INFINITY PROPERTY & CASUALTY CORP
Form 10-K
February 28, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______ to ______

Commission file number 0-50167

INFINITY PROPERTY AND CASUALTY CORPORATION

(Exact name of registrant as specified in its charter)

OHIO	**03-0483872**
(State of other jurisdiction of	***(I.R.S. Employer***
incorporation or organization)	***Identification No.)***

3700 COLONNADE PARKWAY

BIRMINGHAM, ALABAMA **35243**

(Address of principal executive offices) *(Zip Code)*

(205) 870-4000

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:	Name of each exchange on which registered:
Common Stock, no par value	NASDAQ Global Select Market

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

(Title of class)

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

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

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange from their obligations under those Sections.

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. x Yes ¨ No

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

As of June 30, 2006, the aggregate market value of the voting Common Stock held by non-affiliates of the registrant was $832,810,860 based on the last sale price of Common Stock on that date as reported by The NASDAQ Global Select Market.

As of February 15, 2007, there were 19,494,049 shares of the registrant s Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s proxy statement for the annual meeting of shareholders to be held on May 21, 2007, are incorporated by reference in Part III hereof.

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ON FORM 10-K

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-K

Cautionary Statement Regarding Forward-looking Statements

This Annual Report on Form 10-K contains certain statements that may be deemed to be forward-looking statements that anticipate results based on our estimates, assumptions and plans that are subject to uncertainty. These statements are made subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements in this report not dealing with historical results or current facts are forward-looking and are based on estimates, assumptions, and projections. Statements which include the words believes , seeks , expects , may , should , intends , likely , targets , plans , anticipates , estimates or the negative version of those words and similar statements of a future or forward-looking nature identify forward-looking statements. Examples of such forward-looking statements include statements relating to expectations concerning market conditions, premiums, growth, earnings, investment performance, expected losses, rate changes and loss experience.

Actual results could differ materially from those expected by Infinity depending on: changes in economic conditions and financial markets (including interest rates), the adequacy or accuracy of Infinity s pricing methodologies, actions of competitors, the approval of requested form and rate changes, judicial and regulatory developments affecting the automobile insurance industry, the outcome of pending litigation against Infinity, weather conditions (including the severity and frequency of storms, hurricanes, snowfalls, hail and winter conditions), changes in driving patterns and loss trends. Infinity undertakes no obligation to publicly update or revise any of the forward-looking statements. For a more detailed discussion of some of the foregoing risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, see Risk Factors contained in Item 1A.

ITEM 1

Business

Introduction

Infinity Property and Casualty Corporation (Infinity or the Company) is a holding company that, through subsidiaries, provides personal automobile insurance on a national level with a concentration on nonstandard auto insurance. Infinity is headquartered in Birmingham, Alabama. The Company employed approximately 2,100 persons at December 31, 2006.

Infinity files its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other reports as required with the United States Securities and Exchange Commission (SEC). Any of these documents may be read and copied at the SEC s Public Reference Room at 100 F Street NE, Washington, D.C. 20549. Information regarding the operation of the SEC Public Reference Room may be obtained by calling 1-800-SEC-0330. Infinity s filed documents may also be accessed via the SEC Internet site at: http://www.sec.gov. All of Infinity s SEC filings, news releases and other information may also be accessed free of charge on Infinity s Internet site at: http://www.ipacc.com. Information on Infinity s website is not part of this Form 10-K.

Please see Note 1 to the Consolidated Financial Statements for additional information regarding the history and organization of Infinity. References to Infinity, unless the context requires otherwise, include the combined operations of its subsidiaries (collectively the NSA Group) and the in-force personal insurance business assumed through a reinsurance contract (the Assumed Agency Business) from American Financial Group Inc. s (AFG), formerly our parent company, principal property and casualty subsidiary, Great American Insurance Company (GAI). Unless indicated otherwise, the financial information herein is presented on a GAAP basis.

