

Edgar Filing: National General Holdings Corp. - Form 10-Q

National General Holdings Corp.

Form 10-Q

October 30, 2018

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2017-12-31 0001578735 us-gaap:AffiliatedEntityMember 2018-09-30 0001578735 2018-07-01 2018-09-30

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us-gaap:AdditionalPaidInCapitalMember 2018-01-01 2018-09-30 0001578735 us-gaap:PreferredStockMember

2018-09-30 0001578735 us-gaap:CommonStockMember 2017-12-31 0001578735

us-gaap:AccumulatedOtherComprehensiveIncomeMember 2018-01-01 2018-09-30 0001578735

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us-gaap:PropertyLiabilityAndCasualtyInsuranceSegmentMember 2017-07-01 2017-09-30 0001578735

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us-gaap:PropertyLiabilityAndCasualtyInsuranceSegmentMember 2018-01-01 2018-09-30 0001578735  
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us-gaap:AffiliatedEntityMember nghc:NorthDearbornBuildingCompanyL.P.Member  
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2018-09-30 0001578735 us-gaap:PropertyLiabilityAndCasualtyInsuranceSegmentMember 2018-09-30 0001578735  
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us-gaap:SubsequentEventMember 2019-01-01 2019-12-31 0001578735 nghc:PersonalAutoMember 2017-07-01  
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nghc:ACPRReLtd.MaidenInsuranceCompanyandTechnologyInsuranceCompanyMember  
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us-gaap:MaximumMember us-gaap:SubsequentEventMember 2018-10-01 iso4217:USD nghc:contract nghc:security  
iso4217:USD xbrli:shares xbrli:shares xbrli:pure nghc:investment nghc:plan nghc:segment

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Quarterly Period Ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Transition Period from to  
Commission File Number: 001-36311

**NATIONAL GENERAL HOLDINGS CORP.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware** **27-1046208**  
(I.R.S.  
(State or Other Jurisdiction of Employer  
Incorporation or Organization) Identification  
No.)

**59 Maiden Lane, 38th Floor** **10038**  
**New York, New York**  
(Address of Principal Executive Offices) (Zip Code)  
**(212) 380-9500**  
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer   
Non-Accelerated Filer  Smaller Reporting Company   
Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of October 26, 2018, the number of common shares of the registrant outstanding was 107,132,560.

**NATIONAL GENERAL HOLDINGS CORP.**

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**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements**

**NATIONAL GENERAL HOLDINGS CORP.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(In Thousands, Except Shares and Par Value per Share)**  
**(Unaudited)**

	<b>September 30, 2018</b>	<b>December 31, 2017</b>
<b>ASSETS</b>		
<b>Investments:</b>		
Debt securities, available-for-sale, at fair value (Exchanges - \$311,482 and \$304,934)	\$3,318,097	\$3,139,889
Equity securities, at fair value	40,891	50,341
Short-term investments (Exchanges - \$8,855 and \$22,279)	177,447	38,266
Other investments (related parties - \$233,179 and \$347,548)	327,099	421,292
<b>Total investments</b>	<b>3,863,534</b>	<b>3,649,788</b>
Cash and cash equivalents (Exchanges - \$79 and \$5,442)	395,070	292,282
Restricted cash and cash equivalents (Exchanges - \$184 and \$609)	39,860	65,202
Accrued investment income (related parties - \$1,181 and \$2,334) (Exchanges - \$2,309 and \$1,805)	22,829	22,372
Premiums and other receivables, net (Exchanges - \$64,090 and \$56,792)	1,461,332	1,324,321
Deferred acquisition costs (Exchanges - \$19,277 and \$20,837)	249,492	216,389
Reinsurance recoverable (related parties - \$9,075 and \$15,688) (Exchanges - \$114,789 and \$94,204)	1,527,040	1,294,165
Prepaid reinsurance premiums (Exchanges - \$141,984 and \$100,980)	680,754	517,122
Premises and equipment, net (Exchanges - \$2,261 and \$4,269)	297,980	324,049
Intangible assets, net (Exchanges - \$3,550 and \$3,685)	383,202	404,070
Goodwill	183,984	174,153
Prepaid and other assets (Exchanges - \$8,503 and \$2,263)	144,011	155,830
<b>Total assets</b>	<b>\$9,249,088</b>	<b>\$8,439,743</b>



