

PROFESSIONALS DIRECT INC
Form DEF 14A
April 03, 2006

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

Filed by the Registrant T
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Check the appropriate box:

- £ Preliminary Proxy Statement
 £ Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
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PROFESSIONALS DIRECT, INC.
(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

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(4) Date Filed:

PROFESSIONALS DIRECT, INC.

161 Ottawa Avenue, N.W., Suite 607
Grand Rapids, Michigan 49503

Notice of Annual Meeting of Shareholders

Date: Tuesday, May 9, 2006

Time: 10:00 a.m., local time

Place: Crowne Plaza Grand Rapids
5700 - 28th Street, S.E.
Grand Rapids, Michigan 49546

April 3, 2006

Dear Fellow Shareholder:

You are cordially invited to attend the Annual Meeting of Shareholders of Professional Direct, Inc. on May 9, 2006. At the meeting, we will vote on (i) the election of directors, and (ii) such other business as may properly come before the meeting.

You can vote at the annual meeting if you were a shareholder of record on March 22, 2006. Your Board of Directors recommends that you vote **FOR** each of the nominees.

We look forward to seeing you at the meeting.

By Order of the Board of Directors,

Stephen M. Tuuk
President and Chief Executive Officer

Your vote is important to us. Even if you plan to attend the meeting, please vote now, by signing, dating, and mailing your proxy in the enclosed envelope.

Professionals Direct, Inc.

161 Ottawa Avenue, N.W., Suite 607
Grand Rapids, Michigan 49503

April 3, 2006

Proxy Statement

Time and Place of Meeting

You are cordially invited to attend the annual meeting of shareholders of Professionals Direct, Inc. to be held on Tuesday, May 9, 2006, at the Crowne Plaza Grand Rapids, 5700 - 28th Street, S.E., Grand Rapids, Michigan, 49546, at 10:00 a.m. local time.

Purposes of Meeting

The purpose of the annual meeting is to consider and vote upon:

- (1) Election of directors; and
- (2) Such other business as may properly come before the meeting.

Your Board of Directors recommends that you vote FOR each of the nominees.

You may vote at the meeting if you were a shareholder of record of Professionals Direct at the close of business on March 22, 2006. Each such shareholder is entitled to one vote per share on each matter presented.

As of March 22, 2006, there were 333,500 shares of Professionals Direct common stock issued and outstanding.

Mailing Date

We began mailing this proxy statement and the enclosed form of proxy to our shareholders on and after April 3, 2006.

How to Vote by Proxy

To vote by mail, please sign and return the enclosed form of proxy.

If you specify a choice, the shares represented by your proxy will be voted as specified. If you do not specify a choice, your shares will be voted for the election of the nominees named in this proxy statement as directors and, with respect to any other matter that may come before the meeting, in the discretion of the individuals named as proxies on your proxy.

If any other matters are presented for consideration at the annual meeting, the individuals named in the enclosed form of proxy will have the discretion to vote on those matters. As of the date of this proxy statement, we do not know of any other matters to be considered at the annual meeting.

You may revoke your proxy at any time prior to its exercise by delivering written notice of revocation to the Secretary of Professionals Direct, by signing and delivering a later dated proxy or by attending and voting at the annual meeting.

Required Vote

A plurality of the shares voting is required to elect directors. This means that if there are more nominees than positions to be filled, the nominees for whom the most votes are cast will be elected.

Any other matter voted upon at the meeting will be approved if a majority of the votes cast are voted for such matter.

The presence of the holders of a majority of the votes entitled to be cast at the meeting is necessary to constitute a quorum. If you submit a proxy or attend the meeting in person, your shares will be counted towards the quorum, even if you abstain from voting on some or all of the matters introduced at the meeting. Abstentions and broker non-votes will not be counted as votes on any matter expected to come before the meeting.

Election of Directors

The Board of Directors presently consists of ten individuals, divided into three classes of four, three, and three individuals. Following the annual meeting, the Board of Directors will consist of nine individuals, divided into three equal classes of three individuals. Each class has a term of office of three years, with the term of office of one class expiring at the annual meeting in each successive year. The terms of four directors will expire as of the annual meeting.

The Board of Directors proposes that the following three nominees be elected as directors at the annual meeting for terms expiring at the annual meeting in 2009:

Nominee

David W. Crooks
Thomas F. Dickinson
Blake W. Krueger

Each proposed nominee is willing to be elected and serve as a director. However, if a nominee is unable to serve or is otherwise unavailable for election, which we do not anticipate, the incumbent Board of Directors may or may not select a substitute nominee. If a substitute nominee is selected, your proxy (unless you give alternative instructions) will be voted for the person so selected. If a substitute nominee is not selected, your proxy will be voted for the election of the remaining nominees. Proxies will not be voted for a greater number of persons than the number of nominees named. Each nominee was recommended by the other continuing directors of Professionals Direct.

Biographical information concerning nominees and current directors is presented below. Except as otherwise indicated, each nominee has had the same principal employment for over five years.

Professionals Direct's Board of Directors

Nominees for the Board of Directors

David W. Crooks (age 57) is nominated for a term ending in 2009. He has been a director of Professionals Direct since 2001 and was a director of PDIC from 1993 to 2001. He currently serves as a member of the Audit Committee, Executive Committee and Governance Committee of Professionals Direct. Mr. Crooks is the principal business consultant for Value Added Consultants, Ltd. He is a member of both the American Bar Association and the State Bar of Michigan. From 1983 to 1997, Mr. Crooks served as Vice President, General Counsel and Secretary of Kysor Industrial Corporation, where he was responsible for all legal matters of the corporation, its subsidiaries and divisions and Board of Directors. Before joining Kysor, Mr. Crooks practiced law with Warner Norcross & Judd LLP of Grand Rapids, Michigan. Mr. Crooks is a former member of the Cadillac Area Steering Team, a group of business leaders who provided "community betterment programs," and the Cadillac Local Development Authority, which administered and facilitated an environmental cleanup in the Cadillac Industrial Park. Mr. Crooks holds degrees from Denison University and Vanderbilt School of Law. He also graduated from the United States Air Force pilot training school and served as a military pilot. Mr. Crooks was admitted to the State Bar of Michigan in 1977.

Thomas F. Dickinson (age 49) is nominated for a term ending in 2009. He has been a director of Professionals Direct since 2003. He currently serves as a member of the Audit Committee and Executive Committee of Professionals Direct. Mr. Dickinson is President and Chief Executive Officer of MHA

MHA Insurance Company. Mr. Dickinson joined MHA Insurance Company in 1993 serving in several executive positions before assuming his current role of President and Chief Executive Officer in May 2000. Prior to joining MHA Insurance Company, Mr. Dickinson served Comerica Bank in a variety of positions and joined Foremost Insurance Company in September 1984. At Foremost, he served as Group Product Manager, National Accounts Manager, Strategic Operation Manager, and Agency Director. Mr. Dickinson obtained a Bachelor of Arts degree from Albion College in 1979, majoring in Economics and Computational Math, and received a Master in Business Administration degree from Eastern Michigan University in 1982.

Blake W. Krueger (age 52) is nominated for a term ending in 2009. He has been a director of Professionals Direct since 2003 and currently serves as chair of the Compensation Committee. Mr. Krueger is currently President and Chief Operating Officer for Wolverine World Wide, Inc. Wolverine World Wide, Inc. is a New York Stock Exchange listed international marketer of footwear and accessories with annual sales of over \$1 billion. Wolverine has owned-operations and subsidiaries in Canada and all key European countries and licensees and distributors which serve consumers in more than 160 countries. Mr. Krueger practiced law at Warner Norcross & Judd LLP from 1978 through 1996 in the field of corporate and business law, mergers, acquisitions and securities. Mr. Krueger is a former Director of the Grand Rapids Bar Association Foundation and was listed in the *Best Lawyers of America* while in private practice. Mr. Krueger

Insurance Company and FinCor Holdings, Inc. MHA Insurance Company provides professional medical liability insurance to health care facilities and physicians. In addition, The Risk Management & Patient Safety Institute, a Division of FinCor Holdings, Inc. provides claims and risk management products and services to a national audience. FinCor Holdings, Inc. is the parent holding company of

graduated from the Michigan State University, Honors College in 1975 with a B.A. in Business Administration with High Honors (Magna Cum Laude) and graduated Magna Cum Laude from Wayne State University Law School in 1978, where he was a member of the Wayne State Law Review.

**Your Board of Directors Recommends That You
Vote FOR the Election of All Nominees as Directors**

Continuing Directors with Terms Expiring in 2008

Stephen M. Tuuk (age 52) has been a director of Professionals Direct since 2001 and was a director of (f/k/a Michigan Lawyers Mutual Insurance Company) ("PDIC") from 1993 to 2001. He currently serves as the Chair of the Governance Committee and as the Chair of the Executive Committee of Professionals Direct. Mr. Tuuk has served as President, Chief Executive Officer and Chairman of the Board of Professionals Direct since 2001. In 1986 and 1987, Mr. Tuuk served as counsel to the State Bar of Michigan and the organizing Board of Directors of PDIC in connection with its formation, licensure and capitalization. Thereafter, Mr. Tuuk served as its general counsel from 1988 to 1993. In 1993, Mr. Tuuk became president and chief executive officer and a director of PDIC in order to establish its corporate office and to develop PDIC as an independent business enterprise. Mr. Tuuk is a former member of the State Bar's Standing Committee on Insurance Law and Lawyers Professional Liability Insurance Committee. He is a past president of the National Association of Bar-Related Insurance Companies. Mr. Tuuk was an associate from 1984 to 1989, a full-time member from 1990 to 1992 and a part-time member from 1993 to 1995 at Miller, Canfield, Paddock and Stone, PLC where he practiced in the areas of corporate law and insurance regulation. He received his undergraduate degree with honors from Calvin College in 1975 and his law degree with honors from Valparaiso University in 1978. He is a member of the American Bar Association and the State Bar of Michigan. Mr. Tuuk was admitted to the State Bar of Michigan in 1978.

Thomas J. Ryan (age 58) has been a director of Professionals Direct since

Attorney for the Township of Bloomfield and the Township of Southfield and City Attorney for the City of the Village of Clarkston and the City of Orchard Lake Village. In addition to the Oakland County Bar Association, he served as a member of the Oakland/Livingston Legal Aid Board of Directors and was its Vice President from 1994 to 1995. Mr. Ryan served on the Oakland County Bar Association Board of Directors and was its President from 1993 to 1994. He received his undergraduate degree from the University of Notre Dame and his law degree from the University of Detroit. He has been in the private practice of law since January 1977. Mr. Ryan was admitted to the State Bar of Michigan in 1973.

Joseph A. Fink (age 63) has been a director of Professionals Direct since 2002. He currently serves as a member of the Compensation Committee and as the Company's representative to the Insurance Institute of Michigan. Mr. Fink is a member with Dickinson Wright, PLLC and serves as Director of the firm's Insurance Industry Task Force. He is a member of the State Bar of Michigan. Mr. Fink is a Fellow of the Michigan Bar Foundation, is listed in *Who's Who in American Law* and *Who's Who in the Law*, is named in *Best Lawyers in America* for commercial litigation, and is a member of the Association of Life Insurance Counsel and the International Association of Insurance Receivers. He is a past member of the Michigan Defense Trial Counsel Association, the Ingham County Commercial Mediation Panel and former Chair of the Trial Experience Subcommittee of the DeVitt Committee on Trial Competency of the U.S. District Court, Western District of Michigan. He has also served as a member of the U.S. Courts Committee and the Committee on Local Rules for

2001 and was a director of PDIC from 1995 to 2001. He currently serves as a member of the Governance Committee of Professionals Direct. He is a member of the American Bar Association, the State Bar of Michigan, Oakland County Bar Association, and the Oakland Ancient Order of Hibernians. He is a past President of the State Bar of Michigan, serving as its 66th President from September 2000 to September 2001. Mr. Ryan also was a member of the Board of Commissioners of the State Bar of Michigan since 1992. He also is Attorney for the Village of Beverly Hills and the City of Keego Harbor, Prosecuting

the U.S. District Court, Western District of Michigan. Mr. Fink has served as an Adjunct Professor on Trial Advocacy at the Thomas M. Cooley Law School and is a former member and Secretary of the Olivet College Board of Trustees. His legal expertise is in the areas of insurance and commercial and regulatory litigation. He has represented the Michigan Office of Financial and Insurance Services as well as numerous insurance industry clients before the Michigan Office of Financial and Insurance Services. Mr. Fink received his undergraduate degree from Oberlin College and his law degree from the Duke University School of Law. Mr. Fink was admitted to the State Bar of Michigan in 1968.

Continuing Directors with Terms Expiring in 2007

Tracy T. Larsen (age 46) has been a director of Professionals Direct since 2001 and was a director of PDIC from 1996 to 2001. He currently serves as a member of the Executive Committee of Professionals Direct. Mr. Larsen is the managing partner of the Grand Rapids office of Barnes & Thornburg LLP and an attorney at law. Prior to joining Barnes & Thornburg LLP in 2003, Mr. Larsen was a partner with Warner Norcross & Judd LLP. He is a member of the American Bar Association and the State Bar of Michigan. He is a past chairman of the Business Law Section of the State Bar of Michigan. Mr. Larsen has been elected a Fellow of the Michigan Bar Foundation, is listed in *Who's Who in American Law*, and has been named in *Best Lawyers of America* and *America's Leading Business Lawyers*. His legal expertise encompasses all aspects of corporate and securities law, with an emphasis on mergers, acquisitions and corporate finance. Mr. Larsen is a graduate of Hope College (A.B. summa cum laude, 1981) and Indiana University School of Law (J.D. magna cum laude, 1984). He holds numerous academic distinctions and honors, including being named Phi Beta Kappa and Baker Scholar and being elected to the Order of the Coif and the Order of the Barristers. While at Indiana University, Mr. Larsen served as the Executive Editor of the Indiana Law Journal and was a member of the National Moot Court Team. He was admitted to the State Bar of Michigan in 1984.

Mary L. Ursul (age 47) has been a director of Professionals Direct since 2002 and was a director of PDIC from 1995 to 2000. Ms. Ursul joined Professionals Direct in 2000 as an

Kent Commerce Bank, a wholly-owned subsidiary of Capital Bancorp, Ltd.

