Renewal	77,704	77,222
	156,635	160,296
Closed retail locations:		
New	404	2,845
Renewal	2,388	4,015
	2,792	6,860
Independent agents	1,161	2,447
Total policies in force	160,588	169,603
	March 31,	
	2011	2010
Retail locations:		
Open retail locations:		
Liability-only	95,408	96,828
Full coverage	61,227	63,468
	156,635	160,296
Closed retail locations:		
Liability-only	1,674	4,368
Full coverage	1,118	2,492
	2,792	6,860
Independent agents	1,161	2,447
Total policies in force	160,588	169,603

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.

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.

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

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Loss and loss adjustment expense	72.7%	68.4%	74.6%	67.6%
Expense	31.1%	27.1%	27.8%	27.1%
Combined	103.8%	95.5%	102.4%	94.7%

Excluding the severance and related benefits charges incurred in connection with the separation of certain executive officers of \$1.3 million during March 2011, the expense ratios for the three and nine months ended March 31, 2011 were 28.0% and 26.8%, respectively, and the combined ratios for the three and nine months ended March 31, 2011 were 100.7% and 101.4%, respectively.

The non-standard personal automobile insurance industry is cyclical in nature. Accordingly, adverse economic conditions impact our customers and many will choose to reduce their coverage or go uninsured during a weak economy.

Investments

We use the services of an independent investment manager to manage our 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. 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.

Our consolidated investment portfolio was \$184.3 million at March 31, 2011 and consisted of fixed maturity securities and an investment in a mutual fund, all carried at fair value with unrealized gains and losses reported as a separate component of stockholders' equity. At March 31, 2011, we had gross unrealized gains of \$9.2 million and gross unrealized losses of \$0.7 million.

At March 31, 2011, 94.8% of the fair value of our fixed maturity 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, 2011. 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 \$35.5 million at March 31, 2011 and represented 20% of our fixed maturity portfolio. At March 31, 2011, 85% of our CMOs were considered investment grade by nationally recognized rating agencies. In addition, 78% of our CMOs were rated AAA and 64% of our CMOs were backed by agencies of the United States government. Of the non-agency backed CMOs, 38% were rated AAA.

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

The following table summarizes our investment securities at March 31, 2011 (in thousands).

March 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agencies	\$ 26,686	\$ 1,022	\$	\$ 27,708
State	7,410	281		7,691
Political subdivisions	1,797	26	(15)	1,808
Revenue and assessment	26,203	967	(228)	26,942
Corporate bonds	72,456	4,202	(297)	76,361
Collateralized mortgage obligations:				
Agency backed	21,132	1,427		22,559
Non-agency backed residential	5,819	239	(140)	5,918
Non-agency backed commercial	6,555	506		7,061
Redeemable preferred stock	176		(4)	172
Total fixed maturities, available-for-sale	168,234	8,670	(684)	176,220
Investment in mutual fund, available-for-sale	7,501	560		8,061
	\$ 175,735	\$ 9,230	\$ (684)	\$ 184,281

The following table sets forth the scheduled maturities of our fixed maturity securities at March 31, 2011 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.

March 31, 2011	Securities with Unrealized Gains	Securities with Unrealized Losses	Securities with No Unrealized Gains or Losses	All Fixed Maturity Securities
One year or less	\$ 16,201	\$	\$	\$ 16,201
After one through five years	72,948			72,948
After five through ten years	34,744			34,744
After ten years	10,733	6,056		16,789
No single maturity date	33,852	1,686		35,538
	\$ 168,478	\$ 7,742	\$	\$ 176,220

Other-Than-Temporary Impairment

In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320-10-65, *Recognition and Presentation of Other-Than-Temporary Impairments*, 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 prior to the impairment charge.

The determination of whether unrealized losses are other-than-temporary requires judgment based on subjective as well as objective factors. We routinely monitor our investment 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 SEC 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.

Table of Contents

FIRST ACCEPTANCE CORPORATION 10-Q

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* (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 review 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 discussed in Note 2 to our consolidated financial statements which incurred OTTI charges of \$0.4 million and \$0.8 million for the nine months ended March 31, 2011 and 2010, respectively. We believe that the unrealized losses on the remaining non-agency backed CMOs 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.