*See accompanying notes to unaudited condensed consolidated financial statements.*

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**NATIONAL GENERAL HOLDINGS CORP.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(In Thousands, Except Shares and Par Value per Share)**  
**(Unaudited)**

	<b>September 30, 2018</b>	<b>December 31, 2017</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
Unpaid loss and loss adjustment expense reserves (Exchanges - \$175,945 and \$143,353)	\$2,855,135	\$2,663,557
Unearned premiums and other revenue (Exchanges - \$264,418 and \$225,395)	2,331,855	2,032,605
Reinsurance payable (Exchanges - \$61,232 and \$68,275)	655,692	398,047
Accounts payable and accrued expenses (related parties - \$69,376 and \$140,057) (Exchanges - \$4,391 and \$8,827)	464,889	431,881
Debt	675,263	713,710
Other liabilities (Exchanges - \$59,544 and \$41,582)	223,275	246,518
<b>Total liabilities</b>	<b>\$7,206,109</b>	<b>\$6,486,318</b>
<b>Stockholders' equity:</b>		
Common stock, \$0.01 par value - authorized 150,000,000 shares, issued and outstanding 107,132,560 shares - 2018; authorized 150,000,000 shares, issued and outstanding 106,697,648 shares - 2017.	\$1,071	\$1,067
Preferred stock, \$0.01 par value - authorized 10,000,000 shares, issued and outstanding 2,565,120 shares - 2018; authorized 10,000,000 shares, issued and outstanding 2,565,000 shares - 2017.	450,000	420,000
Aggregate liquidation preference \$450,000 - 2018, \$420,000 - 2017.		
Additional paid-in capital	923,124	917,751
Accumulated other comprehensive income:		
Unrealized foreign currency translation adjustment, net of tax	(15,140 )	(7,810 )
Unrealized losses on investments, net of tax	(53,441 )	(302 )
Total accumulated other comprehensive income (loss)	(68,581 )	(8,112 )
Retained earnings	751,320	597,863
<b>Total National General Holdings Corp. Stockholders' Equity</b>	<b>2,056,934</b>	<b>1,928,569</b>
Non-controlling interest	(13,955 )	24,856
<b>Total stockholders' equity</b>	<b>\$2,042,979</b>	<b>\$1,953,425</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$9,249,088</b>	<b>\$8,439,743</b>

*See accompanying notes to unaudited condensed consolidated financial statements.*

**NATIONAL GENERAL HOLDINGS CORP.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(In Thousands, Except Shares and Per Share Data)  
(Unaudited)

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
<b>Revenues:</b>				
Net earned premium	\$ 939,527	\$ 864,301	\$ 2,787,971	\$ 2,764,537
Ceding commission income	59,100	50,102	158,976	91,604
Service and fee income	142,690	122,526	415,313	373,644
Net investment income	30,696	25,150	81,702	81,725
Net gain (loss) on investments	(3,170 )	47,605	(22,756 )	44,018
Other income (expense)	—	(3,901 )	—	(198 )
<b>Total revenues</b>	<b>1,168,843</b>	<b>1,105,783</b>	<b>3,421,206</b>	<b>3,355,330</b>
<b>Expenses:</b>				
Loss and loss adjustment expense	657,310	639,145	1,961,804	1,969,156
Acquisition costs and other underwriting expenses	191,470	163,585	542,040	527,100
General and administrative expenses	235,733	214,127	691,167	680,806
Interest expense	12,583	11,495	38,775	34,590
<b>Total expenses</b>	<b>1,097,096</b>	<b>1,028,352</b>	<b>3,233,786</b>	<b>3,211,652</b>
<b>Income before provision for income taxes</b>	<b>71,747</b>	<b>77,431</b>	<b>187,420</b>	<b>143,678</b>
Provision for income taxes	15,518	18,475	38,261	40,751
<b>Net income</b>	<b>56,229</b>	<b>58,956</b>	<b>149,159</b>	<b>102,927</b>
Net (income) loss attributable to non-controlling interest	12,153	(1,311 )	31,979	4,973
<b>Net income attributable to NGHC</b>	<b>68,382</b>	<b>57,645</b>	<b>181,138</b>	<b>107,900</b>
Dividends on preferred stock	(7,875 )	(7,875 )	(23,625 )	(23,625 )
<b>Net income attributable to NGHC common stockholders</b>	<b>\$ 60,507</b>	<b>\$ 49,770</b>	<b>\$ 157,513</b>	<b>\$ 84,275</b>
<b>Earnings per common share:</b>				
Basic	\$ 0.56	\$ 0.47	\$ 1.47	\$ 0.79
Diluted	\$ 0.55	\$ 0.46	\$ 1.44	\$ 0.78
<b>Dividends declared per common share</b>	<b>\$ 0.04</b>	<b>\$ 0.04</b>	<b>\$ 0.12</b>	<b>\$ 0.12</b>
<b>Weighted average common shares outstanding:</b>				
Basic	107,101,837	106,645,601	106,944,461	106,556,662
Diluted	109,563,392	108,520,964	109,315,780	108,690,139