Julius A. Otten (age 67) has been a director of Professionals Direct since 2002 and currently serves as the Chair of the Audit Committee. Mr. Otten is a Certified Public Accountant (CPA) in the State of Michigan. He is a member of the Michigan Association of Certified Public Accountants (MACPA), where he has served as an officer and director. In the past, he has chaired the MACPA's Member Insurance and Annual Meeting committees. He is also a member of the American Institute of Certified Public Accountants (AICPA), where he has served on Council. He retired in 1999 after a 36-year association with KPMG LLP, where he served as partner-in-charge of the firm's Michigan insurance industry practice. Since retirement from KPMG, Mr. Otten has worked as an independent consultant principally on matters requiring insurance industry expertise. He has worked with the Office of Financial and Insurance Services (OFIS) of the State of Michigan on behalf of various insurers and has served on task force committees organized by the OFIS and others. He has also represented the MACPA on OFIS issues affecting the accounting profession. Mr. Otten received his BBA and MBA degrees from the School of Business Administration at The University of Michigan. He currently serves on the Board of the Paton Accounting Fund and the Paton Accounting Center at the University of Michigan, Ann Arbor, the Financial and Accounting Advisory Board at the University of Michigan, Dearborn, and on the Accounting Advisory Board of Henry Ford Community College. He is also a director of American Community

executive officer and served as Vice President and Secretary until September 2005. In 2006, Ms. Ursul joined FinCor Holdings, Inc. as its Senior Director of Business Development and Strategic Planning. FinCor Holdings is a holding company with its principal subsidiary being MHA Insurance Company, a medical malpractice insurance company. Ms. Ursul practiced law from 1985 to 1988 with Dykema Gossett and from 1988 to 1989 had her own practice. From 1989 to 1998, Ms. Ursul served as General Counsel and Director of Administrative Services at Blodgett Memorial Medical Center and from 1998 to 2000 served as General Counsel/VP Administrative Services and was Corporate Compliance Officer for Spectrum Health, a large healthcare system located in Grand Rapids, Michigan. She is a current member of the State Bar of Michigan. Ms. Ursul received a B.S. degree in nursing from New York University in 1981 and a law degree from the University of Detroit School of Law. Ms. Ursul was admitted to the State Bar of Michigan in 1985. Ms. Ursul is a director of

Mutual Insurance Company and North Pointe Holdings Corp. and the chair of their audit committees.

Director with Term Expiring in 2006

Stephen M. Westfield (age 44) has been a director of Professionals Direct since 2002. Mr. Westfield joined Professionals Direct in April 1994 as Director of Finance and Accounting. In April of 1997, he was appointed to the position of Vice President, Finance and Information Systems, and Treasurer, and in 1999 assumed the position of Vice President of Finance and Treasurer of Professionals Direct and PDIC. Effective October 1, 2005, he was also appointed Secretary of Professionals Direct. Before joining Professionals Direct, he worked for ten years with Plante & Moran, a public accounting and consulting firm. His experience in public accounting was with a large variety of clients in the audit practice, including manufacturing, schools, governmental units and service industries. Mr. Westfield received a B.B.A. degree from Western Michigan University in December 1983. He is a Certified Public Accountant (CPA), a member of the American Institute of Certified Public Accountants and a former member of the MACPA.

Committees of the Board of Directors

The Board of Directors has established four committees. Each standing committee is chaired by an outside director, unless otherwise decided by the Board of Directors.

The *Governance Committee* is a standing committee of the Board and functions, in part, as the nominating committee. Its role is: (a) to review and oversee all material aspects of the Board's governance of itself and of Professionals Direct, (b) to review and to nominate candidates for Board positions and for Board committee positions, (c) to review business arrangements which may present actual or potential conflicts of interest, and (d) to review and oversee any vendor relationships a Board member may have with Professionals Direct or any of its subsidiaries. At least annually, the Governance Committee will review and make recommendations to the full Board as to any changes in policies and procedures. The Governance Committee will consider nominees recommended by shareholders if such shareholder nominations are properly received in accordance with the procedures set forth in Professionals Direct's Articles of Incorporation (described below under "Shareholder Nominations"). A copy of the Governance Committee Charter was included as an Appendix to Professionals Direct's 2004 Proxy Statement.

The Board of Directors believes the Company and its shareholders are best served by having a Board of Directors that brings a diversity of education, experience, skills and perspective to Board meetings. While the Board of Directors expects each director to be a highly qualified individual, it has no specific qualifications or criteria for nomination for election or appointment

considers its Governance Committee to be sufficiently independent to meet the needs of the Company and its shareholders.

The Governance Committee held one meeting in 2005.

The Audit Committee is a standing committee of the Board. Its role is to act on behalf of the Board and oversee all material aspects of Professional Direct's financial reporting, control and audit functions, except those specifically related to the responsibilities of another standing committee. The Audit Committee's roles include a particular focus on the qualitative aspects of financial reporting to shareholders and on the processes for the management of business and financial risk and for compliance with significant applicable legal, ethical and regulatory requirements. The role also includes coordination with other Board committees and maintenance of strong, positive working relationship with management, external and internal auditors, counsel and other committee advisors.

The members of the Audit Committee are Julius A. Otten (Chair), David W. Crooks and Thomas F. Dickinson.

The Audit Committee held four meetings in 2005.

The Board has determined that Mr. Otten is an audit committee financial expert, as that term is defined in Item 401(e)(2) of Regulation S-B to the Securities Exchange Act of 1934. Mr. Otten is independent, as that term is used in Item 7(d)(3)(iv) of Schedule 14A under the Securities Exchange Act of 1934.

to the Board. The Governance Committee identifies and evaluates candidates for nomination to the Board of Directors annually. Candidates are recommended to the full Board and, after considering the Governance Committee's recommendations, the Board recommends a slate of nominees to the shareholders. The manner in which nominees are evaluated by the Governance Committee does not change based upon whether nominees are recommended by a security holder.

The members of the Governance Committee are Stephen M. Tuuk (Chair), David W. Crooks, and Thomas J. Ryan. Messrs. Crooks and Ryan are independent directors, as defined in Rule 4200(a)(15) of the National Association of Securities Dealers. Mr. Tuuk is not independent. The Board of Directors

The Audit Committee has been established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934. Professionals Direct has adopted the definition for audit committee member independence enacted by the NASDAQ Stock Market, set forth in NASD Rule 4350(d)(2), and each member of the Audit Committee is independent under such definition.

The *Compensation Committee* is a standing committee of the Board. Its role is to act on behalf of the Board and to oversee and recommend to the full Board on all material aspects of Professionals Direct's compensation for directors and executive officers.

The members of the Compensation Committee are Blake Krueger (Chair), David W. Crooks and Joseph A. Fink.

The Compensation Committee held two meetings in 2005.

The *Executive Committee* is a standing committee of the Board. Its role is to provide assistance to the Board in fulfilling its responsibility to the shareholders, potential shareholders and investment community by exercising the full powers and authority of the Board in the management of business affairs and property of Professionals Direct during intervals between meetings of the full Board.

The members of the Executive Committee are Stephen M. Tuuk (Chair), David W. Crooks, Thomas F. Dickinson and Tracy T. Larsen.

The Executive Committee held five meetings in 2005.

Compensation of Directors

Each director who is not an employee is paid a quarterly fee of \$3,000, \$700 for each Board meeting and \$350 for each committee meeting. In addition, the chair of the audit committee and the chair of the compensation committee each receive an annual fee of \$5,000 and \$2,000, respectively. Directors of the Company who are employees do not receive any compensation for their services as members of the Board of Directors. All directors are reimbursed for expenses incurred in connection with their attendance at meetings of the Board of Directors.

Total Outside Directors' Compensation for 2005:

Name	Amount
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special meeting of shareholders called for election of directors (an "election meeting"). To make such a nomination, a shareholder must deliver - not less than 120 days prior to the date of the election meeting in the case of an annual meeting and not more than seven days following the date of notice of the election meeting in the case of a special meeting - a notice to the Secretary of Professionals Direct setting forth with respect to each proposed nominee: the name, age, business address and residence address of the nominee; the principal occupation or employment of the nominee; the number of shares of capital stock of Professionals Direct that are beneficially owned by the nominee; a statement that the nominee is willing to be nominated and to serve; and such other information concerning the nominee as would be required under the rules of the Securities and Exchange Commission to be included in a proxy statement soliciting proxies for the election of the nominee.

Meetings of the Board of Directors

During the fiscal year ended December 31, 2005, the Board of Directors held eight meetings. No incumbent director attended fewer than 75 percent of the total number of meetings of the Board of Directors and meetings held by all committees of the Board of Directors on which that incumbent director served in 2005, except that Mr. Thomas J. Ryan attended less than 75% of such meetings. All directors are expected to attend the annual meeting of shareholders unless prevented from doing so by compelling personal circumstances. Eight of the ten directors attended the 2005 annual meeting of Professionals Direct.

David W. Crooks	\$20,400
Tracy T. Larsen	19,000
Thomas J. Ryan	15,850
Joseph A. Fink	16,900
Julius A. Otten	23,650
Thomas F. Dickinson	19,000
Blake W. Krueger	18,200
Mary L. Ursul	3,700
Total	\$136,700

Shareholder Nominations

A shareholder of record may nominate an individual for a directorship, provided such shareholder is entitled to vote at the applicable annual meeting or

Shareholder Communications with Directors

Shareholders who wish to send communications to the Company's Board of Directors may do so by sending them in care of the Secretary of the Company at the address which appears on the first page of this proxy statement. Such communications may be addressed either to specified individual directors or the entire Board. The Secretary has the discretion to screen and not forward to directors communications which the Secretary determines in his or her discretion are communications unrelated to the business or governance of the Company and its subsidiaries, commercial solicitations, offensive, obscene, or otherwise inappropriate. The Secretary will, however, compile all shareholder communications which are not forwarded and such communications will be available to any director.

Ownership of Professionals Direct Stock

The following table shows the number of shares of Professionals Direct stock beneficially owned on December 31, 2005, by each of Professionals Direct's directors and nominees for director, each of the executive officers, and all of Professionals Direct's directors and executive officers as a group. No shareholder known to management of Professionals Direct beneficially owned more than 5% of the shares of Professionals Direct stock outstanding on December 31, 2005. As a group, Professionals Direct's directors, nominees for director and executive officers owned 20.2% of Professionals Direct's outstanding stock on December 31, 2005.

Name of Beneficial Owner⁽¹⁾	Amount and Nature of Beneficial Ownership⁽²⁾	Percentage of Class⁽³⁾
Stephen M. Tuuk	16,675	5.0%
Stephen M. Westfield	10,100	3.0%
David W. Crooks	11,000	3.3%
Thomas F. Dickinson	0	0.0%
Joseph A. Fink	6,800	2.0%
Blake W. Krueger	0	0.0%
Tracy T. Larsen	6,000	1.8%
Julius A. Otten	0	0.0%
Thomas J. Ryan	2,200	0.7%
Mary L. Ursul	14,500	4.3%
All Executive Officers, Directors and Nominees for Director as a group (10 persons)	67,275	20.2%

(1) The address of each beneficial owner is 161 Ottawa Avenue, N.W., Suite 607, Grand Rapids, Michigan, 49503.

(2) The numbers of shares stated are based on information furnished by each person listed and include shares personally owned of record by that person and shares which, under applicable regulations, are considered to be otherwise beneficially owned by that person. Under these regulations, a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares voting power or dispositive power with respect to the security. Voting power includes the power to vote or direct the voting of the security. Dispositive power includes the power to dispose or direct the disposition of the security. A person would also be considered the beneficial owner of a

security if the person has a right to acquire beneficial ownership of the security within 60 days, but no shares listed are deemed to be beneficially owned for this reason. These numbers include shares as to which the listed person is legally entitled to share voting or dispositive power by reason of joint ownership, trust or other contract or property right, and shares held by spouses and minor children over whom the listed person may have substantial influence by reason of relationship.

(3) Percentage of beneficial ownership is based on 333,500 shares of common stock outstanding.

Executive Compensation

Summary of Compensation

The following table sets forth for the fiscal year ended December 31, 2005, the cash and non-cash compensation awarded to, earned by or paid to Stephen M. Tuuk, President, Chief Executive Officer and director, Mary L. Ursul, Vice President, Secretary and director, and Stephen M. Westfield, Vice President, Treasurer and director. No other executive officers of the Company earned more than \$100,000 in total annual salary and bonus for 2005 in all capacities in which such person served the Company.

Name and Principal Position	Year	Annual Compensation		All Other Compensation ⁽¹⁾
		Salary	Bonus	
Stephen M. Tuuk, President and Chief Executive Officer	2005	\$239,140	\$ 16,000	\$ 9,000
	2004	239,140	0	8,000
	2003	230,140	150,000	7,000
Mary L. Ursul, Vice President and Secretary ⁽²⁾	2005	127,088	0	2,975
	2004	158,640	7,500	6,500
	2003	152,640	112,500	6,000
Stephen M. Westfield, Vice President, Secretary and Treasurer ⁽³⁾	2005	132,140	4,000	2,202
	2004	132,140	0	6,500
	2003	125,140	30,000	6,000

(1) Consisting of the Company's 50% matching contribution under its 401(k) plan.

(2) On August 1, 2005, Mary L. Ursul resigned as Secretary and Vice President of Professionals Direct and its subsidiaries effective September 30, 2005. Ms. Ursul did not resign from her position as a director of the Company.

(3) On October 1, 2005, Stephen W. Westfield was appointed Secretary of Professionals Direct.

In 2005, Professionals Direct adopted the Professionals Direct, Inc. Outside Directors' Deferred Compensation Plan. The Outside Directors' Deferred Compensation Plan is an unfunded, supplemental nonqualified deferred compensation plan. Only directors who are not employees of Professionals Direct or its subsidiaries are eligible to participate in the Outside Directors' Deferred Compensation Plan unless excluded from participation by the Compensation Committee pursuant to an individual agreement or arrangement. Amounts deferred under the Outside Directors' Deferred Compensation Plan are credited on the books of Professionals Direct to an account established for that director as a number of stock units equal to the cash amount of deferred director's fees divided by the market value of one share of Professionals Direct common stock on the date the deferred director's fees would have been payable. In 2005, no directors deferred fees pursuant to the Outside Directors' Deferred Compensation Plan.