We believe that the remaining securities having unrealized losses at March 31, 2011 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, 2011 Compared with the Three and Nine Months Ended March 31, 2010

Consolidated Results

Revenues for the three months ended March 31, 2011 decreased 6% to \$52.8 million from \$56.1 million in the same period in the prior year. Loss before income taxes for the three months ended March 31, 2011 was \$1.9 million, compared with income before income taxes of \$2.2 million for the three months ended March 31, 2010. Net loss for the three months ended March 31, 2011 was \$1.6 million, compared with net income of \$2.1 million for the three months ended March 31, 2010. Basic and diluted net loss per share was \$0.03 for the three months ended March 31, 2011, compared with basic and diluted net income per share of \$0.04 for the three months ended March 31, 2010.

Revenues for the nine months ended March 31, 2011 decreased 6% to \$157.6 million from \$167.2 million in the same period in the prior year. Loss before income taxes for the nine months ended March 31, 2011 was \$3.4 million, compared with income before income taxes of \$6.6 million for the nine months ended March 31, 2010. Net loss for the nine months ended March 31, 2011 was \$3.3 million, compared with net income of \$6.3 million for the nine months ended March 31, 2010. Basic and diluted net loss per share was \$0.07 for the nine months ended March 31, 2011, compared with basic and diluted net income per share of \$0.13 for the nine months ended March 31, 2010.

Table of Contents

FIRST ACCEPTANCE CORPORATION 10-Q

Insurance Operations

Revenues from insurance operations were \$52.8 million for the three months ended March 31, 2011, compared with \$56.1 million for the three months ended March 31, 2010. Revenues from insurance operations were \$157.5 million for the nine months ended March 31, 2011, compared with \$167.1 million for the nine months ended March 31, 2010.

Loss before income taxes from insurance operations for the three months ended March 31, 2011 was \$0.1 million, compared with income before income taxes from insurance operations of \$3.6 million for the three months ended March 31, 2010. Income before income taxes from insurance operations for the nine months ended March 31, 2011 was \$1.4 million, compared with \$11.6 million for the nine months ended March 31, 2010.

Premiums Earned

Premiums earned decreased by \$3.2 million, or 7%, to \$43.4 million for the three months ended March 31, 2011, from \$46.7 million for the three months ended March 31, 2010. For the nine months ended March 31, 2011, premiums earned decreased by \$10.4 million, or 7%, to \$129.9 million from \$140.3 million for the nine months ended March 31, 2010. The decreases in premiums earned were primarily due to a decline in the number of PIF from 169,603 at March 31, 2010 to 160,588 at March 31, 2011, which was impacted by the closure of underperforming stores. At March 31, 2011, we operated 385 stores, compared with 405 stores at March 31, 2010. Premiums earned were also negatively impacted by an increase in the percentage of PIF with liability-only coverage. Although the number of PIF sold through our open stores decreased from 160,296 at March 31, 2010 to 156,635 at March 31, 2011, for those policies quoted, we have experienced a higher close ratio for the three and nine months ended March 31, 2011 compared with the same periods in the prior year.

Commission and Fee Income

Commission and fee income decreased to \$7.4 million for the three months ended March 31, 2011, from \$7.5 million for the three months ended March 31, 2010. For the nine months ended March 31, 2011, commission and fee income increased 2% to \$21.8 million from \$21.4 million for the nine months ended March 31, 2010. This increase in commission and fee income was a result of higher fee income related to commissionable ancillary products sold through our retail locations offset by the decrease in the number of PIF.

Investment Income

Investment income was \$2.0 million for both the three months ended March 31, 2011 and 2010. For the nine months ended March 31, 2011, investment income increased to \$6.3 million from \$6.0 million during the nine months ended March 31, 2010. This increase in investment income was primarily a result of the higher yield obtained on the mutual fund investment made in June 2010. At March 31, 2011 and 2010, the tax-equivalent book yields for our fixed maturities portfolio were 4.6% and 4.2%, respectively, with effective durations of 3.01 and 3.36 years, respectively.

Net realized losses on investments, available-for-sale

Net realized losses on investments, available-for-sale during the three months ended March 31, 2011 included \$0.1 million of charges related to OTTI on certain non-agency backed CMOs. Net realized losses on investments, available-for-sale during the three months ended March 31, 2010 consisted of net realized losses on sales of securities.