*See accompanying notes to unaudited condensed consolidated financial statements.*

**NATIONAL GENERAL HOLDINGS CORP.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In Thousands)  
(Unaudited)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
<b>Net income</b>	\$56,229	\$58,956	\$149,159	\$102,927
<b>Other comprehensive income, net of tax:</b>				
Foreign currency translation adjustment, net of tax (tax - three months - \$(115) and \$(650); nine months - \$(1,948) and \$(1,765))	1,041	(1,205 )	(7,330 )	(3,277 )
Gross gain (loss) on investments, net of tax (tax - three months - \$(3,227) and \$5,404; nine months - \$(19,676) and \$21,335)	(13,347 )	10,037	(74,019 )	39,623
Reclassification adjustments for investment gain/loss included in net income:				
Other (gain) loss on investments, net of tax (tax - three months - \$(382) and \$(17,082); nine months - \$3,725 and \$(21,624))	(1,438 )	(31,722 )	14,012	(40,159 )
<b>Other comprehensive loss, net of tax</b>	<b>\$(13,744 )</b>	<b>\$(22,890 )</b>	<b>\$(67,337 )</b>	<b>\$(3,813 )</b>
<b>Comprehensive income</b>	<b>42,485</b>	<b>36,066</b>	<b>81,822</b>	<b>99,114</b>
Comprehensive (income) loss attributable to non-controlling interest	13,014	(2,038 )	38,811	6,570
<b>Comprehensive income attributable to NGHC</b>	<b>\$55,499</b>	<b>\$34,028</b>	<b>\$120,633</b>	<b>\$105,684</b>

*See accompanying notes to unaudited condensed consolidated financial statements.*

**NATIONAL GENERAL HOLDINGS CORP.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
(In Thousands, Except Shares)  
(Unaudited)

	Nine Months Ended September 30, 2018									
	Common Stock		Preferred Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Non-controlling Interest	Total	
	Shares	\$	Shares	\$						
<b>Balance January 1, 2018</b>	106,697,648	\$ 1,067	2,565,000	\$ 420,000	\$ 917,751	\$ (8,112 )	\$ 597,863	\$ 24,856		\$ 1,953,425
Cumulative-effect adjustment of change in accounting principles	—	—	—	—	—	36	8,794	—		8,830
Net income (loss)	—	—	—	—	—	—	181,138	(31,979 )		149,159
Foreign currency translation adjustment, net of tax	—	—	—	—	—	(7,330 )	—	—		(7,330 )
Change in unrealized loss on investments, net of tax	—	—	—	—	—	(53,175 )	—	(6,832 )		(60,007 )
Issuance of preferred stock	—	—	120	30,000	(110 )	—	—	—		29,890
Common stock dividends	—	—	—	—	—	—	(12,850 )	—		(12,850 )
Preferred stock dividends	—	—	—	—	—	—	(23,625 )	—		(23,625 )
Common stock issued under employee stock plans and exercises of stock options	557,622	4	—	—	1,645	—	—	—		1,649
Shares withheld related to net share settlement	(122,710 )	—	—	—	(2,955 )	—	—	—		(2,955 )
Stock-based compensation	—	—	—	—	6,793	—	—	—		6,793
<b>Balance September 30, 2018</b>	107,132,560	\$ 1,071	2,565,120	\$ 450,000	\$ 923,124	\$ (68,581 )	\$ 751,320	\$ (13,955 )		\$ 2,042,979
	Nine Months Ended September 30, 2017									
	Common Stock		Preferred Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Non-controlling Interest	Total	
	Shares	\$	Shares	\$						
<b>Balance January 1, 2017</b>	106,428,092	\$ 1,064	2,565,000	\$ 420,000	\$ 913,787	\$ 11,475	\$ 539,114	\$ 31,918		\$ 1,917,358
Net income (loss)	—	—	—	—	—	—	107,900	(4,973 )		102,927
Foreign currency translation adjustment, net of tax	—	—	—	—	—	(3,277 )	—	—		(3,277 )
Change in unrealized gain (loss) on investments, net of tax	—	—	—	—	—	1,061	—	(1,597 )		(536 )
Purchase of non-controlling interest	—	—	—	—	—	—	—	(243 )		(243 )
Common stock dividends	—	—	—	—	—	—	(12,760 )	—		(12,760 )
Preferred stock dividends	—	—	—	—	—	—	(23,625 )	—		(23,625 )
Common stock issued under employee stock plans and exercises of stock options	317,688	3	—	—	1,116	—	—	—		1,119
Shares withheld related to net share settlement	(75,012 )	—	—	—	(1,707 )	—	—	—		(1,707 )
Stock-based compensation	—	—	—	—	6,281	—	—	—		6,281
<b>Balance September 30, 2017</b>	106,670,768	\$ 1,067	2,565,000	\$ 420,000	\$ 919,477	\$ 9,259	\$ 610,629	\$ 25,105		\$ 1,985,537