In 2005, Professionals Direct adopted the Professionals Direct, Inc. Employee and Director Stock Purchase Plan (the "Stock Purchase Plan"). The purpose of the Stock Purchase Plan is to encourage employees and directors of Professionals Direct and its subsidiaries to promote the best interests of Professionals Direct and align the interests of employees and directors with those of Professionals Direct's shareholders by permitting employees and directors to purchase shares of Professionals Direct common stock at a price less than the market price. All employees and directors of Professionals Direct or its subsidiaries are eligible to participate in the Stock Purchase Plan, except

temporary employees. An employee or director who wishes to participate in the Stock Purchase Plan must authorize Professionals Direct to make regular payroll deductions from the employee's payroll, or from the director's fees, as applicable, to be used for the purchase of stock pursuant to the Stock Purchase Plan. The purchase price of each

share is equal to 90% of the market value of shares of Professionals Direct common stock on the annual stock purchase date, unless the compensation committee determines to use a higher price. The compensation committee may determine the maximum level of individual participation annually, in its discretion. However, in no event may a participant purchase Professionals Direct common stock under the Stock Purchase Plan in an amount less than \$10,000 per year or in excess of \$60,000 per year. In addition, no participant is permitted to purchase shares under the Stock Purchase Plan if the participant, immediately after purchasing such shares, would own stock possessing 5% or more of the total combined voting power or value of all classes of stock of Professionals Direct or any of its subsidiaries. In 2005, no purchases were made pursuant to the Stock Purchase Plan.

Except as described above, the Company had no equity compensation plans, stock options and made no long-term incentive plan awards in 2005.

Employment Contracts

The Company has employment agreements with its executive officers as described below.

Agreement with Mr. Tuuk. The Company has an employment agreement with Mr. Tuuk. The agreement provides that the Company and Mr. Tuuk may end the employment at any time and for any reason. If the Company ends Mr. Tuuk's employment without cause, then it is required to pay Mr. Tuuk's base salary and benefits for 24 months from the date of termination. If Mr. Tuuk resigns his employment or is terminated without cause, then Mr. Tuuk is immediately deemed to have resigned from the Company's Board of Directors and as a director of PDIC and any of the subsidiaries. Upon termination of employment and for 24 months thereafter, Mr. Tuuk may not compete against the Company, PDIC or any of the subsidiaries in any state in which they are doing business.

Agreement with Mr. Westfield. The Company has an employment termination and severance agreement with Mr. Westfield which provides that the Company and Mr. Westfield may end his employment at any time and for any reason. If the Company ends Mr. Westfield's employment without cause, then it must pay Mr. Westfield's base salary and benefits for 12 months from the date of termination. Upon termination of employment and for 12 months thereafter, Mr. Westfield may not compete against the Company, PDIC or any of the subsidiaries in any state in which they are doing business.

Audit Committee Report

The Audit Committee has reviewed and discussed the audited financial statements of Professionals Direct for the year ended December 31, 2005, with management. The Audit Committee has discussed with the independent auditors the matters required to be discussed by SAS 61 (Codification of Statements on Auditing Standards, AU§380). The Audit Committee has received the written disclosures and the letter from the independent accountants required by Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees) and has discussed with the independent accountant the independent accountant's independence. Based on the review and discussions referred to in this paragraph, the Audit Committee recommended to the Board of Directors that the audited financial statements of Professionals Direct for the year ended December 31, 2005, be included in Professionals Direct's Annual Report on Form 10-KSB for the year ended December 31, 2005.

This Audit Committee Report and the names of each Audit Committee member listed below shall not be deemed to be "soliciting material," or to be "filed" with the Commission or subject to Regulation 14A or

14C, other than as provided in Item 306 of Regulation S-B, or to be liabilities of Section 18 of the Securities Exchange Act of 1934, except to the extent that Professionals Direct specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act of 1933 or the Securities Exchange Act of 1934. Such information will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that Professionals Direct incorporates it by reference.

The Board of Directors has adopted a written charter for the Audit Committee. A copy of the Audit Committee Charter was included as an Appendix to Professionals Direct's 2005 Proxy Statement.

Respectfully submitted,

Julius A. Otten, Chairman
David W. Crooks
Thomas F. Dickinson

Related Matters

Solicitation of Proxies

We will initially solicit proxies by mail. Professionals Direct officers, directors and employees may also solicit proxies in person, by telephone or by facsimile without additional compensation. Professionals Direct will bear the entire cost of soliciting proxies.

Certain Relationships and Related Transactions

Stephen M. Tuuk serves as a director on the Board of Directors of Lawyers Reinsurance Company ("LRC"). Mr. Tuuk receives no compensation or any other remuneration for serving as a director on LRC's Board of Directors. LRC is a reinsurance company owned by various members of the National Association of Bar Related Insurance Companies. Professionals Direct Finance, Inc., a wholly owned subsidiary of the Company, made an initial investment in LRC of \$250,000 representing 12.5% of its common stock. Through negotiations by outside brokers, the Company cedes premium to LRC in the layer of \$4 million in excess of \$1 million. LRC is under no obligation to contract with the Company. LRC is a participant in a 2005 reinsurance treaty of PDIC. During 2005, premiums of \$336,000 were ceded to and \$155,000 in losses were paid by LRC. As of December 31, 2005, unearned premiums ceded to LRC were \$147,000.

Tracy T. Larsen is a member of the Board of Directors of Professionals Direct and a partner in the law firm Barnes & Thornburg LLP. Barnes & Thornburg has been retained by the Company to provide certain legal services, the fees for which are expected to be less than \$50,000 in 2006. As a partner of Barnes & Thornburg, Mr. Larsen will receive a small fraction of

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires Professionals Direct's directors and officers to file reports of ownership and changes in ownership of shares of common stock with the Securities and Exchange Commission. Directors and officers are required by the Securities and Exchange Commission regulations to furnish Professionals Direct with copies of all Section 16(a) reports they file. Based on its review of the copies of the Section 16(a) reports received by Professionals Direct (or written representations from certain reporting persons that no Forms 5 were required for those persons), we believe that, from January 1 through December 31, 2005, our directors and officers filed all reports required by Section 16(a) in a timely manner.

Code of Ethics

Professionals Direct has adopted a Code of Ethics that applies to the Chief Executive Officer and Vice President of Finance.

Shareholder Proposals

If you would like a proposal to be presented at the annual meeting of shareholders in 2007 and if you would like your proposal to be included in Professionals Direct's proxy statement and form of proxy relating to that meeting, you must submit the proposal to Professionals Direct in accordance with Securities and Exchange Commission Rule 14a-8. Professionals Direct must receive your proposal by November 28, 2006, for your proposal to be eligible for inclusion in the proxy statement and form of proxy relating to that meeting. To be considered timely, any other proposal that you intend to present at the 2007 annual meeting of

the fees received by the law firm, the amount of which is expected to be less than \$1,000. All director's fees received by Mr. Larsen from Professionals Direct are remitted to Barnes & Thornburg.

shareholders must similarly be received by Professionals Direct by November 28, 2006.

Independent Registered Public Accounting Firm

The Board of Directors has selected BDO Seidman, LLP as Professionals Direct's principal Independent Registered Public Accounting Firm for 2006. Representatives of BDO Seidman, LLP will be present at the annual meeting, have an opportunity to make a statement, and be available to respond to appropriate questions.

Audit Fees. The aggregate fees billed for professional services rendered by Professionals Direct's principal accountant, BDO Seidman LLP, for the audit of Professionals Direct's annual financial statements, for the review of financial statements included in Professionals Direct's Forms 10-QSB and for services provided in connection with statutory and regulatory filings for each of the last two fiscal years were \$103,761 and \$79,419 in 2005 and 2004, respectively.

Audit-Related Fees. No audit-related fees were paid in the last two fiscal years.

Tax Fees. The aggregate fees billed for tax compliance, tax advice and tax planning services rendered by Professionals Direct's principal accountant, BDO Seidman LLP, for each of the last two fiscal years were \$40,217 and \$77,456 in 2005 and 2004, respectively.

All Other Fees. No other fees were paid in the last two fiscal years.

All of the hours expended on BDO Seidman, LLP's engagement to audit Professionals Direct's financial statements for the year ended December 31, 2005, were performed by BDO Seidman, LLP's full-time, permanent employees.

Audit Committee Pre-Approval Policies and Procedures. The Audit Committee has the authority and responsibility to pre-approve all audit and permissible non-audit services provided to Professionals Direct by Professionals Direct's principal accountant.

All pre-approvals of audit and permissible non-audit services granted by the Audit Committee must be reasonably detailed as to the particular services to be provided and do not result in the delegation of the Audit Committee's pre-approval responsibilities to management. Pre-approvals of services granted by the Audit Committee do not use monetary limits as the only basis for pre-approval and do not provide for broad categorical approvals (e.g., tax compliance services under \$10,000). Pre-approval policies and practices adopted by the Audit Committee are designed to ensure that the Audit Committee knows what particular services it is being asked to pre-approve so that it can make a well-reasoned assessment of the impact of the service on the principal accountant's independence.

The Audit Committee may delegate to one or more designated members of the Audit Committee the authority to grant pre-approvals of permissible non-audit services. The decisions of any Audit Committee member to whom authority is delegated to pre-approve permissible non-audit services are reported to the full Audit Committee.

None of the audit-related fees or tax fees were approved by the Audit Committee pursuant to the *de minimus* exception set forth in Section 210.2-01(c)(7)(i) of Regulation S-X of the Securities Exchange Act of 1934.

Proxy

**PROFESSIONALS DIRECT,
INC.**
161 Ottawa Avenue, N.W., Suite
607
Grand Rapids, Michigan 49503
Annual Meeting of Shareholders

May 9, 2006

The undersigned shareholder appoints Stephen M. Tuuk and Stephen M. Westfield, or either of them, each with power to appoint his substitute, attorneys and proxies to represent the shareholder and to vote and act with respect to all shares that the shareholder would be entitled to vote on all matters that come before the annual meeting of shareholders of Professionals Direct, Inc. referred to above or any adjournment of that meeting.

This proxy is solicited on behalf of the Board of Directors. If this proxy is properly executed, the shares represented by this proxy will be voted as specified. If no specification is made, the shares will be voted for election of all nominees named on this proxy as directors. The shares represented on this proxy will be voted in the discretion of the proxies on any other matters that may come before the meeting.

- 1. Election of the following nominees to the board of directors of the Company for the terms expiring at the annual meeting in the year indicated:

<i>Name</i>	<i>Term Expires</i>
David W. Crooks	2009
Thomas F. Dickinson	2009
Blake W. Krueger	2009
FOR ALL _____	WITHHOLD ALL _____

Your Board of Directors recommends that you vote FOR all nominees

Sign this proxy in the same way that your stock is registered with the Company (as may be shown on the printed label affixed below). Corporate officers should indicate their title and the corporation's full name. Persons signing on behalf of other entities should indicate their capacity and the entity's full name.

Dated: _____, 2006

Shareholder Name
(shown on stock certificate or address label)

Place Label Here

By:

Representative capacity, if any

For purposes of planning the annual meeting, please indicate whether you plan to attend the annual meeting in person:
 Yes No

Please Sign, Date, and Return this Proxy Promptly Using the Enclosed Envelope

**2006
Annual Report**

PRESIDENT'S MESSAGE

TO OUR SHAREHOLDERS:

We are pleased to present our 2005 results in this annual report.

Professionals Direct is in the business of providing insurance programs to lawyers. Professionals Direct operates as a service provider in more than 40 states and as an insurance underwriter in 36 states. It is a nationally recognized source for lawyers professional liability and for other insurance products for the legal community. Both 2004 and 2005 represented a maturation of our business model after large percentage growth increases in 2002 and 2003. In the past two years, Professionals Direct improved the sustainability of its presence in this niche.

In 2005, Professionals Direct earned \$502,000 or \$1.51 per share. Book value per share increased to \$31.79 per share. The book value per share represents a significant increase over the \$10 acquisition price paid in the July, 2001 demutualization.

Please read the enclosed report and participate in our system of corporate governance by voting in person at our annual meeting or by proxy.

Sincerely,

Stephen M. Tuuk
President and Chief Executive Officer

Professionals Direct, Inc.

2006 Annual Report

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Professionals Direct, Inc.

Professionals Direct Inc. is an insurance holding company with four wholly-owned subsidiaries, Professionals Direct Insurance Company, the property and casualty insurance company (“PDIC”); Professionals Direct Employer Organization, Inc., an inactive Michigan professional employer organization; Professionals Direct Finance, Inc., a premium finance company (“Finance”) and Professionals Direct Insurance Services, Inc., a company providing underwriting, claims, accounting, information technology services and selling professionals liability and other insurance (“Services”). PDIC, Professionals Direct’s principal subsidiary, provides professional liability insurance to attorneys and law firms in Michigan and other states. Through its other subsidiaries, Professionals Direct provides underwriting, policy issuance, claims administration, accounting and information technology services to insurance companies and provides financing for premiums to customers of PDIC.

A Message to our Shareholders

This 2006 Annual Report contains audited financial statements and a detailed financial review. This is Professionals Direct, Inc.’s 2006 Annual Report to Shareholders. Although attached to our proxy statement, this report is not part of our proxy statement, is not deemed to be soliciting material, and is not deemed to be filed with the Securities and Exchange Commission (the “SEC”) except to the extent that it is expressly incorporated by reference in a document filed with the SEC.

Our Annual Report on Form 10-KSB, as filed with the SEC, will be provided to any shareholder, without charge, upon written request to Professionals Direct, Inc., Attn. Corporate Secretary, 161 Ottawa Avenue, N.W., Suite 607, Grand Rapids, Michigan 49503.

Five Year Summary of Selected Financial Data

The following table provides selected consolidated financial and operating data (unaudited) for Professionals Direct and its subsidiaries as of December 31, 2005, 2004, 2003, 2002 and 2001 and for the years then ended. The consolidated financial and operating data are derived from, and should be read in conjunction with, Professionals Direct's Consolidated Financial Statements and Notes thereto.