The Personal Automobile Market

Personal auto insurance is the largest line of property and casualty insurance, accounting for approximately 36% of the estimated $449 billion of annual industry premiums. Personal auto insurance is comprised of preferred, standard and nonstandard risks. Nonstandard auto insurance is intended for drivers who, due to factors such as their driving record, age or vehicle type, represent a higher than normal risk. As a result, customers who purchase nonstandard auto insurance generally pay higher premiums for similar coverage than the drivers qualifying for standard or preferred policies. While there is no established industry-recognized distinction between nonstandard policies and all other personal auto policies, Infinity believes that nonstandard auto risks generally constitute between 15% and 20% of the personal automobile insurance market, with this range fluctuating according to competitive conditions in the market. Independent agents sell approximately one-third of all personal automobile insurance. The remainder is sold by captive agents or directly by insurance companies to their customers. Infinity believes that, relative to the standard and preferred auto insurance market, a disproportionately larger piece of nonstandard auto insurance is sold through independent agents.

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The personal auto insurance industry is cyclical, characterized by periods of price competition and excess capacity, followed by periods of high premium rates and shortages of underwriting capacity. In the late 1990s, many automobile insurers attempted to capture more business by reducing rates. Infinity believes that these industry-wide rate reductions, combined with increased severity and frequency trends during the years 1998 through 2000, contributed to the deterioration of industry loss ratios in that period. Infinity reacted by increasing personal auto rates by 15% in 2001 and 12% in 2002. Most of the industry, including some of the largest companies, raised rates and tightened underwriting standards in order to address poor results. Other insurance companies withdrew from the market because of their inability to compete successfully, impaired capital positions, or because of a decrease in the availability of reinsurance. However, beginning in the second half of 2003, competitors who remained in the marketplace began to compete more aggressively for independent agents business by offering increased sales and commission incentives. This competition for the independent agents business continued in 2004, 2005 and throughout 2006. Infinity also noted that during 2005 and 2006 some competitors began to reduce their overall rates with larger rate reductions in certain segments of the business. The personal automobile component of the Consumer Price Index reflects this trend as it indicates personal automobile insurance rates have increased just 0.8% and 1.0% during 2006 and 2005, respectively, after increasing 3.4% and 4.5% during 2004 and 2003, respectively. Infinity s average rate increases were 2.0%, 2.7%, 2.2% and 0.8%, for 2003, 2004, 2005 and 2006, respectively.

The personal auto insurance industry is highly competitive and, except for regulatory considerations, there are relatively few barriers to entry. Infinity generally competes with other insurers on the basis of price, coverages offered, claims handling, customer service, agent commission, geographic coverage and financial strength ratings. Infinity competes with both large national writers and smaller regional companies. In 2005, the five largest automobile insurance companies accounted for approximately 48% of the industry s net written premiums and the largest ten accounted for approximately 64% (2006 industry data not available). Approximately 363 insurance groups compete in the personal auto insurance industry, according to A.M. Best. Some of these groups specialize in nonstandard auto insurance, while others insure a broad spectrum of personal auto insurance risks.

Operations

Infinity is organized into four regions; West, South, East and Central. Each region has its own product management, field claims operation, and business development staff. The regions are also supported by the following centralized departments: marketing, claims, customer service, treasury, human resources and information technology resources. Monthly executive team meetings, which include the Chief Executive Officer, the Chief Financial Officer, the Chief Legal Officer, the Chief Human Resources Officer, the Chief Information Technology Officer, the Chief Actuary, the Centralized Claims Officer and the four regional presidents, allow for sharing of information among regions and for setting policies and making key strategic decisions.

Infinity estimates that approximately 98% of its personal auto business is nonstandard auto insurance. Based on data published by A.M. Best, Infinity believes that it is the third largest provider of nonstandard auto coverage through independent agents in the United States. Infinity also writes standard and preferred personal auto insurance, nonstandard commercial auto insurance and complementary personal lines insurance products.

Summarized historical financial data for Infinity is presented below (in thousands).

	Twelve months ended December 31,		
	2006	**2005**	**2004**
Gross written premium	$ 992,409	$ 1,002,813	$ 963,757
Net written premium	982,190	979,635	917,756
Net earnings	87,282	106,308	96,398

	as of December 31,	
	2006	**2005**

Total assets	$ 2,014,354	$ 1,971,728
Total liabilities	1,349,753	1,345,134
Total shareholders equity	664,601	626,594

Infinity has a history of favorable underwriting results. The following table compares Infinity s statutory combined ratio in past years with those of the private passenger auto industry. The statutory combined ratio is the sum of the loss ratio (the ratio of losses and

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loss adjustment expenses (LAE) to net earned premiums) and the expense ratio (when calculated on a statutory accounting basis, the ratio of underwriting expenses to net written premiums). When the combined ratio is under 100%, underwriting results are generally considered profitable; when the ratio is over 100%, underwriting results are generally considered unprofitable.