See accompanying notes to unaudited condensed consolidated financial statements.

**NATIONAL GENERAL HOLDINGS CORP.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(In Thousands)**  
**(Unaudited)**

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 149,159	\$ 102,927
Reconciliation of net income to net cash provided by (used in) operating activities:		
Net (gain) loss on investments	22,756	(44,018 )
Bad debt expense	55,989	47,248
Depreciation and amortization	64,980	71,199
Stock-compensation expense	6,793	6,281
Deferred income taxes	64	(5,642 )
Other, net	858	1,549
Changes in assets and liabilities:		
Accrued investment income	(1,641 )	4,756
Premiums and other receivables	(208,847 )	(284,837 )
Deferred acquisition costs	(36,647 )	(6,569 )
Reinsurance recoverable	(233,216 )	(195,149 )
Prepaid reinsurance premiums	(163,632 )	(328,058 )
Prepaid expenses and other assets	28,274	16,238
Unpaid loss and loss adjustment expense reserves	199,905	285,086
Unearned premiums and other revenue	316,556	300,336
Reinsurance payable	258,686	233,158
Accounts payable and accrued expenses	24,874	(4,200 )
Other liabilities	(24,837 )	89,926
<b>Net cash provided by operating activities</b>	<b>460,074</b>	<b>290,231</b>
<b>Cash flows from investing activities:</b>		
Purchases of:		
Debt securities, available-for-sale	(1,358,877)	(1,560,177)
Debt securities, trading	—	(163,807 )
Equity securities	(1,297 )	(67,108 )
Short-term investments	(2,055,421)	(4,988,664)
Other investments	(27,620 )	(53,593 )
Premises and equipment	(84,779 )	(93,504 )
Proceeds from:		
Sale and maturity of debt securities, available-for-sale	1,180,945	1,558,296
Sale and maturity of debt securities, trading	—	153,072
Sale of equity securities	3,448	60,041
Sale of short-term investments	1,916,739	4,977,978
Sale and return of other investments	120,905	61,024
Other investing activities	(18,724 )	(18,337 )
<b>Net cash used in investing activities</b>	<b>(324,681 )</b>	<b>(134,779 )</b>

*See accompanying notes to unaudited condensed consolidated financial statements.*

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**NATIONAL GENERAL HOLDINGS CORP.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH  
FLOWS**