	Years Ended				
	2005	2004	2003	2002	2001
(in thousands of dollars, except for per share and ratio data)					
Revenue Data:					
Direct premiums written	\$ 25,902	\$ 24,009	\$ 24,294	\$ 10,404	\$ 7,066
Net premiums written	16,401	14,085	20,118	8,479	5,956
Net premiums earned	15,375	16,203	15,927	6,790	5,648
Fees and commissions earned	792	731	619	474	665
Net investment income	1,171	893	926	1,410	1,506
Finance and other income earned	153	152	127	116	121
Total Revenues	17,491	17,979	17,599	8,790	7,940
Losses and Expense Data:					
Losses and loss adjustment expenses	12,521	11,937	7,737	4,851	2,265
Operating and administrative expenses	3,785	4,804	5,420	3,511	3,922
Interest	506	447	300	200	99
Total Expenses	16,812	17,188	13,457	8,562	6,286
Income before federal income taxes and policyholder dividend	679	791	4,142	228	1,654
Policyholder dividend	0	0	0	316	297
Income (loss) before federal income taxes	679	791	4,142	(88)	1,357
Federal income tax expense (benefit)	177	260	1,442	(62)	527
Net Income (Loss)	\$ 502	\$ 531	\$ 2,700	\$ (26)	\$ 830
Selected Balance Sheet Data:					
(at year end)					
Total investments and cash	\$ 43,407	\$ 37,863	\$ 36,410	\$ 22,451	\$ 19,341
Total assets	71,348	54,441	46,359	30,770	25,572
Total liabilities	60,746	44,153	36,496	23,455	18,286
Total shareholders' equity	10,602	10,288	9,863	7,315	7,286
Per Share Data:					
Net income (loss)	\$ 1.51	\$ 1.59	\$ 8.10	\$ (0.08)	\$ 2.49
Shareholders' equity	\$ 31.79	\$ 30.85	\$ 29.57	\$ 21.93	\$ 21.84
Selected GAAP Ratios:					
Return on prior year equity	4.9%	5.4%	36.9%	(.4%)	23.6%
Return on current year revenue	2.9%	3.0%	15.3%	(.3%)	10.5%
Return on current year assets	0.7%	1.0%	5.8%	(.1%)	3.2%

	Years Ended				
	2005	2004	2003	2002	2001
(in thousands of dollars, except for per share and ratio data)					
Statutory (SAP) Ratio Data:					
Loss ratio (1)	81.5%	76.2%	49.2%	76.9%	41.6%
Expense ratio (2)	22.9%	33.9%	30.8%	37.0%	37.2%
Combined ratio (3)	104.4%	110.1%	80.0%	113.9%	78.8%
Operating ratio (4)	96.7%	104.5%	74.2%	93.4%	61.5%
A. M. Best Industry operating ratio (5)	Not available	94.0%	92.2%	95.9%	104.1%
Statutory surplus (6)	\$17,539	\$16,074	\$16,132	\$10,473	\$9,370
Earned surplus (7)	15,008	13,543	13,601	7,942	6,839
Ratio of statutory net premiums written to statutory surplus	93.5%	87.6%	124.7%	81.0%	63.6%

- (1) Calculated by dividing losses and loss adjustment expenses by net premiums earned.
- (2) Calculated by dividing other underwriting expenses by net premiums written.
- (3) The sum of the statutory loss ratio and the expense ratio.
- (4) Calculated by taking the combined ratio and subtracting the ratio of net investment income divided by net premiums earned. An operating ratio of more than 100% indicates that an insurance company is unable to recoup underwriting losses with investment earnings.
- (5) As reported by A. M. Best, Best's Aggregate & Averages - Property/Casualty (Commercial Casualty Composite).
- (6) Statutory surplus includes \$2.531 million in surplus certificates, interest on which is not accrued until approved for payment by the Michigan Office of Financial and Insurance Services.
- (7) Statutory surplus less surplus contributed under surplus certificates.

Management's Discussion and Analysis

The following discussion and analysis for the years ended December 31, 2005 and 2004 should be read in conjunction with the consolidated financial statements and the notes thereto included elsewhere in this report. The following discussion of our financial condition and results of operations contains certain forward-looking statements. A discussion of the limitations of forward looking statements appears at the end of this section.

Introduction

Net premiums earned and operating and administrative expenses incurred decreased because cessions to reinsurers and related ceding commissions earned increased effective January 1, 2004. Losses and loss adjustment expenses increased because of adjustments to prior years' loss estimates. The following table and discussion compares the financial results for 2005 and 2004:

	Years Ended			Percent Change
	2005	2004	Change	
(in thousands of dollars, except for per share data)				
Revenues:				
Net premiums earned	\$ 15,375	\$ 16,203	\$ (828)	(5.1%)
Fees and commissions earned	792	731	61	8.3%
Net investment income earned	1,171	893	278	31.1%
Finance and other income earned	153	152	1	0.7%
Total Revenues	17,491	17,979	(488)	(2.7%)
Expenses:				
Losses and loss adjustment expenses	12,521	11,937	584	4.9%
Operating and administrative	3,785	4,804	(1,019)	(21.2%)
Interest	506	447	59	13.2%
Total Expenses	16,812	17,188	(376)	(2.2%)
Income before federal income tax expense	679	791	(112)	(14.2%)
Federal income tax expense	177	260	(83)	(31.9%)
Net Income	\$ 502	\$ 531	\$ (29)	(5.5%)
Selected Balance Sheet Data:				
(at year end)				
Total investments and cash	\$ 43,407	\$ 37,863	\$ 5,544	14.6%
Total assets	71,348	54,441	16,907	31.1%
Total liabilities	60,746	44,153	16,593	37.6%
Total shareholders' equity	10,602	10,288	314	3.1%
Per Share Data:				
Net income	\$ 1.51	\$ 1.59	\$ (0.08)	(5.0%)
Shareholders' equity	\$ 31.79	\$ 30.85	\$ 0.94	3.1%

Results of Operations (000 omitted):

The following is a summary and analysis of the material revenue and expense components of our operational results for 2005 with comparisons to 2004.

Net Premiums Earned. Net premiums earned is equal to direct premiums earned (premiums earned for policies written) less ceded premiums earned (amounts ceded to reinsurers) and is our primary source of revenue. Direct premiums written and ending gross unearned premium were proportionately higher in 2005 than in 2004. However, net premiums earned in 2005 did decrease from 2004, primarily because beginning ceded unearned premium was 134.5% higher in 2005 than 2004, the result of decreasing our retention beginning with 2004 business.

The effects of these changes are seen in the table below:

	Years Ended			Percent Change
	2005	2004	Change	
	(in thousands of dollars)			
Beginning gross unearned premium	\$ 10,738	\$ 10,468	\$ 270	2.6%
Beginning ceded unearned premium	(4,163)	(1,775)	(2,388)	(134.5%)
Beginning net unearned premium	6,575	8,693	(2,118)	(24.4%)
Direct premiums written	25,902	24,009	1,893	7.9%
Ceded premiums written	(9,501)	(9,924)	423	4.3%
Net premiums written	16,401	14,085	2,316	16.4%
Ending gross unearned premium	11,776	10,738	1,038	9.7%
Ending ceded unearned premium	(4,175)	(4,163)	(12)	(0.3%)
Ending net unearned premium	7,601	6,575	1,026	15.6%
Net premiums earned	\$ 15,375	\$ 16,203	\$ (828)	(5.1%)

Direct premiums written were 7.9% higher in 2005 than in 2004. This increase resulted from a 3% increase in the number of policies written and a 5% increase in the average premium per policy. Net premiums written in 2005 were 16.4% higher. This increase resulted from the increase in direct premiums written, a nominal decrease in ceded premium rates under the 2005 reinsurance treaty and the elimination of a ceded premium liability related to a prior treaty.

For policies with 2005 effective dates, PDIC maintained the same per claim retention as for 2004. Decisions on the appropriate level of reinsurance are impacted by a variety of market factors from pricing, to availability and credit quality of reinsurers, and our level of surplus. As such, reinsurance retentions may vary from year to year. As a result of significant growth in written premium experienced in 2003 and the level of surplus to written premium, it was determined that maintaining the lower retention level of 2004 for 2005 would be in the best interest of the Company. Market factors allowed us to continue with this retention level. In 2006, we do not expect to see material changes in direct premiums written or in our reinsurance retention.

Fees and Commissions Earned. Fees and commissions originate primarily from two sources. First are membership fees, which are earned by Lawyers Direct Risk Purchasing Group, Inc., an affiliate organized, formed and managed by Services as part of the Lawyers Direct® program for one to five person law firms. Second are commissions, which are earned by Services from placing insurance with unrelated third parties and performing management services. Fee and commission income earned was \$792 in 2005, an increase of \$61 or 8.3%, compared to 2004. Almost all of this increase was attributable to an increase in commission income from Services.

Net Investment Income. Net investment income is comprised of interest on fixed maturity investments and realized investment gains and losses. The net investment income increase of \$278 or 31.1% in 2005 as

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compared to 2004 is attributable to an increase in invested assets, increasing interest rates, and slightly greater duration. Increasing rates accounted for approximately \$203,000 of the increase with the remainder attributable to the increase in invested assets.

Finance and Other Income Earned. Finance income is generated from premium financing incidental to the sale of PDIC's insurance policies. Premium financing is offered to PDIC policyholders in Michigan and selected other states. In the fourth quarter of 2005, premium finance rates were increased and, as a result, finance income is expected to increase slightly in 2006.

Losses and Loss Adjustment Expenses. Overall profitability is materially influenced by the loss estimate for current year claims, plus the favorable or adverse development related to estimates for prior years' claims. For 2005, PDIC recorded losses and loss adjustment expenses of \$12,521, of which \$11,212 was for current year losses and \$1,309 was for prior years' losses. For 2004, PDIC recorded losses and loss adjustment expenses of \$11,937 of which \$10,948 was for 2004 losses and \$989 was for losses prior to 2004. Adjustments to prior year claims estimates reflect current experience. Incurred losses are determined based on loss reserve estimates which are set after considering the results of the reserve analysis performed by our independent actuary. The loss ratio for 2005 continues to be above our historic average. Volatility in the loss ratio can be expected given the complex nature of lawyers professional liability claims and multi-year settlement periods. Due to the size of our reserves, even a small percentage change in the loss reserve liability can have a material impact on our results of operations and loss ratio for the period in which the change occurs.

The loss ratio is the sum of the losses and loss adjustment expenses incurred expressed as a percentage of net premiums earned. The loss ratio for the year was 81.4% compared to 73.7% for 2004. Three factors impacted the 2005 loss ratio when compared to 2004. The first was a change in estimate for prior years' losses, primarily due to additional severity on existing claims from the 2002 through 2004 years. The second was a change in estimate for adjusting and other expense reserves as a result of increasing costs to defend and adjust claims over what we had previously reserved. The third was the previously discussed decrease in net premiums earned. The increase in estimate for prior years' losses of \$1,309 plus the increase in adjusting and other expenses of \$316 increased the 2005 loss ratio 10.6%.

The losses recorded in 2005 significantly increased direct and ceded loss reserves, which in turn increased total assets and total liabilities as compared to 2004. This increase is primarily the result of two claims reserved at policy limits, both of which were unsettled as of December 31, 2005.

Operating and Administrative Expenses. Operating and administrative expenses for 2005 compared to 2004 decreased \$1,019 or 21.2%. This decrease primarily resulted from ceding commissions earned which were \$1,697 and \$1,080 in 2005 and 2004, respectively, and a decline in acquisition costs resulting from operating efficiencies and a reduction in commission rates to certain agents.

Interest Expense. Interest expense in 2005 increased \$59 from 2004, primarily because of increased interest rates and outstanding debt. Most line of credit debt was refinanced with trust preferred securities during 2005. Interest expense increased \$142 on trust preferred securities and decreased \$83 on lines of credit.

Income Taxes. The effective federal income tax rate was 26.1% for 2005 compared to 32.9% for 2004. While the 2004 effective rate approximated the expected rate, the 2005 effective rate is lower because of tax-exempt interest.

Financial Condition, Liquidity, and Capital Resources (000 omitted):

Professionals Direct, Inc. is a legal entity separate and distinct from its subsidiaries. Because the parent holding company has no other business operations, management fees and dividends from its subsidiaries represent the principal source of funds for its obligations, including debt service. The management fees paid by PDIC are

pre-approved by the Office of Financial and Insurance Services (“OFIS”), the regulatory body in Michigan responsible for the oversight of the insurance subsidiary. Under the terms of the plan that governed the Company’s conversion, PDIC is prohibited from making any dividend payments to the parent holding company until such time as the surplus certificates are repaid in full. The management fees paid by the remaining subsidiaries are determined from time-to-time by the Board of Directors. The payment of management fees and dividends by our other subsidiaries are limited only by solvency requirements.

The primary sources of liquidity, on both a short-term and long-term basis, are funds provided by insurance premiums collected, net investment income, recoveries from reinsurance, and proceeds from the maturity or sale of

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invested assets. The primary uses of cash, on both a short-term and long-term basis, are losses, loss adjustment expenses, operating expenses, reinsurance premiums, taxes, debt repayment and acquisition of investments.

Trends or uncertainties that may impact short-term or long-term liquidity include changes in the cost and availability of reinsurance, changes in interest rates and changes in investment income. As the costs of obtaining reinsurance may change in the future, we intend to adjust the rates we charge our customers. However, such rate changes may be limited by competition or regulation. We believe that we will be able to manage these reinsurance costs so the impact on overall liquidity is minimized.

When interest rates decline, the cost of borrowing decreases and the market value of our investment portfolio, which primarily consists of debt securities, generally increases. At the same time, the overall yield on new investments tends to decrease. When interest rates increase, the opposite effects are realized. While interest rates continue to be low, they are starting to increase. We believe that it is unlikely material gains will be realized on portfolio assets or be a source of liquidity during 2006.

At December 31, 2005, we had cash and cash equivalents of \$9,309. A substantial portion of this was or will be invested in bonds in the first quarter of 2006. Remaining cash and cash equivalents are expected to be used to fund operations and loss and reinsurance payments.

Our net cash flow from operations for 2005 was \$6,062 compared to \$4,164 for 2004. This increase can be attributed to an increase in retained premium and an increase in recoveries from reinsurers. This cash flow was partially invested in fixed maturities which resulted in negative cash flow from investing activities of \$1,660 for the year. Cash provided by financing activities was \$513, the result of net repayments under the lines of credit offset by the proceeds from the issuance of trust preferred securities. Last year net borrowings decreased \$1,767.

To provide additional liquidity, we have three lines of credit available from a bank. The first line is a \$1,800 revolving line used by Finance to finance insurance premiums and bears interest at .5% over the bank's prime rate. This line had \$170 outstanding at December 31, 2005. The second line is for \$1,000, which can be used for potential acquisitions, and bears interest at 1% over the bank's prime rate. The third line is a \$3,000 declining balance facility that matures October 1, 2006. As a result of the declining balance feature, the maximum credit available under this facility at December 31, 2005 was \$1,950. The second and third lines have no amounts outstanding as of December 31, 2005. These lines of credit require, among other things, that we maintain a minimum tangible net worth of \$7,500, that PDIC maintain a minimum surplus of not less than 240% of the Authorized Control Level Risk Based Capital (as defined by the National Association of Insurance Commissioners), and that we deliver periodic financial reports to the bank. The Company was in compliance with all covenants as of December 31, 2005. The bank has a security interest in substantially all assets of the Company, Services and Finance. In addition, the shares of PDIC are pledged, subject to the rights of policyholders under insurance laws and the rights of insurance regulators.