For the nine months ended March 31, 2011, net realized losses on investments, available-for-sale included \$0.1 million in net realized gains on sales and \$0.4 million of charges related to OTTI on certain non-agency backed CMOs. Net realized losses on investments, available-for-sale during the nine months ended March 31, 2010 included \$0.3 million in net realized gains on sales and \$0.8 million of charges related to OTTI on certain non-agency backed CMOs. For additional information with respect to the determination of OTTI losses on investment securities, see Note 2 to our consolidated financial statements.

Table of Contents**FIRST ACCEPTANCE CORPORATION 10-Q***Loss and Loss Adjustment Expenses*

The loss and loss adjustment expense ratio was 72.7% for the three months ended March 31, 2011, compared with 68.4% for the three months ended March 31, 2010. The loss and loss adjustment expense ratio was 74.6% for the nine months ended March 31, 2011, compared with 67.6% for the nine months ended March 31, 2010. We experienced favorable development related to prior periods of \$0.6 million for the three months ended March 31, 2011, compared with \$4.1 million for the three months ended March 31, 2010. For the nine months ended March 31, 2011, we experienced unfavorable development related to prior periods of \$0.4 million, compared with favorable development of \$10.2 million for the nine months ended March 31, 2010. The favorable development for the three months ended March 31, 2011 was primarily due to lower than anticipated paid severity on accidents occurring during the first six months of calendar year 2010. The lower than anticipated paid severity was primarily related to bodily injury and physical damage coverages in Georgia.

Excluding the development related to prior periods, the loss and loss adjustment expense ratios for the three months ended March 31, 2011 and 2010 were 74.1% and 77.2%, respectively. Excluding the development related to prior periods, the loss and loss adjustment expense ratios for the nine months ended March 31, 2011 and 2010 were 74.4% and 74.9%, respectively. The decrease for the three months ended March 31, 2011 compared with the same period in the prior year was primarily due to lower than anticipated frequency of accidents in our property and physical damage coverages. The three and nine months ended March 31, 2011 were both impacted by higher loss adjustment expense resulting from (i) the increase in the percentage of claims related to liability-only coverage policies and (ii) increased investigative efforts with regards to no-fault claims in Florida.

As previously disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2010, we are in the process of implementing a new multivariate pricing program in all states in which we operate. We believe that this new pricing program will provide us with greater pricing segmentation and improve our pricing relative to the risk we are insuring. As of March 31, 2011, approximately 16% of our PIF have been underwritten using this new pricing program, which has been implemented in six of the twelve states in which we operate.

Operating Expenses

Insurance operating expenses increased 4% to \$21.0 million for the three months ended March 31, 2011 from \$20.1 million for the three months ended March 31, 2010. The increase was primarily a result of severance and related benefits charges of \$1.3 million incurred in connection with the separation of certain executive officers during March 2011 offset by 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. For the nine months ended March 31, 2011, insurance operating expenses decreased 3% to \$57.9 million from \$59.4 million for the nine months ended March 31, 2010. The decrease was primarily a result of the reduction in costs offset by severance and related benefits charges noted above.

The expense ratio was 31.1% for the three months ended March 31, 2011, compared with 27.1% for the three months ended March 31, 2010. The expense ratio was 27.8% for the nine months ended March 31, 2011, compared with 27.1% for the same period in the prior fiscal year. Excluding the severance and related benefits charges noted above, the expense ratios for the three and nine months ended March 31, 2011 were 28.0% and 26.8%, respectively, compared to 27.1% for both periods in the prior fiscal year. This increase for the three months ended March 31, 2011 compared with the same period in the prior year was primarily due to the decrease in premiums earned noted above.

Overall, the combined ratio increased to 103.8% for the three months ended March 31, 2011 from 95.5% for the three months ended March 31, 2010. For the nine months ended March 31, 2011, the combined ratio increased to 102.4% from 94.7% for the nine months ended March 31, 2010. Excluding the severance and related benefits charges noted above, the combined ratios for the three and nine months ended March 31, 2011 were 100.7% and 101.4%, respectively.