	2006	2005	2004	2003	2002	2001	2002-2006	1997-2006
Infinity	88.7%	90.0%	90.3%	94.9%	92.6%	104.6%	91.1%	96.8%
Industry (a)	93.0%	95.1%	94.3%	98.4%	104.2%	107.9%	96.8%	100.1%
Percentage points better than industry	4.3%	5.1%	4.0%	3.5%	11.6%	3.3%	5.7%	3.3%

(a) Private passenger auto industry combined ratios were obtained from A.M. Best. The industry combined ratio for 2006 is an estimate.

Products

Personal Automobile is Infinity s primary insurance product. It provides coverage to individuals for liability to others for bodily injury and property damage and for physical damage to an insured s own vehicle from collision and various other perils. In addition, many states require policies to provide for first party personal injury protection, frequently referred to as no-fault coverage. Infinity offers three primary products to individual drivers: the Low-Cost product, which offers the most restricted coverage, the Value-Added product, which offers broader coverage and higher limits, and the Premier product, which offers the broadest coverage and is designed for standard and preferred risk drivers. For the year ended December 31, 2006, Infinity s mix of personal automobile gross written premium was 14% Low-Cost, 84% Value-Added and 2% Premier.

Commercial Vehicle provides coverage to businesses for liability to others for bodily injury and property damage and for physical damage to vehicles from collision and various other perils. Infinity offers nonstandard commercial automobile insurance to companies that employ one or more nonstandard risk drivers. Target businesses include fleets of 12 or fewer vehicles. Businesses that are involved in what Infinity considers to be hazardous operations or interstate commerce are generally avoided.

Classic Collector provides protection for classic collectible automobiles. Infinity s Classic Collector program provides coverage to individuals with classic or antique automobiles for liability to others for bodily injury and property damage and for physical damage to an insured s own vehicle from collision and various other perils.

Infinity s three product groups contributed the following percentages of total gross written premiums:

	Twelve months ended December 31,		
	2006	2005	2004
Personal Automobile	94%	93%	94%
Commercial Vehicle	4%	5%	4%
Classic Collector	2%	2%	2%
Total	100%	100%	100%

Distribution and Marketing

Infinity distributes its products primarily through a network of over 14,000 independent agencies (with approximately 17,000 locations). Independent agencies were responsible for approximately 94% of Infinity s gross written premiums for the twelve-month period ended December 31, 2006. In 2006, three independent agencies each accounted for between 2% and 3% of Infinity s gross written premiums, and three other agencies each accounted for between 1% and 2% of the Company s gross written premiums. Infinity pays each agent a commission, based on contractual rates multiplied by the premiums the agent generates. On a limited basis, Infinity also offers contingent commission arrangements, typically in the form of higher commission rates, to agencies in order to spur premium growth in profitable areas. In 2006, contingent commission arrangements represented approximately 1.5% of the total agency compensation.

Infinity also fosters agent relationships by providing them with access to Infinity s Internet web-based software applications along with programs and services designed to strengthen and expand their marketing, sales and service capabilities. Infinity s Internet-based software applications provide many of its agents with real-time underwriting, claims and policy information. Infinity believes

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the array of services that it offers to its agents adds significant value to their businesses. For example, Infinity s Providing Agents Service and Support Program is an incentive-based program through which Infinity s agents receive assistance in critical areas such as training, advertising and promotion.

Strategic partnerships are another mode of distribution for Infinity. These are relationships with non-affiliated property and casualty insurers that have their own captive agency forces. These companies usually provide standard and preferred auto coverage through one of their own companies while utilizing Infinity s companies for their nonstandard risks. Infinity believes these relationships are mutually beneficial because its partners gain access to Infinity s nonstandard auto expertise, and Infinity gains access to a new distribution channel. This channel represented approximately 6% of gross written premiums in 2006.

Infinity is licensed to write auto insurance in all 50 states but is committed to growth in selected states that management believes offer the greatest opportunity for premium growth and profitability. Infinity classifies the states in which it operates into three categories:

Top Five Focus States States included in this category are California, Connecticut, Florida, Georgia and Pennsylvania

14 Remaining Focus States States included in this category are Alabama, Alaska, Arizona, Colorado, Indiana, Mississippi, Missouri, Nevada, Ohio, South Carolina, Tennessee, Texas, Virginia and Wisconsin

Non-Focus States Infinity is either maintaining its renewal writings in these states or is ceasing operations in these states.
Within many of these 19 Focus States, Infinity has identified key urban areas in which its efforts will be focused. In addition, because Infinity continually evaluates its market opportunities, the mix of states within each category may change over time as new market opportunities arise, as the allocation of resources change, or as a result of changes in regulatory environments.