Based on historical trends, market conditions and our business plans, we believe that our existing resources and sources of funds will be sufficient to meet our short-term and long-term liquidity needs over the next year and beyond. Because economic, market and regulatory conditions may change, however, there can be no assurance that our funds will be sufficient to meet these liquidity needs. In addition, competition, pricing, the frequency and severity of losses and interest rates could significantly affect our short-term and long-term liquidity needs.

Critical Accounting Estimates and Judgments

The consolidated financial statements include certain amounts, based upon informed estimates and judgments made by management, for transactions not yet complete or for which the ultimate resolution is not certain. Such estimates and judgments affect the reported amounts in the financial statements. Although management believes that they are making the best decisions based upon information then available, it is possible that as conditions and experience

develop, these estimates may change and may be materially different from originally reported in the financial statements. Our reserves for unpaid loss and loss adjustment expenses and the related amounts due from reinsurers represent the most critical estimates present within the financial statements.

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Amounts recoverable from reinsurers are estimated in a manner consistent with the provisions of the reinsurance agreement and the establishment of the liability for loss and loss adjustment expenses.

Loss and Loss Adjustment Expense Reserves

PDIC maintains reserves for payment of losses and loss adjustment expenses for reported claims and for claims incurred but not reported arising from policies that have been issued. PDIC provides for the estimated ultimate cost of those claims without regard to how long it takes to settle them or the time value of money. The determination of reserves involves actuarial and statistical projections of what PDIC expects to be the cost of the ultimate settlement and administration of such claims based on facts and circumstances then known, estimates of future trends in claim severity, and other variable factors such as inflation and changing judicial theories of liability.

Management estimates of the loss reserve liability are reviewed by independent actuaries twice each year. Several variables and methodologies are used to calculate the appropriate amount of the loss reserve liability that should be recorded. Key variables utilized to develop the loss reserve estimate include:

- Loss reporting patterns
- Payment patterns
- Loss severity trend rates
- Application of Michigan loss patterns and loss to premium relationships to Non-Michigan business
- Case reserve setting patterns

The key actuarial methodologies used include:

- Incurred development method
- Paid development method
- Case development method
- Incurred Bornhuetter-Ferguson method
- Paid Bornhuetter-Ferguson method
- Frequency/severity method

Small changes to any of the assumptions regarding the key variables can significantly alter the outcome of the actuarial analysis. Because of the number of factors considered, it is neither practical nor meaningful to isolate a single variable and calculate the impact of changing that item. It is possible in assessing the overall results of an actuarial review to observe the magnitude of deviation the various methodologies create. The various methodologies rely to differing degrees on individual key variables, and as a result some insight into the sensitivity of those key variables can be observed. It is important to note that because not all methodologies are appropriate for all years, the difference in estimates amongst the various methodologies does not necessarily represent a reasonable range around the booked reserves. Only the most recent four years are assessed using the full range of methodologies. These four years represent approximately 90% of total net retained reserves. The range of the results of the various methodologies was from 22% below to 55% above the best estimate of \$15.9 million for the four years.

An in-depth review of loss reserves is undertaken on a semi-annual basis. However, management continually reviews and updates the data underlying the estimation of its loss reserves and makes adjustments when we believe the emerging data supports a change. Any adjustments necessary are reflected in current operations. As a result of the variety of variables and methodologies that are considered, there is a significant risk that actual incurred losses will develop differently from these estimates.

In the years after a claim is reported, there is a significant amount of uncertainty over what the ultimate loss will be. Therefore, the estimate of future loss costs for claims recently reported tends to be less accurate. As claims get older, the estimate of future loss costs may be less inaccurate, but are still subject to material fluctuations until the claims are paid or otherwise closed. Eventually, all claims in a particular year are paid or closed and no additional development, favorable or adverse, will be experienced because the amount of the loss is certain.

Another factor that impacts incurred losses is development related to claims reported in prior years. Favorable or adverse development occurs when subsequent estimates of the loss reserve liability change. A subsequent decrease in estimate results in favorable development; a subsequent increase in estimate results in adverse development. Favorable or adverse development is reflected as a decrease or increase in the current year's losses and loss adjustment expenses. As shown in the reserve development table that follows, the original estimates of our net loss reserves have resulted in favorable development (redundancy) in six of the last ten years and adverse development in four of the last ten years (deficiency).

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The estimation of ultimate liability for losses and loss adjustment expenses is an inherently uncertain process and does not represent an exact calculation of that liability. Claims may not be brought until several years after the acts or omissions that gave rise to the claim occurred. Ultimate loss costs, even for similar events, vary significantly depending upon many factors. Professional liability claims are typically resolved over an extended period of time, often three years or more. The combination of changing conditions and the extended time required for claim resolution results in a loss cost estimation process that requires actuarial expertise and the application of significant judgment. Such estimates require periodic revision. PDIC's current reserve policy recognizes this uncertainty by maintaining case supplement reserves (*commonly referred to as IBNR reserves*) to provide for the possibility that actual results may be less favorable compared to the estimated costs as developed during the normal case reserve estimation process. The case supplement reserve is determined by estimating the ultimate liability for the claims which have been made and reported and then subtracting the case reserves. Case supplement reserves as a percentage of total reserves at December 31, 2005 were 41.6%. PDIC does not discount its reserves to recognize the time value of money.

When a claim is reported to PDIC, claims personnel establish a case reserve for the estimated amount of the ultimate payment. This estimate reflects an informed judgment based upon general insurance reserving practices and on the experience and knowledge of the estimator regarding the nature and value of the specific claim, the severity of injury or damage, and the policy provisions relating to the type of loss. The claims staff periodically adjusts case reserves as more information becomes available.

Each quarter, PDIC computes its estimated liability using appropriate principles and procedures. Because the establishment of loss reserves is an inherently uncertain process, however, there can be no assurance that losses will not exceed reserves. Adjustments in aggregate reserves, if any, are reflected in the operating results of the period during which such adjustments are made. As required by insurance regulatory authorities, PDIC annually receives a statement of opinion from its appointed actuary concerning the reasonableness of its reserves. At December 31, 2005, the recorded reserves were \$17 greater than the point estimate of our independent actuary.

A reconciliation of the beginning and ending net liability for unpaid losses and loss adjustment expenses for the years ended December 31, 2005 and 2004 is provided in Note 7 to the consolidated financial statements included in this report.

The following table, known as the Loss Reserve Development Table, presents information over the preceding ten years regarding the payment of our losses as well as changes to (the development of) our estimates during that time period. The table includes direct losses and is net of reinsurance recoverables. The gross liability for losses before reinsurance, as shown on the balance sheet, and the reconciliation of that gross liability to amounts net of reinsurance are reflected at the top and bottom of the table. We do not discount our reserves for the time value of money. Information presented in the table is cumulative and, accordingly, each amount includes the effects of all changes in amounts for prior years. The table presents the development of our balance sheet reserves; it does not present accident year or policy year development data. Conditions and trends that have affected the development of liabilities in the past may not necessarily occur in the future. The volatility of professional liability claim frequency and severity makes the prediction of the ultimate loss very difficult. Likewise, the long time frame for professional liability claims to develop and be paid further complicates the process of estimating losses. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on this table.

The following may be helpful in understanding the Loss Reserve Development Table:

The line titled "Reserve for unpaid losses net of reinsurance recoverables" reflects the Company's reserve for losses and loss adjustment expenses, less the receivables from reinsurers, each as showing in the Company's consolidated financial statements at the end of each year (the Balance Sheet Reserves).

The section titled "Cumulative net paid, as of:" reflects the cumulative amounts paid as of the end of each succeeding year with respect to the previously recorded Balance Sheet Reserves.

The section titled "Re-estimated net liability, as of:" reflects the re-estimated amount of the liability previously recorded as Balance Sheet Reserves that includes the cumulative amounts paid and an estimate of additional liability based upon claims experience as of the end of each succeeding year (the Net Re-estimated Liability).

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The line titled “Net cumulative redundancy (deficiency)” reflects the difference between the previously recorded Balance Sheet Reserve for each applicable year and the Net Re- estimated Liability relating thereto as of the end of the most recent fiscal year.

[insert table here]

	December 31,										
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
	(in thousands)										
Original gross liability - end of year	\$ 11,728	\$ 16,309	\$ 15,921	\$ 13,721	\$ 14,375	\$ 13,051	\$ 9,589	\$ 10,138	\$ 13,461	\$ 21,048	\$ 35,468
Less: reinsurance recoverables	(4,067)	(7,643)	(5,394)	(4,503)	(7,142)	(5,909)	(2,539)	(2,469)	(2,163)	(5,699)	(17,812)
Reserve for unpaid losses net of reinsurance recoverables	7,661	8,666	10,527	9,218	7,233	7,142	7,050	7,669	11,298	15,349	17,656
Cumulative net paid, as of:											
One year later	4,236	5,050	4,395	3,199	2,552	1,776	3,645	2,878	6,232	8,129	
Two years later	7,625	8,800	6,865	4,967	3,624	3,503	4,400	5,110	9,521		
Three years later	9,719	10,114	7,846	5,474	3,948	3,730	5,316	6,297			
Four years later	10,308	10,806	8,205	5,589	3,991	4,557	5,591				
Five years later	10,738	11,057	8,227	5,618	4,721	4,619					
Six years later	10,832	11,077	8,263	6,054	4,762						
Seven years later	10,786	11,115	8,689	6,063							
Eight years later	10,791	11,541	8,690								
Nine years later	10,792	11,542									
Ten years later	10,792										

Re-estimated net liability, as of:											
One year later	9,778	11,337	10,392	8,359	6,653	5,345	7,061	7,330	12,287	16,658	
Two years later	11,051	12,035	9,815	7,320	5,235	5,311	6,885	6,705	13,466		
Three years later	11,221	11,811	9,439	6,217	5,238	5,234	5,699	7,426			
Four years later	10,998	11,950	8,647	6,217	5,131	4,754	5,808				
Five years later	11,236	11,422	8,652	6,120	4,853	4,714					
Six years later	11,038	11,427	8,562	6,146	4,863						
Seven years later	11,038	11,414	8,690	6,151							
Eight years later	11,053	11,542	8,706								
Nine years later	10,792	11,558									
Ten years later	10,792										
Net cumulative redundancy (deficiency)	(3,131)	(2,892)	1,821	3,067	2,370	2,428	1,242	243	(2,168)	(1,309)	
Gross re-estimated liability - latest	16,857	19,036	14,413	11,360	10,952	9,431	8,121	11,176	18,420	31,599	
Re-estimated reinsurance recoverables	(6,065)	(7,478)	(5,707)	(5,209)	(6,089)	(4,717)	(2,313)	(3,750)	(4,954)	(14,941)	
Net re-estimated liability - latest	10,792	11,558	8,706	6,151	4,863	4,714	5,808	7,426	13,466	16,658	
Gross cumulative redundancy (deficiency)	\$ (5,129)	\$ (2,727)	\$ 1,508	\$ 2,361	\$ 3,423	\$ 3,620	\$ 1,468	\$ (1,038)	\$ (4,959)	\$ (10,551)	

As previously discussed, the process of estimating loss and loss adjustment expense reserves is inherently uncertain, which results in favorable and adverse development on initial estimates. The table above illustrates such uncertainty. Another variable in the process of estimating reserves is the quality of the claims administration. The underlying

claims must be promptly analyzed to accurately estimate the potential loss. Prior to 1997, PDIC's claims were administered by an outside claims administrator. Beginning in 1997, PDIC hired its own employees to administer the claims. At the same time, PDIC engaged a new actuarial firm.

An independent actuary that specializes in the lawyers' professional liability industry performs a semi-annual study for PDIC that results in a recommended level for loss and loss adjustment expense reserves. The actuary reviews PDIC's historical claim payment data and premiums data. In addition, the actuary performs statistical analyses based upon many factors, including the size of the firms insured, the ages of the attorneys, the practice areas of the

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attorneys, and the nature of the underlying errors that drive the claims. The actuary also considers the terms of PDIC's reinsurance contracts. Ultimately, based on this examination, the actuary provides PDIC with an estimate of the reserves that should be recorded. These estimates vary from study to study based on new information available about previous claims and uncertainties inherent in new claims. Occasionally, as can be seen in the table, the estimates initially recorded for losses and loss adjustment expenses based upon the actuarial studies prove to be significantly different from actual results.

Beginning in 1996, PDIC has focused its efforts on refining the process of estimating the ultimate cost of claims and in decreasing the length of time it takes to settle a claim. Decreasing the length of time to settle claims brings certainty to the estimates more quickly. In the first few years after bringing claims administration in-house and in reaction to the prior underestimated reserves recorded by the outside claims administrator, reserve levels were too conservative, resulting in high reserves. With more experience, refined assessment procedures and working closely with its actuary, PDIC expects to improve its accuracy for setting initial reserves with the hopes that subsequent development as a percentage of the initial estimate will be minimal. Unfortunately, any improvement in the accuracy of such estimates, if any, will not be known for some time.

Conditions and trends that have affected the development of liabilities in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on this table.

Statutory accounting principles ("Statutory") require reserves to be reported net (i.e. after reinsurance). Generally accepted accounting principles ("GAAP") require reserves to be reported gross (i.e. before reinsurance) with a corresponding asset established for the reinsurance recoverable. When compared on a net basis, Statutory and GAAP reserves are identical.

Market for Common Stock and Dividends

There is no active public trading market for the Company's securities. Bid and asked quotations for the Company's securities may be reported on the over-the-counter bulletin board (the "OTC") under the symbol PFLD. Transactions in the Company's securities are occasionally effected by individuals through the OTC or on an informal basis. The prices at which such transactions are effected are only occasionally reported to the Company.

Holdings. As of December 31, 2005, there were approximately 685 record holders of the Company's common stock.

Dividends. The Company has never declared a cash dividend on its common stock. Payment of dividends by the Company may be contingent on the receipt of dividends from PDIC. The payment of dividends by PDIC is subject to limitations imposed by the Michigan Insurance Code and the plan that governed the Company's Conversion. PDIC is not permitted to make distributions until such time as all Surplus Certificates are redeemed.