Provision (Benefit) for Income Taxes

The benefit for income taxes was \$0.3 million for the three months ended March 31, 2011 compared with the provision for income taxes of \$0.1 million for the same period in the prior fiscal year. For the nine months ended March 31, 2011, the benefit for income taxes was \$0.1 million compared with the provision for income taxes of

\$0.3 million for the same period in the prior fiscal year. The provision (benefit) for income taxes relates to current state income taxes for certain subsidiaries with taxable income. The current fiscal year includes an adjustment that reduced

Table of Contents

FIRST ACCEPTANCE CORPORATION 10-Q

certain accrued state income taxes. At March 31, 2011 and 2010, we established a full valuation allowance against all federal and substantially all state net deferred tax assets.

Real Estate and Corporate

Loss before income taxes from real estate and corporate operations for the three months ended March 31, 2011 was \$1.8 million, compared with a loss before income taxes from real estate and corporate operations of \$1.4 million for the three months ended March 31, 2010. Loss before income taxes from real estate and corporate operations for the nine months ended March 31, 2011 was \$4.8 million, compared with a loss before income taxes from real estate and corporate operations of \$5.0 million for the nine months ended March 31, 2010. 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. We incurred \$1.0 million and \$2.9 million, respectively, of interest expense during the three and nine months ended March 31, 2011 and 2010 related to the debentures issued in June 2007.

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, 2011 was \$3.1 million compared with \$0.4 million for the same period in the prior fiscal year. Net cash used in operating activities for the nine months ended March 31, 2011 and 2010 was primarily the result of a decrease in cash collected from premiums written. Net cash provided by investing activities for the nine months ended March 31, 2011 was \$11.0 million compared with net cash used in investing activities of \$44.2 million for the same period in the prior fiscal year. The nine months ended March 31, 2011 included net reductions in our investment portfolio of \$11.4 million, while the same period in the prior fiscal year included net additions to our investment portfolio of \$43.0 million. The net reductions in the current fiscal year were a result of maturities and paydowns. The net additions in the prior fiscal year were primarily the result of the reinvestment of the proceeds from sales in the prior fiscal year of investments to generate taxable income to utilize expiring tax net operating loss carryforwards.

Our holding company requires cash for general corporate overhead expenses and for debt service related to our debentures payable. The holding company's primary source of unrestricted cash to meet its obligations is the sale of ancillary products to our insureds and, if necessary, the holding company may receive dividends from our insurance company subsidiaries. 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, 2011, we had \$10.4 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 earned surplus, we believe that we have total dividend capacity for the next twelve months of \$18.2 million, of which \$6.3 million is subject to regulatory approval.

The National Association of Insurance Commissioners Model Act for risk-based capital provides formulas to determine each December 31 on an annual basis, 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 also statutory guidelines that suggest that on an annual calendar year basis, an insurance company should not exceed a ratio of net premiums written to statutory capital and surplus of 3-to-1. On a combined basis, the ratios for our insurance company subsidiaries of net premiums written for the last twelve months to statutory capital and surplus were 1.5-to-1 at March 31, 2011. Based on our current forecast on a combined basis, we anticipate that our risk-based capital levels

will be adequate and that our ratio of net premiums written to statutory capital and surplus will not exceed the 3-to-1 statutory guideline for the reasonably foreseeable future. We therefore believe that our insurance company subsidiaries have sufficient statutory capital and surplus available to support their net premium writings in this time frame.

Table of Contents

FIRST ACCEPTANCE CORPORATION 10-Q

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.

Critical Accounting Policies

There have been no significant changes to our critical accounting policies and estimates during the three months ended March 31, 2011 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, 2010.

Off-Balance Sheet Arrangements

We have not entered into any new off-balance sheet arrangements since June 30, 2010. For information with respect to our off-balance sheet arrangements at June 30, 2010, 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, 2010.

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. 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, project, believe, 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:

our future growth, income, income per share and other financial performance measures;

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

the financial condition of, and other issues relating to the strength of and liquidity available to, issuers of securities held in our investment portfolio;

the accuracy and adequacy of our loss reserving methodologies; and

our business and growth strategies.

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, 2010.

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.

Table of Contents**FIRST ACCEPTANCE CORPORATION 10-Q****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 investment 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. Likewise, the underlying investments of our current mutual fund investment are also fixed-income investments. 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.