Total gross written premiums among the three state categories are as follows:

	Twelve months ended December 31,		
	2006	**2005**	**2004**
Top Five Focus States:			
California	50%	48%	48%
Florida	17%	18%	15%
Georgia	7%	5%	6%
Pennsylvania	5%	6%	6%
Connecticut	4%	5%	7%
Sub-Total Top Five Focus States	83%	82%	82%
14 Remaining Focus States	15%	15%	13%
Sub-Total All Focus States	98%	97%	95%
Non-Focus States	2%	3%	5%

Total All States	100%	100%	100%
Total $ (in thousands) All States (1)	$ 986,741	$ 988,670	$ 940,221

(1) 2006, 2005 and 2004 excludes $5.0 million, $9.8 million and $16.4 million, respectively, of premiums written on behalf of other companies. 2006, 2005 and 2004 also exclude $0.7 million, $4.3 million and $7.2 million, respectively, of unearned premium transfers.

Infinity s distribution and marketing efforts are implemented with a focus on maintaining a low-cost structure. Controlling expenses allows Infinity to price competitively and achieve better underwriting returns. Over the five years ended 2005, years for which industry data are available, Infinity s statutory ratio of underwriting expenses to premiums written has averaged 22.5%, which is 3.2 points better than the independent agency segment of the private passenger automobile industry average of 25.7% for the same period.

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Claims Handling

Infinity s claims organization employs approximately 900 people and has 40 field branch offices. Infinity provides a 24-hour, seven days per week toll-free service for its customers to report claims. Infinity predominantly uses its own local adjusters and appraisers, who typically respond to claims within 24 hours of a report. In 2005, Infinity began operating claims service centers, which allow a customer to conveniently drop off their vehicles for repair and pick up a rental car. Two service centers were in operation in 2006 with three planned for opening in 2007.

Infinity is committed to the field handling of claims and believes it provides, when compared to alternative methods, better service to its customers and better control of the claim resolution process. Infinity opens claims branch offices in areas where the volume of business will support them. Customer interactions can occur with generalists (initial and continuing adjusters) and specialists (staff appraisers, field casualty representatives and special investigators) based on local market volume, density and performance. Nationally, over 75% of Infinity s claims are handled face-to-face. Infinity strives for accuracy, consistency and fairness in its claim resolutions.

Reinsurance

Infinity reinsures a portion of its business with other insurance companies. During 2006, Infinity ceded 1.0% of its gross written premiums. Ceding reinsurance permits diversification of risk and limits the maximum loss arising from large or unusually hazardous risks or catastrophic events. Infinity is subject to credit risk with respect to its reinsurers, as the ceding of risk to reinsurers generally does not relieve Infinity of its liability to insureds until claims are fully settled. To mitigate this credit risk, Infinity currently cedes business only to reinsurers that meet its credit ratings criteria. All reinsurers rated by A.M. Best, except one, have at least an A rating, with none lower than A- . The reinsurer presently rated A- has set aside, in trust, assets that fully collateralize its reinsurance obligation to Infinity. During the years 2002 through 2004, Infinity ceded a portion of its automobile physical damage business through reinsurance agreements with Inter-Ocean Reinsurance Company Ltd. and American-Re Insurance Company (collectively the Quota Share Agreements). The Quota Share Agreements were commuted before 2005 and were not renewed or replaced. See Note 10 of the Consolidated Financial Statements for further discussion.

Ratings

A.M. Best has assigned Infinity s insurance company subsidiaries a group financial strength rating of A (Excellent). According to A.M. Best, A ratings are assigned to insurers that have, on average, excellent balance sheet strength, operating performance and business profile when compared to the standards established by A.M. Best and, in A.M. Best s opinion, have an excellent ability to meet their ongoing obligations to policyholders . A.M. Best bases its ratings on factors that concern policyholders and not upon factors concerning investor protection.