Recent Sales of Unregistered Securities. On June 30, 2005, the Company issued a junior subordinated debenture (the "Debenture") having a principal amount of \$3,093,000 to Professionals Direct Statutory Trust II (the "Trust"). Cumulative interest on the Debenture accrues from June 30, 2005, and is payable quarterly in arrears. The rate is fixed at 7.785% until September 15, 2010, thereafter it is variable at a rate of three-month LIBOR (London Interbank Offering Rate) plus 3.625%. The Debenture is subordinate and junior to all senior indebtedness (as defined in the Indenture) of the Company with the exception of other Trust Preferred Securities. The Debenture matures on September 15, 2035, but may be redeemed in whole or in part beginning September 15, 2010.

On June 30, 2005, the Trust sold capital securities ("Capital Securities") for \$3 million to investors and issued common securities ("Common Securities") for \$93,000 to the Company. All of the proceeds from the sale of Capital Securities and Common Securities were invested in the Debenture. Capital Securities and Common Securities represent undivided beneficial interests in the Debenture, which is the sole asset of the Trust. Holders of Capital Securities and

Common Securities are entitled to receive distributions from the Trust on terms which correspond to those of the Debenture. Distributions by the Trust and payments on liquidation of the Trust or redemption of Capital Securities are guaranteed by the Company to the extent the Trust has funds available (the "Guarantee"). The Company's obligations under the Guarantee, taken together with its obligations under the Debenture and the Indenture, constitute a full and unconditional guarantee of all of the Trust's obligations under the Capital Securities issued by the Trust.

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The trust preferred securities were issued in reliance on an exemption from registration under Section 4(2) of the federal Securities Act of 1933.

Equity Compensation Plans. The following table provides information about Professionals Direct's equity compensation plans regarding the number of securities to be issued under these plans, the weighted-average exercise prices of options outstanding under these plans and the number of securities available for future issuance as of December 31, 2005.

EQUITY COMPENSATION PLANS

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders (1)	0	n/a	70,000
Equity compensation plans not approved by security holders	0	n/a	0
Total	0	n/a	70,000

(1) Consists of the Professionals Direct, Inc. Outside Directors' Deferred Compensation Plan and the Professionals Direct, Inc. Employee and Director Stock Purchase Plan. The numbers of shares reflected in column (c) in the table above with respect to the Outside Directors' Deferred Compensation Plan (35,000 shares) and Employee and Director Stock Purchase Plan (35,000 shares) represent shares that may be issued other than upon the exercise of an option, warrant or right. Each plan listed above contains customary anti-dilution provisions that are applicable in the event of a stock split or certain other changes in Professionals Direct's capitalization.

New Accounting Standards

In December 2004, Financial Accounting Standards Board (FASB) issued Statement No. 123(R), "Share-Based Payment" to expand and clarify Statement No. 123, "Accounting for Stock-Based Compensation" in several areas. SFAS 123(R) requires companies to measure the cost of employee services received in exchange for an award of an equity instrument based on the grant-date fair value of the award. SFAS 123(R) becomes effective January 1, 2006 and will be applied prospectively. While the Company's Employee and Director Stock Purchase Plan may be subject to this standard, any effect is expected to be immaterial to the Company's financial statement.

Forward-Looking Statements

This report contains forward-looking statements, including, but not limited to, statements relating to the Company's business objectives and strategy. Such forward-looking statements are based on current expectations, management beliefs, certain assumptions made by the Company's management, and estimates and projections about the Company's industry. Words such as "anticipates", "believes", "estimates", "expects", "forecasts", "intends", "judgment", "objective", "projects", "seeks", and variations of such words and similar expressions are intended to identify such forward-looking statements. Determination of loss and loss adjustment expense reserves and amounts due from reinsurers are based substantially on estimates and the amounts so determined are inherently forward-looking.

Forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict with respect to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may differ materially from those expressed, forecasted, or contemplated by any such forward-looking statements. Other factors, some of which are listed below, also influence the results of operations, financial condition and business of the Company and its subsidiaries:

Future economic conditions and the legal and regulatory environment in the markets served by the Company's subsidiaries;

Reinsurance market conditions, including changes in pricing and availability of reinsurance;

Financial market conditions, including, but not limited to, changes in interest rates and the values of investments;

Inflation;

Credit worthiness of the issuers of investment securities, reinsurers and others with whom the Company and its subsidiaries do business;

Estimates of loss reserves and trends in losses and loss adjustment expenses;

Changing competition;

The Company's ability to execute its business plan;

The effects of war and terrorism on investment and reinsurance markets;

The effects of hurricanes, earthquakes and other natural disasters on investment and reinsurance markets;

Changes in financial ratings issued by independent organizations, including A.M. Best, Standard & Poors and Moody's;

The Company's ability to enter new markets successfully and capitalize on growth opportunities;

The Company's ability to comply with internal control audit requirements that are expected to become effective in 2007; and

Changes in the laws, rules and regulations governing insurance holding companies and insurance companies, as well as applicable tax and accounting matters.

Changes in any of these factors, or others, could have an adverse affect on the business or results of operations of the Company or its subsidiaries. Unless required by law, the Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Report of Independent Registered Public Accounting Firm

The Board of Directors
Professionals Direct Inc. and Subsidiaries
Grand Rapids, Michigan

We have audited the accompanying consolidated balance sheet of Professionals Direct Inc. and Subsidiaries as of December 31, 2005, and the related consolidated statements of income and comprehensive income, shareholders' equity and cash flows for the two years in the period then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Professionals Direct Inc. and Subsidiaries as of December 31, 2005, and the consolidated results of their operations and their cash flows for the two years in the period then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO Seidman, LLP

Grand Rapids, Michigan
March 3, 2006, except for Note 15 which is as of March 21, 2006

PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

<i>December 31,</i>	2005
<i>Assets (Note 9)</i>	(000)
Fixed maturities held to maturity, at amortized cost (Note 3)	\$ 4,312
Fixed maturities available for sale, at fair value (Note 3)	29,496
Other invested asset, at cost which approximates fair value	290
Total investments	34,098
Cash and cash equivalents	9,309
Receivables:	
Premiums (Note 4)	1,394
Amounts due from reinsurers (Note 8)	17,875
Investment income	399
Other	109
Prepaid reinsurance premiums	4,175
Property and equipment, net (Note 6)	353
Deferred acquisition costs (Note 14)	1,378
Net deferred federal income taxes (Note 13)	1,578
Intangible assets, net (Note 5)	630
Other assets	50
	37,750
Total Assets	\$ 71,348
<i>Liabilities and Shareholders' Equity</i>	
<i>Liabilities</i>	
Loss and loss adjustment expense reserves (Note 7)	\$ 35,468
Unearned premiums	11,776
Amounts due to reinsurers	1,855
Lines of credit (Note 9)	170
Unearned ceding commissions (Note 14)	714
Accrued expenses and other liabilities	1,383
Accrued interest	1,653
Federal income taxes payable	196
Surplus certificates (Note 11)	2,531
Trust preferred securities (Note 10)	5,000
Total Liabilities	60,746
Commitments and Contingencies (Notes 8, 9 and 15)	
Shareholders' Equity (Note 11)	
Preferred stock, no par (500,000 shares authorized, no shares issued)	-

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Common stock, no par (5,000,000 shares authorized, 333,500 shares issued and outstanding)	3,206
Retained earnings	7,801
Accumulated other comprehensive loss (Note 18)	(405)
<i>Total Shareholders' Equity</i>	10,602
<i>Total Liabilities and Shareholders' Equity</i>	\$ 71,348

See accompanying notes to consolidated financial statements

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME

<i>Year ended December 31,</i>	2005	2004
	(000)	(000)
<i>Revenues</i>		
Net premiums earned (Note 8)	\$ 15,375	\$ 16,203
Fees and commissions earned	792	731
Net investment income (Note 3)	1,171	893
Finance and other income earned	153	152
<i>Total Revenues</i>	17,491	17,979
<i>Expenses</i>		
Losses and loss adjustment expenses incurred (Notes 7 and 8)	12,521	11,937
Operating and administrative (Note 14)	3,785	4,804
Interest	506	447
<i>Total Expenses</i>	16,812	17,188
Income before federal income tax expense	679	791
Federal Income Tax Expense (Note 13)	177	260
<i>Net Income</i>	502	531
Other Comprehensive Loss (Note 18)	(188)	(106)
<i>Comprehensive Income</i>	\$ 314	\$ 425
<i>Per share of common stock (not in thousands):</i>		
<i>Basic and diluted net income per share</i>	\$ 1.51	\$ 1.59
<i>Basic and diluted comprehensive income per share</i>	.94	1.27

See accompanying notes to consolidated financial statements

PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common shares	Common stock par value (000)	Retained earnings (000)	Accumulated other comprehensive loss (000)	Total (000)
Balance, January 1, 2004	333,500	\$ 3,206	\$ 6,768	\$ (111)	9,863
Net income for the year	-	-	531	-	531
Net depreciation on available for sale securities, net of taxes (Note 18)	-	-	-	(106)	(106)
Balance, December 31, 2004	333,500	\$ 3,206	\$ 7,299	\$ (217)	10,288
Net income for the year	-	-	502	-	502
Net depreciation on available for sale securities, net of taxes (Note 18)	-	-	-	(188)	(188)
Balance, December 31, 2005	333,500	3,206	7,801	(405)	10,602

See accompanying notes to consolidated financial statements

PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>Year ended December 31,</i>	2005	2004
	(000)	(000)
<i>Operating Activities</i>		
Net income	\$ 502	\$ 531
Adjustments to reconcile net income to net cash from operating activities:		
Deferred federal income tax expense	(43)	(267)
Realized gains	-	(5)
Depreciation	147	152
Amortization	631	868
Changes in operating assets and liabilities:		
Premiums receivable	(292)	150
Amounts due from reinsurers	(11,596)	(3,913)
Investment income receivable	5	(47)
Other receivable	239	(16)
Prepaid reinsurance premiums	(12)	(2,388)
Federal income taxes recoverable	561	(561)
Deferred acquisition costs	37	214
Other assets	(47)	23
Loss and loss adjustment expense reserves	14,420	7,587
Unearned premiums	1,038	270
Amounts due to reinsurers	(181)	1,543
Unearned ceding commissions	(72)	675
Accrued expenses and other liabilities	396	(482)
Accrued interest	133	136
Federal income taxes payable	196	(306)
Net cash from operating activities	6,062	4,164
<i>Investing Activities</i>		
Cost of available for sale fixed maturities acquired	(5,207)	(11,917)
Cost of held to maturity fixed maturities acquired	(4,072)	(252)
Proceeds from sales or maturities of fixed maturities available for sale	7,821	7,207
Cost of property and equipment acquired	(202)	(47)
Net cash for investing activities	(1,660)	(5,009)
<i>Financing Activities</i>		
Net repayments under lines of credit	(2,337)	(1,767)
Payment of debt issue costs	(150)	-
Proceeds from issuance of trust preferred securities	3,000	-
Net cash from (for) financing activities	513	(1,767)
<i>Net Increase (Decrease) in Cash and Cash Equivalents</i>	4,915	(2,612)

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Cash and Cash Equivalents, beginning of year		4,394		7,006
Cash and Cash Equivalents, end of year	\$	9,309	\$	4,394

Supplemental Disclosures of Cash Flow Information

Federal income tax payments (recoveries) - net	\$	(537)	\$	1,387
Interest payments		373		311

See accompanying notes to consolidated financial statements

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization of the Company and Nature of Business

Professionals Direct Inc. (Company) is an insurance holding company with four subsidiaries (see Note 2). One of the subsidiaries, Professionals Direct Insurance Company (PDIC) is the former Michigan Lawyers Mutual Insurance Company (the Mutual). The Mutual was originally formed in the State of Michigan on June 4, 1987, for the principal purpose of providing professional liability insurance on a claims-made basis to attorneys practicing in Michigan. PDIC continues to provide professional liability insurance to attorneys and law firms in Michigan and other states. In 2005, 36% of premiums were written in Michigan, 9% in Florida, 7% each in Arizona, Colorado and Pennsylvania with the balance in twenty-three additional states with no other state exceeding 7%.

The Lawyers Direct Risk Purchasing Group (Group) was formed during 2002 to facilitate the purchase of liability insurance by certain of the Company's insureds. The Group is a non-profit corporation with current management of the Company comprising its Board.

2. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP).

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries (Professionals Direct Insurance Company, a property and casualty insurance company; Professionals Direct Employer Organization, Inc., an inactive Michigan professional employer organization; Professionals Direct Finance, Inc. (Finance), a premium finance company; Professionals Direct Insurance Services, Inc. (Services), a company providing underwriting, claims, accounting, information technology services and selling professionals liability and other insurance), plus Lawyers Direct Risk Purchasing Group, which the company controls.

Professionals Direct Statutory Trust I and Professionals Direct Statutory Trust II are accounted for under the equity method in the accompanying financial statements. They are not consolidated because the Company is not the primary beneficiary.

All significant intercompany transactions and balances have been eliminated.

Investments

The Company classifies marketable investment securities in one of three categories: trading, available for sale, or held to maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Held to maturity securities are those securities which the Company has the ability and intent to hold until maturity. All other securities are classified as available for sale.

Held to maturity securities are recorded at amortized cost. Unrealized gains and losses are excluded from comprehensive income.

Available for sale securities are recorded at fair value based upon quoted market prices of the underlying securities. Unrealized gains and losses, net of the related tax effect, on available for sale securities are excluded from net income and reported as accumulated other comprehensive income (loss), until realized. A decline in the fair value of any available for sale security below cost, that is deemed other than temporary, is charged to earnings and results in the establishment of a new cost basis for the security.

Premiums and discounts are amortized or accreted over the life of the related fixed maturity security as an adjustment to yield using the effective interest method. Dividend and interest income is recognized when earned. Realized gains and losses are included in earnings and are derived using the specific identification method for determining the cost of the securities sold.

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Other Invested Asset

Other invested asset is an investment in a non-public reinsurance company accounted for using cost basis accounting. The fair value of this investment represents management's best estimate of fair value based upon information received from the investee. A decline in the estimated fair value of any other invested asset below cost that is deemed other than temporary is charged to earnings and results in the establishment of a new cost basis for the security.

Cash and Cash Equivalents

Cash and cash equivalents include money market mutual funds and investments with original maturities of three months or less and are stated at cost, which approximates fair value.