**(In Thousands)  
(Unaudited)**

	<b>Nine Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash flows from financing activities:</b>		
Proceeds from debt	—	95,000
Repayments of debt	(39,000 )	(86,441 )
Issuance of preferred stock, net (fees \$110 and \$0)	29,890	—
Issuance of common stock — employee share options	1,649	1,119
Taxes paid related to net share settlement of equity awards	(2,955 )	(1,707 )
Dividends paid to common shareholders	(12,826 )	(12,781 )
Dividends paid to preferred shareholders	(23,625 )	(23,625 )
<b>Net cash used in financing activities</b>	<b>(46,867 )</b>	<b>(28,435 )</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>(11,080 )</b>	<b>5,938</b>
<b>Net increase in cash, cash equivalents, and restricted cash</b>	<b>77,446</b>	<b>132,955</b>
<b>Cash, cash equivalents, and restricted cash at beginning of the period</b>	<b>357,484</b>	<b>285,900</b>
<b>Cash, cash equivalents, and restricted cash at end of the period</b>	<b>\$434,930</b>	<b>\$418,855</b>
<b>Supplemental disclosures of non-cash investing and financing activities:</b>		
Accrued common stock dividends	\$4,286	\$4,267
Accrued preferred stock dividends	7,875	7,875

*See accompanying notes to unaudited condensed consolidated financial statements.*

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**NATIONAL GENERAL HOLDINGS CORP.**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(In Thousands, Except Shares and Per Share Data)**

**1. Basis of Reporting**

The accompanying unaudited interim condensed consolidated financial statements include the accounts of National General Holdings Corp. and its subsidiaries (the “Company” or “NGHC”) and have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the U.S. Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These interim condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 previously filed with the SEC on February 26, 2018. The balance sheet at December 31, 2017, has been derived from the audited consolidated financial statements at that date. The interim condensed consolidated financial statements as of and for the three and nine months ended September 30, 2017 have been adjusted from the information set forth in the Form 10-Q for the quarterly period ended September 30, 2017. See Note 3, “Revisions of Previously Issued Financial Statements” in the Company’s 2017 Form 10-K.

These interim condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the interim period and all such adjustments are of a normal recurring nature. The results of operations for the interim period are not necessarily indicative, if annualized, of those to be expected for the full year. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

The unaudited condensed consolidated financial statements include the accounts and operations of Adirondack Insurance Exchange, a New York reciprocal insurer, and New Jersey Skylands Insurance Association, a New Jersey reciprocal insurer (together with their subsidiaries, the “Exchanges” or “Reciprocal Exchanges”). The Company has no ownership interest in the Reciprocal Exchanges but manages their business operations and has the ability to direct their activities through its wholly-owned management companies. The Reciprocal Exchanges are property and casualty insurers.

For the three and nine months ended September 30, 2017, the Company reclassified “earnings (losses) of equity method investments with related parties” as a component of “net investment income” on its condensed consolidated statements of income to conform to the current-year quarter presentation.

A detailed description of the Company’s significant accounting policies and management judgments is located in the notes to the audited consolidated financial statements, included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC.

**NATIONAL GENERAL HOLDINGS CORP.**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(In Thousands, Except Shares and Per Share Data)**

**2. Recent Accounting Pronouncements**

*Adopted During 2018*

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," to remove inconsistencies and weaknesses in revenue requirements, provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition practices, and provide improved disclosure requirements. While the guidance excludes revenue from insurance contracts, investments and financial instruments from its scope, the guidance is applicable to the Company's service and fee income not specifically exempted from the guidance. The Company adopted ASU 2014-09 and all the related amendments ("ASC 606") effective January 1, 2018, using the modified retrospective method and recorded a cumulative-effect adjustment to the opening balance sheet, increasing retained earnings by \$8,830. See Note 3, "Service and Fee Income" for additional information.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," to provide users of financial statements with more useful information on the recognition, measurement, presentation, and disclosure of financial instruments. Specifically, under ASU 2016-01, equity investments (other than those accounted for using the equity method of accounting or those subject to consolidation) are to be measured at fair value with changes in fair value recognized in earnings. The Company adopted ASU 2016-01 effective January 1, 2018, and recorded a cumulative-effect adjustment to the opening balance sheet, increasing Accumulated Other Comprehensive Income ("AOCI") by \$36 and decreasing retained earnings by the same amount. To conform to the current-year quarter presentation, equity securities are presented in a single line in the Company's condensed consolidated balance sheets and statements of cash flows.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory," which requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The Company adopted ASU 2016-16 effective January 1, 2018. Based on the intra-entity transfers of assets executed by the Company, the adoption of this guidance did not have an effect on the Company's results of operations, financial position or liquidity.