Regulatory Environment

Infinity s insurance company subsidiaries are subject to regulation and supervision by insurance departments of the jurisdictions in which they are domiciled or licensed to transact business. State insurance departments have broad administrative power relating to licensing insurers and agents, regulating premium rates and policy forms, establishing reserve and investment requirements, prescribing statutory accounting methods and the form and content of statutory financial reports, and regulating methods and processes of how an insurer conducts it business. Recent examples of the latter include the establishment of auto rating factor regulations, proscription on credit based insurance scoring, prohibition of certain business practices with auto body repair shops, and attempts to set uniform auto body repair shop parts and labor rates. Some of these regulatory actions have come with the support of legislation, while others have been contested through judicial challenges.

Under state insolvency and guaranty laws, regulated insurers can be assessed or required to contribute to state guaranty funds to cover policyholder losses resulting from insurer insolvencies. Insurers are also required by many states, as a condition of doing business in the state, to participate in various assigned risk pools, reinsurance facilities or underwriting associations, which provide various insurance coverages to individuals who otherwise are unable to purchase that coverage in the voluntary market. Participation in these involuntary plans is generally in proportion to voluntary writings of related lines of business in that state. The underwriting results of these plans traditionally have been unprofitable. The amount of premiums Infinity might be required to assume in a given state in connection with an involuntary plan may be reduced because of credits Infinity may receive for nonstandard policies that it voluntarily writes. Many states have laws and regulations that limit an insurer s ability to exit a market. For example, certain states limit an automobile insurer s ability to cancel and non-renew policies.

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State insurance departments that have jurisdiction over Infinity s insurance subsidiaries may conduct on-site visits and examinations of the insurers affairs. At December 31, 2006, Infinity s insurance subsidiaries were involved in four market conduct examinations, including a field claims examination and a related order to show cause in California. These examinations have from time to time given rise to, and are likely to give rise to in the future, regulatory orders requiring remedial, injunctive or other action on the part of an insurance subsidiary or the assessment of substantial fines or other penalties against Infinity s insurance subsidiaries.

The insurance laws of the states of domicile of Infinity s insurance subsidiaries contain provisions to the effect that the acquisition or change of control of a domestic insurer or of any entity that controls a domestic insurer cannot be consummated without the prior approval of the relevant insurance regulator. In addition, certain state insurance laws contain provisions that require pre-acquisition notification to state agencies of a change in control with respect to a non-domestic insurance company licensed to do business in that state. Such approval requirements may deter, delay or prevent certain transactions affecting the ownership of Infinity s common stock.

Infinity is a holding company with no business operations of its own. Consequently, Infinity s ability to pay dividends to shareholders and meet its debt payment obligations is largely dependent on dividends or other distributions from its insurance company subsidiaries, current investments and cash held. State insurance laws restrict the ability of Infinity s insurance company subsidiaries to declare shareholder dividends. These subsidiaries may not make an extraordinary dividend until thirty days after the applicable commissioner of insurance has received notice of the intended dividend and has not objected in such time or has approved the payment of the extraordinary dividend within the 30-day period. An extraordinary dividend is defined as any dividend or distribution that, together with other distributions made within the preceding twelve months, exceeds the greater of 10% of the insurer s surplus as of the preceding December 31st, or the insurer s net income for the twelve-month period ending the preceding December 31st, in each case determined in accordance with statutory accounting practices. In addition, an insurer s remaining surplus after payment of a cash dividend to shareholder affiliates must be both reasonable in relation to its outstanding liabilities and adequate to its financial needs.

If a shareholder dividend does not rise to the statutory level of an extraordinary dividend, then it is an ordinary dividend. While an insurance company s ability to pay an ordinary dividend does not require the approval of a state insurance department, the company must, by law, file a 10-day notice of ordinary dividend with the appropriate insurance departments. Insurance companies that fail to notify an insurance department of the payment of an ordinary dividend are assessed administrative fines.

The ordinary dividend capacity and payment activity of Infinity s insurance companies for the three most recent years are shown in the following table (in thousands).

	2007	2006	2005
Maximum ordinary dividends available to Infinity (a)	$ 113,896	$ 160,350	$ 62,664
Dividends paid from subsidiaries to parent		$ 160,000	62,500

(a) The 2007 maximum ordinary dividend includes a one-time addition of approximately $33 million due to dividends paid to the lead insurance company in the pool from its insurance subsidiaries. The 2006 maximum ordinary dividend includes a one-time addition of approximately $72 million due to a change in the intercompany reinsurance arrangements that became effective January 1, 2005.