Property and Equipment

Property and equipment, consisting principally of computer equipment and software, is stated at cost, less accumulated depreciation and amortization. Software development costs, consisting principally of the costs of external consultants, are capitalized and amortized over estimated useful lives. Depreciation and amortization are provided using accelerated and straight-line methods over estimated useful lives, which range from three to seven years.

Intangible Assets

Intangible assets consist of customer lists and non-compete agreements that are amortized on a straight-line basis over the estimated benefit periods from two to fifteen years and debt issue costs that are amortized by the effective interest method over the term of the securities.

Revenue Recognition

Insurance premiums are earned on a daily pro-rata basis over the term of the policy. Most policies have a term of twelve months.

Commission Income

Commissions are recognized when the respective policies become effective.

Deferred Acquisition Costs and Unearned Ceding Commissions

Acquisition costs, consisting of commissions, premium taxes and other underwriting costs are deferred and amortized ratably over the terms of the policies, generally one year. The recoverability of deferred acquisition costs is assessed and such costs are reduced if a premium deficiency exists. Unearned ceding commissions are deferred and amortized ratably over the terms of the treaties.

Unearned Premiums

Unearned premiums represent the portion of premiums written which is applicable to the unexpired terms of policies in force, calculated using the daily pro-rata basis.

Loss and Loss Adjustment Expenses

Unpaid losses and loss adjustment expenses (LAE) are provided for as claims are incurred. The provision for unpaid losses and loss adjustment expenses includes: (1) the accumulation of individual case estimates for claims and claim adjustment expenses reported prior to the close of the accounting period; (2) estimates for unreported claims based on historical and industry data; (3) estimates of expenses for investigating and adjusting

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

claims based on the experience of the Company and the industry; and (4) estimates of additional development of these losses over case basis estimates based upon past experience.

Inherent in the estimates of ultimate claims are expected trends in claim severity, frequency and other factors that may vary as claims are settled. The amount of uncertainty in the estimates for liability coverage is significantly affected by such factors as the amount of claim experience relative to the development period, knowledge of the actual facts and circumstances and the amount of risk retained. The liability for losses and loss adjustment expenses is necessarily an estimate and while it is believed to be adequate, the ultimate liability could exceed or be less than such estimate. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments are reflected in current operations.

Reinsurance

In the normal course of business, the Company seeks to reduce the risk of loss that may arise from significant events that cause unfavorable underwriting results by reinsuring certain levels of risk with reinsurers.

Amounts recoverable from reinsurers are estimated in a manner consistent with the provisions of the reinsurance agreement and the establishment of the liability for loss and loss adjustment expenses. Premiums earned, losses and loss adjustment expenses and policy acquisition costs are reported net of the amounts related to reinsurance ceded to other companies. Amounts recoverable from reinsurers related to the portions of the liabilities for losses and loss adjustment expenses and unearned premiums ceded are reported as assets.

Federal Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates in effect at the balance sheet date. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as a charge or credit to income tax expense in the period that includes the enactment date.

Use of Estimates

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

The most significant estimates that are susceptible to significant change in the near term relate to the determination of the loss and loss adjustment expense reserves and amounts due from reinsurers. Although considerable variability is inherent in these estimates, management believes that they are fairly stated based on presently available information. Estimates are reviewed regularly and adjusted as deemed appropriate. Such adjustments are reflected in current operations.

Earnings Per Share of Common Stock

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding. Diluted earnings per share is equal to basic earnings per share as there are no stock options or other

dilutive instruments outstanding.

Certain Significant Risks

Following is a description of the more significant risks facing property/casualty insurers and how the Company mitigates those risks:

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Legal/Regulatory Risk - is the risk that changes in the legal or regulatory environment in which an insurer operates will change and create additional loss costs or expenses not anticipated by the insurer in pricing its products. That is, regulatory initiatives designed to reduce insurer profits or new legal theories may create costs for the insurer beyond those recorded in the financial statements. The Company mitigates this risk through underwriting and loss adjusting practices intended to identify and minimize the adverse impact of this risk.

Credit Risk - is the risk that issuers of securities owned by the Company will default, or other parties, including reinsurers and customers which owe the Company money, will not pay. The Company has a concentration of amounts due from customers in the State of Michigan as approximately 36% of current year revenues were derived from customers in Michigan. The Company manages this risk by adhering to a conservative investment strategy, by maintaining sound reinsurance and credit and collection policies, and by providing for any amounts deemed uncollectible.

Interest Rate Risk - is the risk that interest rates will change and cause a decrease in the value of an insurer's investments. The Company mitigates this risk by attempting to match the maturity schedule of its assets with the expected payout of its liabilities. To the extent that liabilities come due more quickly than assets mature or the Company liquidates investments to meet operating needs, the Company would have to sell assets prior to maturity and recognize a gain or loss. At December 31, 2005, the estimated fair value of the Company's bond portfolio was less than its cost, however the Company believes that it has the ability to hold securities to maturity and therefore minimize the risk of loss recognition.

Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value:

Fixed maturity securities

The fair values of fixed maturity securities are based on quoted market prices, when available or based on values obtained from investment brokers.

Cash and cash equivalents

The carrying amount is a reasonable estimate of fair value.

Premiums and Finance Receivables and Accounts Payable and Accrued Expenses

The carrying amount is considered to be a reasonable estimate of fair value due to their short-term nature.

Surplus Certificates

The carrying amount is a reasonable estimate of fair value due to the restrictive nature and limited marketability of the notes.

Notes Payable

The fair value of amounts outstanding on the Company's line of credit arrangements is equal to the unpaid balance of the notes due to the variable rate of interest on the arrangement.

Trust Preferred Securities

The carrying value of the issue dated June 30, 2005 is a reasonable estimate of fair value based on interest rates as of December 31, 2005.

The carrying value of the issue dated December 4, 2002 is a reasonable estimate of fair value due to its variable rate of interest.

3. Investments

A summary of amortized cost, gross unrealized gains and losses, and fair value of fixed maturities is as follows:

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

<i>December 31, 2005</i>	Amortized cost (000)	Gross unrealized Gains (000)	Losses (000)	Fair value (000)
Fixed maturities held to maturity:				
Obligations of states and political subdivisions	\$ 4,312	\$ 11	\$ 30	\$ 4,293
Fixed maturities available for sale:				
U.S. treasury securities and obligations of U.S. government agencies	6,185	-	94	6,091
Obligations of states and political subdivisions	11,752	-	357	11,395
Corporate securities	10,775	4	182	10,597
Mortgage and other asset-backed securities	1,415	2	4	1,413
Total fixed maturities	\$ 34,439	\$ 17	\$ 667	\$ 33,789

The amortized cost and fair value of fixed maturities, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

<i>December 31, 2005</i>	Amortized cost (000)	Fair value (000)
Fixed maturities held to maturity, other than mortgage and other asset-backed securities:		
Due after five years through ten years	\$ 1,667	\$ 1,674
Due after ten years	2,645	2,619
Total fixed maturities held to maturity	4,312	4,293
Fixed maturities available for sale, other than mortgage and other asset-backed securities:		
Due in one year or less	8,044	7,968
Due after one year through five years	14,962	14,575
Due after five years through ten years	4,505	4,392
Due after ten years	1,201	1,148
Total fixed maturities available for sale	28,712	28,083
Mortgage and other asset-backed securities	1,415	1,413
	\$ 34,439	\$ 33,789

Proceeds from sales of available for sale fixed maturities were \$7,170,000 and \$6,325,011 in 2005 and 2004, respectively, on which gross gains of \$0 and \$4,932 were realized in 2005 and 2004, respectively. There were no realized losses in either year.

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Other than Temporary Impairments of Securities and Unrealized Losses on Investments

At December 31, 2005, the Company had 67 securities deemed to be temporarily impaired. These investments had unrealized losses of less than 7% each and no single security loss exceeded \$40,000. Forty-seven investments have had unrealized losses for more than one year, which losses aggregated \$549,000 at December 31, 2005.

In concluding that investments with unrealized losses are not other-than-temporarily impaired, positive evidence consisted of: 1) no specific events related to credit risk of the issuer caused concern; 2) interest payments are current; 3) market prices have risen; 4) changes in market value are normal relative to fluctuations in overall interest rates; and 5) the Company has the intent and ability to hold the security until the anticipated recovery in value occurs.

The fair value and amount of unrealized losses segregated by the time period the investment has been in an unrealized loss position is as follows:

December 31, 2005	Less than 12 months		Greater than 12 months	
	Fair value of investments with unrealized losses (000)	Gross unrealized losses (000)	Fair value of investments with unrealized losses (000)	Gross unrealized losses (000)
Debt Securities:				
U.S. treasury securities and obligations of U.S. government agencies	\$ 1,065	\$ 11	\$ 4,525	\$ 83
Obligations of states and political subdivisions	2,021	23	9,374	334
Corporate securities	2,525	51	7,030	131
Mortgage and other asset-backed securities	1,193	3	22	1
Totals	\$ 6,804	\$ 88	\$ 20,951	\$ 549

At December 31, 2005, investments with a fair value of \$2,965,438 and amortized cost of \$2,993,847 were on deposit with regulatory authorities, as required by law.

Net investment income was comprised of the following components:

<i>Year ended December 31,</i>	2005	2004
	(000)	(000)
Investment income:		
Fixed maturities	\$ 1,054	\$ 927
Short-term investments	219	59
Net realized gains (losses)	-	5
	1,273	991
Less investment expenses	102	98

Net investment income	\$	1,171	\$	893
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No individual investment exceeds ten percent of shareholders' equity.

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. Premiums and Deductibles Receivable and Allowance for Doubtful Accounts

Premium receivables are primarily customer obligations due under terms of premium finance contracts. We sell our policies exclusively to lawyers and law firms. Professionals Direct Finance, Inc. provides premium financing to policyholders of Professionals Direct Insurance Company for up to seventy-five percent of the premium. Typically, Finance will accept installment payments over nine months, including a finance charge. Finance holds the policy as collateral and if an account is delinquent will have the insurance company cancel the policy. The return of unearned premium should exceed the amount owed on the contract and the difference is paid to the policyholder. As a result, no allowance for doubtful accounts is provided.

Deductible receivables are amounts due from policyholders under the terms of the policy when the Company pays indemnity or expenses on behalf of a policyholder. There are typically a limited number of policyholders with deductible balances outstanding. We record an allowance for doubtful accounts based on specifically identified amounts that we believe to be uncollectible. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. The allowance for doubtful accounts at December 31, 2005 and 2004 was \$20,000 and \$25,000, respectively.

5. Intangible Assets

Intangible assets consist of the following:

<i>December 31,</i>	2005 (000)
Cost:	
Debt issue costs	\$ 289
Covenants not to compete	310
Renewal rights and customer lists	526
	1,125
Less accumulated amortization	495
Net intangible assets	\$ 630

Intangible assets include debt issue costs of \$150,237 and \$93,848 incurred in 2005 and 2002, respectively, in connection with the issuance of trust preferred securities (see Note 10), and \$45,000 incurred in 2003 in connection with additional bank financing. In 2002, the Company purchased the renewal rights to the direct written lawyers professional liability policies of Interlex Insurance Company for \$309,000. In conjunction with this purchase, the Company obtained certain non-competition covenants from Interlex and its employees for \$132,428 and acquired the renewal rights and a covenant not to compete from a former Interlex agent for \$49,371.

The renewal rights are being amortized on a straight line basis over fifteen years. The covenants are being amortized over the associated duration of the covenant up to 51 months. Debt issue costs are being amortized by the effective interest method over the term of the repayment period ranging from 3 to 30 years, and have been included in interest expense. Amortization expense incurred related to intangible assets during 2005 and 2004 amounted to \$65,789 and \$93,542, respectively. Intangible assets are assessed for impairment at least quarterly, or more often if circumstances suggest that an impairment of the carrying value of the asset may exist. No impairment was deemed to have occurred

during 2005 or 2004.

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Future amortization expense is as follows:

Year ending December 31,

		(000)
2006	\$	62
2007		43
2008		43
2009		43
2010		43
Thereafter		396
	\$	630

6. Property and Equipment

Property and equipment consist of the following:

December 31,

		2005 (000)
Cost:		
Computer equipment	\$	287
Furniture and other equipment		258
Computer software		1,237
Leasehold improvements		47
		1,829
Less accumulated depreciation and amortization		1,476
Net property and equipment	\$	353

7. Loss and Loss Adjustment Expense Reserves

Activity in the loss and loss adjustment expense reserves is summarized as follows:

December 31,

		2005 (000)		2004 (000)
Balance , beginning of year	\$	21,048	\$	13,461
Less reinsurance balances recoverable		(5,699)		(2,163)
Net balance, beginning of year		15,349		11,298
Incurred related to:				
Current year		11,212		10,948

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Prior years	1,309	989
Total incurred	12,521	11,937
Paid related to:		
Current year	2,085	1,654
Prior years	8,129	6,232
Total paid	10,214	7,886
Net balance, end of year	17,656	15,349
Plus reinsurance balances recoverable	17,812	5,699
Balance, end of year	\$ 35,468	\$ 21,048

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The 2005 increase in incurred losses related to prior years is primarily attributable to years 2002, 2003 and 2004 and resulted from increases in reserves caused by increased loss severity. The 2004 increase in incurred losses related to prior years resulted from similar adverse loss development on primarily the 2002 and 2003 years.

8. Reinsurance

In the normal course of business, the Company seeks to reduce the loss that may arise from events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Although reinsurance agreements contractually obligate the Company's reinsurers to reimburse the Company for their proportionate share of losses, they do not discharge the primary liability of the Company. The Company is contingently liable for unpaid losses and loss adjustment expenses and unearned premiums associated with ceded insured risks in the event the assuming insurance organizations fail to meet their contractual obligations.

In 2005 and 2004, the Company's net retention on the majority of the policies issued was \$250,000 per claim.

Amounts due from reinsurers consisted of amounts related to the following:

<i>December 31,</i>	2005
	(000)
Paid loss and loss adjustment expenses	\$ 63
Unpaid loss and loss adjustment expenses	17,812
	\$ 17,875

The effect of reinsurance on premiums written and earned is as follows:

	2005		2004	
	Written	Earned	Written	Earned
	(000)	(000)	(000)	(000)
Direct	\$ 25,902	\$ 24,864	\$ 24,009	23,739
Ceded	(9,501)	(9,489)	(9,924)	(7,536)
Net Premiums	\$ 16,401	\$ 15,375	\$ 14,085	16,203

As a result of reinsurance ceded, losses and loss adjustment expenses incurred were reduced by \$14,813,363 and \$5,309,163 in 2005 and 2004, respectively. This increase in ceded losses is primarily the result of two claims that together have been reserved at policy limits. Both of these cases remain unresolved as of December 31, 2005.