*Not Yet Adopted*

With the exception of those adopted above or discussed below, there have been no recent accounting pronouncements, changes in accounting pronouncements, or quantitative or qualitative progress made towards implementation of outstanding accounting pronouncements during the nine months ended September 30, 2018, as compared to those described in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, that are of significance, or potential significance, to the Company.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new standard establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. In July 2018, the FASB issued ASU 2018-11, "Targeted Improvements," to provide an entity with

another transition approach to apply the new lease standard and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company established a coordinated team to implement Topic 842, as amended. The Company is in the process of determining the scope of impact, data gathering, assessment, and evaluating its processes to meet the standard update, accounting, reporting, and disclosure requirements. The Company expects the adoption will have a significant impact on its consolidated financial statements, primarily to the consolidated balance sheets by recognizing a ROU asset and corresponding lease liability and related disclosures, due to the addition of operating leases previously accounted for as off-balance sheet transactions. The Company is currently unable to quantify the impact of adopting this guidance.

In July 2018, the FASB issued ASU 2018-09, “Codification Improvements,” which includes clarifications to existing codifications or corrections of unintended application of guidance that is not expected to have a significant effect on current

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accounting practice or create a significant administrative cost to most entities. The amendments affect a wide variety of topics in the codification. The transition and effective date guidance is based on the facts and circumstances of each amendment. Some of the amendments in this update do not require transition guidance and were effective upon issuance of this update. However, many of the amendments in this update do have transition guidance with effective dates for annual periods beginning after December 15, 2018. None of the applicable topics were deemed to have a material impact in the Company's interim condensed consolidated financial statements. However, the Company is currently evaluating the impact of applicable sections on its results of operations and financial position once those sections are adopted beginning after December 15, 2018.

In August 2018, the FASB issued ASU 2018-12, "Financial Services-Insurance (Topic 944)," to make targeted improvements to the existing recognition, measurement, presentation and disclosure requirements for long-duration contracts issued by an insurance entity. The new standard is intended to: (i) improve the timeliness of recognizing changes in the liability for future policy benefits and modify the rate used to discount future cash flows, (ii) simplify and improve the accounting for certain market-based options or guarantees associated with deposit (or account balance) contracts, (iii) simplify the amortization of deferred acquisition costs and (iv) improve the effectiveness of the required disclosures. The new standard is effective for fiscal years beginning after December 15, 2020. Early adoption is permitted. The Company is currently unable to quantify the impact of adopting this guidance.

In August 2018, the SEC adopted the final rule under SEC Release No. 33-10532, "Disclosure Update and Simplification," amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition, the amendments expanded the disclosure requirements on the analysis of stockholders' equity for interim financial statements. Under the amendments, an analysis of changes in each caption of stockholders' equity presented in the balance sheet must be provided in a note or separate statement. The analysis should present a reconciliation of the beginning balance to the ending balance of each period for which a statement of comprehensive income is required to be filed. This final rule is effective on November 5, 2018. The impact of this rule will be limited to disclosure requirements.

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**3. Service and Fee Income**

On January 1, 2018, the Company adopted ASC 606 for in scope contracts with customers using the modified retrospective method. Financial statements presented prior to the adoption of ASC 606 are reported under the previous guidance of ASC 605, "Revenue Recognition." ASC 606 is applicable to the Company's service and fee income, primarily related to the recognition of commission revenue in the Accident and Health segment.

*Disaggregation of Revenue by Type and Operating Segment*

The following tables summarize revenue by type and operating segment within service and fee income:

	Three Months Ended September 30,					
	2018			2017		
	Property and Casualty	Accident and Health <sup>(1)</sup>	Total	Property and Casualty	Accident and Health	Total
Commission revenue	\$25,404	\$17,874	\$43,278	\$24,454	\$11,053	\$35,507
Finance and processing fees	29,804	935	30,739	24,294	1,896	26,190
Installment fees	23,841	—	23,841	20,938	—	20,938
Group health administrative fees	—	18,364	18,364	—	15,611	15,611
Late payment fees	8,164	19	8,183	7,337	29	7,366
Other service and fee income	9,019	9,266	18,285	13,011	3,903	16,914
Total	\$96,232	\$46,458	\$142,690	\$90,034	\$32,492	\$122,526
NGHC	\$94,657	\$46,458	\$141,115	\$85,950	\$32,492	\$118,442
Reciprocal Exchanges	1,575	—	1,575	4,084	—	4,084
Total	\$96,232	\$46,458	\$142,690	\$90,034	\$32,492	\$122,526
	Nine Months Ended September 30,					
	2018			2017		
	Property and Casualty	Accident and Health <sup>(1)</sup>	Total	Property and Casualty	Accident and Health	Total
Commission revenue	\$68,547	\$51,190	\$119,737	\$74,215	\$44,142	\$118,357
Finance and processing fees	91,676	3,223	94,899	72,907	6,201	79,108
Installment fees	68,928	—	68,928	59,623	—	59,623
Group health administrative fees	—	57,461	57,461	—	45,619	45,619
Late payment fees	24,360	69	24,429	20,775	97	20,872
Other service and fee income	27,216	22,643	49,859	38,316	11,749	50,065
Total	\$280,727	\$134,586	\$415,313	\$265,836	\$107,808	\$373,644
NGHC	\$276,261	\$134,586	\$410,847	\$258,178	\$107,808	\$365,986
Reciprocal Exchanges	4,466	—	4,466	7,658	—	7,658
Total	\$280,727	\$134,586	\$415,313	\$265,836	\$107,808	\$373,644

<sup>(1)</sup> The impact to commission revenue for the three and nine months ended September 30, 2018 was an increase of \$6,318 and \$5,471, respectively, as a result of applying ASC 606. Prior period amounts have not been adjusted under the modified retrospective method.



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**4. Investments**

*(a) Available-For-Sale Debt Securities*

The amortized cost, gross unrealized gains and losses, and fair value of available-for-sale debt securities were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2018				
U.S. Treasury	\$40,836	\$ 638	\$(491 )	\$40,983
Federal agencies	34,111	—	(909 )	33,202
States and political subdivision bonds	273,639	808	(6,154 )	268,293
Foreign government	44,212	631	(4 )	44,839
Corporate bonds	1,145,408	1,585	(24,022 )	1,122,971
Residential mortgage-backed securities	972,683	196	(37,773 )	935,106
Commercial mortgage-backed securities	528,117	213	(10,460 )	517,870
Asset-backed securities	62,004	721	(136 )	62,589
Structured securities	292,942	754	(1,452 )	292,244
Total	\$3,393,952	\$ 5,546	\$(81,401 )	\$3,318,097
NGHC	\$3,074,258	\$ 5,236	\$(72,879 )	\$3,006,615
Reciprocal Exchanges	319,694	310	(8,522 )	311,482
Total	\$3,393,952	\$ 5,546	\$(81,401 )	\$3,318,097
December 31, 2017				
U.S. Treasury	\$36,236	\$ 987	\$(230 )	\$36,993
Federal agencies	20,711	5	(27 )	20,689
States and political subdivision bonds	418,557	4,431	(3,907 )	419,081
Foreign government	55,575	2,736	(57 )	58,254
Corporate bonds	1,053,777	14,809	(7,697 )	1,060,889
Residential mortgage-backed securities	1,020,481	211	(15,953 )	1,004,739
Commercial mortgage-backed securities	143,519	2,340	(1,816 )	144,043
Asset-backed securities	421	—	(7 )	414
Structured securities	390,514	4,959	(686 )	394,787
Total	\$3,139,791	\$ 30,478	\$(30,380 )	\$3,139,889
NGHC	\$2,835,293	\$ 27,117	\$(27,455 )	\$2,834,955
Reciprocal Exchanges	304,498	3,361	(2,925 )	304,934
Total	\$3,139,791	\$ 30,478	\$(30,380 )	\$3,139,889

As of September 30, 2018 and December 31, 2017, the Company had no other-than-temporary impairments (“OTTI”) in AOCI related to available-for-sale debt securities.