State insurance laws require Infinity s insurance companies to maintain specified levels of statutory capital and surplus. Generally, the net admitted assets of insurance companies that, subject to other applicable insurance laws and regulations, are available for transfer to the parent company cannot include the net admitted assets required to meet the minimum statutory surplus requirements of the states where the companies are licensed. In addition, for competitive reasons, Infinity s insurance company subsidiaries need to maintain adequate financial strength ratings from independent rating agencies. Both of these factors may limit the ability of Infinity s insurance subsidiaries to declare and pay dividends.

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ITEM 1A

RISK FACTORS

Infinity s business operations face a number of risks. These risks should be read and considered with other information provided in this report.

Because of the significant concentration of Infinity s business in California, Infinity s profitability may be adversely affected by negative developments in the California insurance market, including, among others, recent regulations on rating factors and rate of return.

California, Infinity s largest market, generated approximately 50% of Infinity s gross written premiums in 2006. Infinity s California business also generates substantial underwriting profit. Consequently, Infinity s revenues and profitability are affected by the dynamic nature of regulatory, legal, economic and competitive conditions in that state. Recent examples of potentially adverse regulatory or judicial developments in California include regulations restricting territory as a rate factor (Rating Factor Regulations), limiting the after-tax rate of return allowed an insurer (Rate Approval Regulations), restrictions on the type of compensation paid to, or fees charged by, independent brokers, and measures to regulate how an insurer establishes reasonable costs to be covered for paint and materials in automobile repairs, and the manner in which an insurer can make referrals to an automobile repair shop. These developments could negatively affect premium revenue or make it more expensive or less profitable for Infinity to conduct business in the state.

Recent attempts by insurance trade associations to halt enforcement of the Rating Factor Regulations have been largely unsuccessful. As a consequence, the Company has submitted class plan and rate filings with the California Department of Insurance (CDI). The CDI, however, has not yet approved these filings and may require further rate adjustments. Other automobile insurers doing business in the state have also, or will in the coming months, submit modified class and rate plans in response to the Rate Factor Regulations. As this process is likely to continue through 2007, it is difficult to predict how or when these rate changes may impact Infinity from a competitive standpoint, or to what extent the Rate Factor Regulations will affect the profitability of the business Infinity writes in California.

Cyclical conditions in the personal automobile insurance industry, particularly in the market for nonstandard insurance, could reduce Infinity s profitability.

The personal automobile industry is in the midst of a soft market cycle, which is characterized by heightened price competition and excess underwriting capacity. To enhance revenue growth during this cycle, some insurers may opt to reduce rates or loosen underwriting standards. Such actions may make it more challenging for Infinity to maintain or grow market share and achieve desired underwriting margins. The soft market cycle may also cause some companies that have traditionally focused on writing standard and preferred risks to compete with Infinity for the nonstandard business. New competition from such companies, some of which have greater financial, technical and operating resources than Infinity, could adversely impact Infinity s profitability and growth prospects.

Profitability may be affected if Infinity fails to accurately price the risks it underwrites.

Infinity s profitability depends on its ability to set premium rates accurately. Pricing with accuracy is complicated by inflationary pressures on medical care, auto parts and repair services costs, and is dependent on the availability of sufficient, reliable data on which to project both severity and frequency trends and timely recognition of changes in loss cost trends. This process poses more of a challenge in markets where Infinity has less geographic presence and experience. Consequently, Infinity could underprice risks, which could negatively affect its profit margins, or overprice risks, which could reduce sales volume and competitiveness. Either scenario could adversely affect profitability.

Extra-contractual losses arising from bad faith claims could result in losses that are material to Infinity s results of operations.

In California, Florida, and other states where Infinity has substantial operations, the judicial climate, case law or statutory framework are often viewed as less favorable toward an insurer in litigation brought against it by policyholders and third-party claimants.

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RISK FACTORS

This tends to increase an insurer s exposure to extra-contractual losses, or monetary damages beyond policy limits, in what are known as bad faith claims. Such claims have in the past, and may in the future, result in losses to Infinity that are material to the Company s operating results.

The failure to maintain and further develop reliable and efficient information and technology systems would be disruptive to Infinity s operations and diminish its ability to compete successfully.