The Company holds collateral under related reinsurance agreements in the form of irrevocable letters of credit with various banks. At December 31, 2005, the balance of these letters of credit was \$4,221,774.

9. Lines of Credit

At December 31, 2005, the Company owed \$170,000 under a \$1.8 million line of credit that bears interest at .5% over the bank's prime rate (effectively 7.75% at December 31, 2005). At December 31, 2005, the Company

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

had available a second line of credit of \$1,000,000 that bears interest at 1.0% over the bank's prime rate (effectively 8.25% at December 31, 2005). The Company had available a third line of credit of \$3,000,000 that bears interest at 1.25% over the bank's prime rate (effectively 8.5% at December 31, 2005). This line of credit has a declining balance facility and matures October 1, 2006. As a result of the declining balance feature, the maximum credit available under this facility at December 31, 2005 was \$1,950,000. All of the lines of credit grant a security interest in substantially all assets of the Company, Services and Finance. In addition, the Company provided a pledge of its shares of PDIC. All of the lines of credit impose financial covenants. The Company was in compliance with all covenants as of December 31, 2005.

10. Trust Preferred Securities

Issue dated June 30, 2005:

On June 30, 2005, the Company issued a junior subordinated debenture (the "Debenture") having a principal amount of \$3,093,000 to Professionals Direct Statutory Trust II (the "Trust"). Cumulative interest on the Debenture accrues from June 30, 2005, and is payable quarterly in arrears. The rate is fixed at 7.785% until September 15, 2010, thereafter it is variable at a rate of three-month LIBOR (London Interbank Offering Rate) plus 3.625%. The Debenture is subordinate and junior to all senior indebtedness (as defined in the indenture) of the Company with the exception of other Trust Preferred Securities. The Debenture matures on September 15, 2035, but may be redeemed in whole or in part beginning on September 15, 2010.

On June 30, 2005, the Trust sold capital securities ("Capital Securities") for \$3 million to investors and issued common securities ("Common Securities") for \$93,000 to the Company. All of the proceeds from the sale of Capital Securities and Common Securities were invested in the Debenture. Capital Securities and Common Securities represent undivided beneficial interests in the Debenture, which is the sole asset of the Trust. Holders of Capital Securities and Common Securities are entitled to receive distributions from the Trust on terms which correspond to those of the Debenture. Distributions by the Trust and payments on liquidation of the Trust or redemption of Capital Securities are guaranteed by the Company to the extent the Trust has funds available (the "Guarantee"). The Company's obligations under the Guarantee, taken together with its obligations under the Debenture and the Indenture, constitute a full and unconditional guarantee of all of the Trust's obligations under the Capital Securities issued by the Trust.

Issue Dated December 4, 2002:

On December 4, 2002, the Company issued a floating rate junior subordinated debenture (the "Debenture") having a principal amount of \$2,062,000 to Professionals Direct Statutory Trust I (the "Trust"). Cumulative interest on the Debenture accrues from December 4, 2002, and is payable quarterly in arrears. The rate is variable at LIBOR (London Interbank Offering Rate) plus 4.00% (not to exceed 12.50%). At December 31, 2005, interest accrued at an annual rate per annum equal to 8.44%. The Debenture is subordinate and junior to all senior indebtedness (as defined in the indenture) of the Company with the exception of other Trust Preferred Securities. The Debenture matures on December 4, 2032, but may be redeemed in whole or in part beginning on December 4, 2007.

On December 4, 2002, the Trust sold floating rate capital securities ("Capital Securities") for \$2 million to investors and issued floating rate common securities ("Common Securities") for \$62,000 to the Company. All of the proceeds from the sale of Capital Securities and Common Securities were invested in the Debenture. Capital Securities and Common Securities represent undivided beneficial interests in the Debenture, which is the sole asset of the Trust. Holders of Capital Securities and Common Securities are entitled to receive distributions from the Trust on terms which

correspond to those of the Debenture. Distributions by the Trust and payments on liquidation of the Trust or redemption of Capital Securities are guaranteed by the Company to the extent the Trust has funds available (the “Guarantee”). The Company’s obligations under the Guarantee, taken together with its obligations under the Debenture and the Indenture, constitute a full and unconditional guarantee of all of the Trust’s obligations under the Capital Securities issued by the Trust.

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Surplus Certificates

Surplus certificates were offered for sale only in the State of Michigan to lawyers resident in and authorized to practice in Michigan, and to law partnerships and professional corporations which have their principal place of business in Michigan. Certificate ownership was required for a lawyer to be insured by the Company prior to March 31, 1995, when the requirement was suspended and, effective December 9, 2000, this requirement was permanently removed.

Certificates have a principal value of \$1,000 each and bear simple interest at the rate of 5.25% per annum from the issuance date until paid. Principal and accrued interest thereon may be paid only from surplus earnings, and then only upon the written consent of the OFIS and in such amounts as are determined by the Board of Directors. Subject to these conditions for repayment, certificates are redeemable by the holder after they have been outstanding for ten years. To date, the Company has received approval to pay certain interest on certificates issued prior to December 31, 1993. Interest payments during 2005 and 2004 to these certificate holders amounted to \$621 and \$0, respectively. At December 31, 2005 interest accrued and unpaid was approximately \$1,628,000.

During the Conversion in 2001, 1,814 surplus certificates were converted to common stock and interest totaling \$540,798 was paid on these converted certificates. At December 31, 2005, 2,531 certificates remain outstanding.

In the event of liquidation, receivership, insolvency, reorganization, dissolution, or termination of existence of the Company, or the sale by the Company of substantially all its assets, the outstanding certificates will be of equal rank with each other regardless of the issuance date of a certificate, and redemption thereof will be subordinate to claims of creditors and policyholders and any other priority claims as provided by the insurance code. If there are insufficient assets in such event to pay in full, interest and principal on all outstanding certificates, payment will be made pro rata.

On January 26, 2006, the OFIS approved the redemption of certificates and interest thereon aggregating \$300,000.

12. Statutory Information

Dividend Restrictions

As required by the Plan of Conversion, PDIC is prohibited from making dividend payments to the Company until such time as the surplus certificates are redeemed. In addition, under Michigan law, the maximum dividend that may be paid by PDIC to the Company during any twelve-month period without the prior approval of the OFIS is the greater of 10% of PDIC's statutory surplus as reported on the most recent Annual Statement filed with the OFIS or the net income of PDIC for the period covered by such Annual Statement.

Statutory Information

At December 31, 2005, statutory surplus of PDIC was \$17.5 million. The State of Michigan requires insurance companies domiciled in Michigan to have minimum statutory surplus of \$7 million. Statutory net income for the years ended December 31, 2005 and 2004 was \$203,336 and \$38,988, respectively.

Risk-Based Capital

The NAIC has established RBC requirements to assist regulators in monitoring the financial strength and stability of property and casualty insurers. Under the NAIC requirements, each insurer must maintain its total capital and surplus above a calculated minimum threshold or take corrective measures to achieve that threshold. PDIC has calculated its RBC levels based on these requirements and determined that it has surplus in excess of the minimum threshold.

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. Federal Income Taxes

Federal income tax expense consists of:

<i>Year ended December 31,</i>	2005	2004
	(000)	(000)
Current	\$ 220	\$ 527
Deferred	(43)	(267)
	\$ 177	\$ 260

The significant components of federal income tax expense were as follows:

<i>Year ended December 31,</i>	2005	2004
	(000)	(000)
Operations	\$ 177	\$ 260
Equity - accumulated other comprehensive loss	(97)	(55)

A reconciliation of the federal statutory tax rate to the Company's effective tax rate is as follows:

<i>Year ended December 31,</i>	2005	2004
Federal statutory tax rate	34.0%	34.0%
Reduction in income taxes relating to tax-exempt municipal bond interest	(7.9)	(1.1)
Effective tax rate	26.1%	32.9%

Several provisions of the Internal Revenue Code specifically affect property and casualty insurers. Such provisions that materially affect the Company are the discounting of loss and loss adjustment expense reserves, a reduction in the allowable deduction for unearned premium reserves, and a reduced exclusion for interest from certain tax-exempt bonds. The tax effects of these and other temporary differences that give rise to deferred tax assets and liabilities are presented below:

<i>December 31,</i>	2005
	(000)
Deferred tax assets:	
Loss reserve discounting	\$ 438
Unearned premium reserves	517
Interest on surplus certificates	544
Other	305
Total gross deferred tax assets	1,804
Deferred tax liabilities:	
Deferred acquisition costs	(226)

Net deferred federal income tax asset	\$	1,578
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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In assessing the realizability of deferred federal income tax assets, management considers whether it is more likely than not that some portion of the deferred federal income tax assets will not be realized. Because of the carryforward provisions of the Internal Revenue Code, and the Company's expectation that temporary differences will reverse during periods in which taxable income is generated, management believes it is more likely than not that the Company will fully realize the net deferred federal income tax assets. Accordingly, no valuation allowance has been established.

14. Deferred Acquisition Costs and Unearned Ceding Commission

Changes in deferred acquisition costs are summarized as follows:

<i>Year ended December 31,</i>	2005	2004
	(000)	(000)
Balance, beginning of year	\$ 1,415	\$ 1,629
Amounts deferred:		
Commissions	1,186	1,417
Premium taxes	420	391
Internal underwriting expenses	1,425	1,356
Total amounts deferred	4,446	4,793
Less amortization	(3,068)	(3,378)
Balance, end of year	\$ 1,378	\$ 1,415

Changes in unearned ceding commission are summarized as follows:

<i>Year ended December 31,</i>	2005	2004
	(000)	(000)
Balance, beginning of year	\$ 786	\$ 111
Ceding commissions deferred	1,624	1,755
Less amortization	(1,696)	(1,080)
Balance, end of year	\$ 714	\$ 786

15. Commitments and Contingencies

The Company has entered into operating leases for office space and equipment. Rental expense for these items totaled \$209,145 and \$200,242 in 2005 and 2004, respectively. Future net minimum lease payments under noncancelable leases are as follows:

Year ending December 31,

(000)

2006	\$	121
2007		21
2008		6
	\$	148

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company purchased an annuity policy from a life insurance company for purposes of funding a structured claim settlement. At December 31, 2005, the Company remains contingently liable for this settlement in the amount of \$396,000.

On March 21, 2006, the Company entered into a non-cancelable lease for office space. The lease is for ten years beginning July 1, 2006 with fixed annual increases in minimum lease payments. Lease payments are waived for the first year. This lease will be accounted for in accordance with Financial Accounting Standards Board (FASB) Statement No. 13, *Accounting for Leases*, which requires that lease expense be equal to the pro-rata portion of the fixed lease payments over the term of the lease rather than as paid. Future net minimum lease payments will be as follows:

<i>Year ending December 31,</i>	(000)
2006	\$ 29
2007	119
2008	179
2009	183
2010	187
Thereafter	1,094
	\$ 1,791

16. Benefit Plans

The Company maintains a 401(k) defined contribution employee benefit plan covering substantially all employees meeting eligibility requirements. The Company matches 50% of employee contributions up to an annual maximum of 5% of an employee's salary. The Company's expense under this plan was \$54,160 and \$53,027 in 2005 and 2004, respectively.

Effective January 1, 2001, the Company established a Savings & Retirement Plan. This plan was established to facilitate employee purchases of Company stock upon demutualization. There has been no activity in this plan. Effective December 31, 2005, the Company has merged the Savings & Retirement Plan into the 401(k) plan.

The Company established an Outside Directors Deferred Compensation Plan and an Employee and Director Stock Purchase Plan effective March 23, 2005 and approved by shareholders May 11, 2005. Each plan authorizes the issuance of 35,000 shares. The Deferred Compensation Plan permits deferral of up to 100% of directors' fees converted to shares based on their fair market value. The Stock Purchase Plan permits employees and directors to purchase Company stock at 90% of fair market value. During 2005, there was no activity in either plan.

17. Related Party Transaction

The Company's president serves on the Board of Directors and is treasurer of Lawyers Reinsurance Company ("Lawyers Re"), in which the Company has an investment. Lawyers Re is a participant in the reinsurance treaties of PDIC. During 2005 and 2004, premiums of \$336,000 and \$253,000 were ceded to Lawyers Re. During 2005,

\$155,000 in losses were paid by Lawyers Re. As of December 31, 2005, unearned premiums ceded to Lawyers Re were \$147,000.

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PROFESSIONALS DIRECT INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. Other Comprehensive Income (Loss)

The significant components of other comprehensive income (loss) were as follows:

<i>Year ended December 31,</i>	2005	2004
	(000)	(000)
Increase in unrealized holding loss on securities	\$ (285)	\$ (156)
Income tax benefit	97	53
	(188)	(103)
Reclassification adjustment for gains included in net income	-	(5)
Income tax benefit	-	2
	-	(3)
Other comprehensive income (loss)	\$ (188)	\$ (106)

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PROFESSIONALS DIRECT, INC. DIRECTORS AND EXECUTIVE OFFICERS

At December 31, 2005

Board of Directors

David W. Crooks - Value Added Consultants, Ltd.
(general business consulting)

Tracy T. Larsen - Barnes & Thornburg, LLP
(a full-service law firm)

Thomas J. Ryan - Thomas J. Ryan, P.C.
(attorney at law)

Joseph A. Fink - Member, Dickinson Wright, PLLC
(a full-service law firm)

Julius A. Otten - Independent consultant
(consulting on matters in the insurance industry)

Thomas F. Dickinson - President and Chief Executive Officer of FinCor Holdings, Inc. / MHA Insurance Company
(medical liability insurance provider)

Blake W. Krueger - President and Chief Operating Officer of Wolverine World Wide, Inc.
(international marketer of footwear and accessories)

Mary L. Ursul - Senior Director of Business Development/Strategic Planning of FinCor Holdings, Inc. / MHA Insurance Company
(medical liability insurance provider)

Stephen M. Tuuk - President and Chief Executive Officer of Professionals Direct, Inc.

Stephen M. Westfield - Vice President, Secretary and Treasurer of Professionals Direct, Inc.

Executive Officers

Stephen M. Tuuk - Chairman, President and Chief Executive

Stephen M. Westfield - Vice President, Secretary and Treasurer