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	\$ 182,420	\$ 179,284	\$ 176,220	\$ 173,242	\$ 170,352	\$ 164,819

The following table provides information about our fixed maturity investments at March 31, 2011 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 premiums or discounts at the time of purchase and OTTI) by expected maturity date for each of the next 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 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 Unrealized Gains	Securities with Unrealized Losses	Securities with No Unrealized Gains or Losses	Amount
2011	\$ 3,175	\$	\$	\$ 3,175
2012	16,210			16,210
2013	24,210			24,210
2014	20,365			20,365
2015	19,393			19,393
Thereafter	76,169	7,765		83,934

Total	\$ 159,522	\$ 7,765	\$	\$ 167,287
Fair value	\$ 168,478	\$ 7,742	\$	\$ 176,220

On June 15, 2007, our 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).

Table of Contents**FIRST ACCEPTANCE CORPORATION 10-Q****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 investment, excluding U.S. government and agency securities, is the \$8.1 million investment in a single mutual fund, or 4% of the investment portfolio. The top five investments make up 13% of the investment portfolio. The average credit quality rating for our fixed maturity portfolio was AA- at March 31, 2011.

The following table presents the underlying ratings of our fixed maturity portfolio by nationally recognized securities rating organizations at March 31, 2011 (in thousands).

Comparable Rating	Amortized Cost	% of Amortized Cost	Fair Value	% of Fair Value
AAA	\$ 65,990	39.2%	\$ 69,100	39.2%
AA+, AA, AA-	35,172	20.9%	37,075	21.1%
A+, A, A-	46,062	27.4%	47,934	27.2%
BBB+, BBB, BBB-	12,247	7.3%	12,924	7.3%
Total investment grade	159,471	94.8%	167,033	94.8%
Not rated	3,725	2.2%	3,742	2.1%
BB+, BB, BB-	1,664	1.0%	1,704	1.0%
B+, B, B-	1,119	0.7%	1,331	0.7%
CCC+, CCC, CCC-	1,005	0.6%	1,116	0.6%
CC+, CC, CC-	921	0.5%	840	0.5%
C+, C, C-	329	0.2%	454	0.3%
Total non-investment grade	5,038	3.0%	5,445	3.1%
Total	\$ 168,234	100.0%	\$ 176,220	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, 2011, our fixed maturity portfolio included three CMOs having sub-prime exposure with a fair value of \$1.0 million and no exposure to Alt-A investments.

Our investment portfolio consists of \$36.4 million of municipal bonds, of which \$22.5 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 at March 31, 2011, 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	\$		\$ 4,661	34%	\$ 4,661	13%
AA+, AA, AA-	11,870	53%	5,350	38%	17,220	47%

Edgar Filing: FIRST ACCEPTANCE CORP /DE/ - Form 10-Q

A+, A, A-	9,080	40%	3,881	28%	12,961	36%
BBB+, BBB, BBB-	1,599	7%			1,599	4%
Total	\$ 22,549	100%	\$ 13,892	100%	\$ 36,441	100%

27

Table of Contents

FIRST ACCEPTANCE CORPORATION 10-Q

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management team, including our Chief Executive Officer and Interim Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended, or the Exchange Act) as of March 31, 2011. Based on that evaluation, our Chief Executive Officer (principal executive officer) and Interim Chief Financial Officer (principal financial officer) concluded that our disclosure controls and procedures were effective as of March 31, 2011 to 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 SEC'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.

Table of Contents

FIRST ACCEPTANCE CORPORATION 10-Q
PART II OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information regarding repurchases by us of our common stock during the periods indicated (in thousands, except per share data). We repurchased 54,965 shares from employees during the three months ended March 31, 2011 to cover payroll withholding taxes in connection with the vesting of restricted common stock.

Period Beginning	Period Ending	Total	Average	Total	Approximate
		Number	Price	Number of	Dollar
		of Shares	Paid	Shares	Value of
		Purchased	per	Purchased	Shares that
			Share	as Part of	May
				Publicly	Yet Be
				Announced	Purchased
				Plans	Under the
				or	Plans or
				Programs	Programs
January 1, 2011	January 31, 2011				
February 1, 2011	February 28, 2011	1,754	\$ 1.83		
March 1, 2011	March 31, 2011	53,211	\$ 1.83		
Total		54,965	\$ 1.83		

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 Interim 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 Interim 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.

Table of Contents

**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 9, 2011

By: /s/ Michael J. Bodayle
Michael J. Bodayle
Vice President, Treasurer and Interim Chief Financial
Officer
(Principal Financial Officer and Principal Accounting
Officer)
30