Infinity is highly dependent on its information technology and business systems performing efficiently and in an uninterrupted fashion to quote, process and service its business, and to perform actuarial functions necessary for pricing and product development. These systems must also possess the capability of undergoing modifications and improvements, from time to time, without interruptions or untimely delays, so that Infinity may meet growing customer demands for user friendly on-line systems and high quality and convenient customer service. The Company is currently undergoing fundamental changes and improvements to its service platform. A material failure in these systems, or failure or delay to achieve these improvements, could interrupt certain processes or degrade business operations and adversely affect our results of operations.

Legal, regulatory and legislative challenges to established practices in the areas of underwriting, claims handling and compensation issues are continually emerging and could adversely impact Infinity s revenues or established methods of doing business.

As automobile insurance industry practices and regulatory, judicial and consumer conditions change, challenges to prevailing industry practices continue to emerge. Recent challenges to Infinity practices relate to:

- the use of an applicant s credit, territory and other rating factors in making risk selection and pricing decisions;
- the manner in which brokers are compensated and provided incentives;
- the use of automated databases to assist in the adjustment of bodily injury claims; and
- the terms and conditions surrounding the use of direct repair shops and towing services.

Some of these practices are the subject of ongoing litigation (See Note 12 of the Consolidated Financial Statements, Legal Proceedings). How or when these issues are ultimately resolved is uncertain. The resolutions could, however, adversely impact Infinity s revenues or its methods of doing business.

The inability to recruit, develop and retain key personnel could prevent Infinity from implementing its business strategy and negatively affect future growth and profitability.

Successful implementation of Infinity s business strategy will depend, in part, upon the continued services of its Chief Executive Officer, James Gober, who is under contract with the Company through December 2008. Infinity s future success will also depend on it attracting and retaining its executives and key personnel. The highly competitive nature of the industry, along with the advantages larger, more established or well known competing firms possess in the recruiting process, pose a challenge for companies like Infinity. The loss of any of the executive officers or key personnel, or the inability to attract and retain new talent, could prevent Infinity from fully implementing its business strategy and negatively affect future growth and profitability.

Infinity may not be able to retain or increase the level of business independent agents and brokers place with Infinity, which could negatively affect revenues.

Infinity must compete with other insurance carriers for independent agents and brokers business in an increasingly competitive marketplace. Some competitors offer superior quoting or business process systems, a larger variety of products, lower prices for insurance coverage, higher commissions or more attractive cash and non-cash incentives. Recent or future regulations, legislation or litigation may also have the effect of limiting the manner in which brokers are compensated or provided incentives, particularly in California where Infinity deals predominantly with brokers as opposed to licensed agents. Such developments could negatively impact revenues in a given market.

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RISK FACTORS

Infinity is vulnerable to a reduction in the amount of business written through the independent agents distribution channel.

Reliance on the independent agency as its primary distribution channel makes Infinity vulnerable to the growing popularity of direct distribution channels, particularly the Internet. Approximately two-thirds of all personal automobile insurance sold in the United States is sold direct or through captive agents (agents employed by one company or selling only one company s products) and approximately one-third is sold by independent agents. A material reduction in the amount of business generated through the independent agency channel could negatively impact Infinity s revenues and growth opportunities.

The failure to effectively manage the on-going consolidation of customer service, information technology and other support functions could be disruptive to Infinity s operations.

Infinity announced in October 2006 plans to consolidate its customer service, treasury, centralized claims, information technology, and other back-office service departments located in several cities to Birmingham, Alabama. Over 400 staff positions will be affected. This consolidation effort will continue throughout 2007 and will require reduction, transfer or replacement of staff, closing of several facilities and lease and renovation of replacement space in Birmingham. Failure to plan for or to effectively execute the plan for consolidation could result in a deterioration of service to policyholders and claimants and adversely impact Infinity s revenues and profitability.

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ITEM 1B

Unresolved Staff Comments

None.

ITEM 2

Properties

Infinity s insurance subsidiaries lease approximately 900,000 square feet of office and warehouse space in numerous cities throughout the United States. All but two of these leases expire within ten years. The most significant leased office spaces are located in Birmingham, Alabama (Infinity s principal office); suburban Atlanta, Georgia; Irving, Texas and suburban Los Angeles, California. See Note 13 of the Consolidated Financial Statements for further information about leases.

ITEM 3

Legal Proceedings

See Note 12 of the Consolidated Financial Statements for a discussion of the Company s material Legal Proceedings.

ITEM 4

Submission of Matters to a Vote of Security Holders

None.