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The amortized cost and fair value of available-for-sale debt securities held as of September 30, 2018, by contractual maturity, are shown in the table below. Actual maturities may differ from contractual maturities because some borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	NGHC		Reciprocal Exchanges		Total	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
September 30, 2018						
Due in one year or less	\$29,967	\$29,852	\$835	\$832	\$30,802	\$30,684
Due after one year through five years	583,084	574,804	138,736	134,659	721,820	709,463
Due after five years through ten years	688,302	675,393	69,653	68,013	757,955	743,406
Due after ten years	308,822	307,228	11,749	11,751	320,571	318,979
Mortgage-backed securities	1,464,083	1,419,338	98,721	96,227	1,562,804	1,515,565
Total	\$3,074,258	\$3,006,615	\$319,694	\$311,482	\$3,393,952	\$3,318,097

**(b) Gross Unrealized Losses**

The tables below summarize the gross unrealized losses on debt securities classified as available for sale, by length of time the security has continuously been in an unrealized loss position.

	Less Than 12 Months			12 Months or More			Total	
	Fair Value	Unrealized Losses	No. of Positions Held	Fair Value	Unrealized Losses	No. of Positions Held	Fair Value	Unrealized Losses
September 30, 2018								
U.S. Treasury	\$31,155	\$(423)	133	\$5,685	\$(68)	126	\$36,840	\$(491)
Federal agencies	32,610	(873)	19	592	(36)	4	33,202	(909)
States and political subdivision bonds	151,897	(4,032)	246	48,607	(2,122)	72	200,504	(6,154)
Foreign government	2,496	(4)	2	—	—	—	2,496	(4)
Corporate bonds	839,198	(18,479)	692	95,014	(5,543)	92	934,212	(24,022)
Residential mortgage-backed securities	859,027	(32,721)	287	73,477	(5,052)	11	932,504	(37,773)
Commercial mortgage-backed securities	466,017	(9,988)	147	8,737	(472)	8	474,754	(10,460)
Asset-backed securities	47,742	(80)	13	1,524	(56)	7	49,266	(136)
Structured securities	168,635	(1,364)	80	4,401	(88)	2	173,036	(1,452)
Total	\$2,598,777	\$(67,964)	1,619	\$238,037	\$(13,437)	322	\$2,836,814	\$(81,401)
NGHC	\$2,318,185	\$(60,081)	1,419	\$228,158	\$(12,798)	317	\$2,546,343	\$(72,879)
Reciprocal Exchanges	280,592	(7,883)	200	9,879	(639)	5	290,471	(8,522)
Total	\$2,598,777	\$(67,964)	1,619	\$238,037	\$(13,437)	322	\$2,836,814	\$(81,401)



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December 31, 2017	Less Than 12 Months			12 Months or More			Total	
	Fair Value	Unrealized Losses	No. of Positions Held	Fair Value	Unrealized Losses	No. of Positions Held	Fair Value	Unrealized Losses
U.S. Treasury	\$21,567	\$(131)	62	\$10,555	\$(99)	20	\$32,122	\$(230)
Federal agencies	10,069	(11)	6	615	(16)	4	10,684	(27)
States and political subdivision bonds	145,396	(1,851)	215	86,894	(2,056)	125	232,290	(3,907)
Foreign government	—	—	—	2,443	(57)	2	2,443	(57)
Corporate bonds	402,236	(4,564)	341	110,207	(3,133)	93	512,443	(7,697)
Residential mortgage-backed securities	886,032	(13,476)	72	89,412	(2,477)	9	975,444	(15,953)
Commercial mortgage-backed securities	50,537	(727)	14	27,072	(1,089)	27	77,609	(1,816)
Asset-backed securities	—	—	—	414	(7)	2	414	(7)
Structured securities	73,561	(631)	18	3,727	(55)	4	77,288	(686)
Total	\$1,589,398	\$(21,391)	728	\$331,339	\$(8,989)	286	\$1,920,737	\$(30,380)
NGHC	\$1,408,081	\$(19,254)	623	\$300,732	\$(8,201)	268	\$1,708,813	\$(27,455)
Reciprocal Exchanges	181,317	(2,137)	105	30,607	(788)	18	211,924	(2,925)
Total	\$1,589,398	\$(21,391)	728	\$331,339	\$(8,989)	286	\$1,920,737	\$(30,380)

There were 1,941 and 1,014 securities at September 30, 2018 and December 31, 2017, respectively, that accounted for the gross unrealized loss, none of which are deemed by the Company to be other-than-temporary impairments. Significant factors influencing the Company's determination that none of these securities were OTTI included the length of time and/or magnitude of unrealized losses in relation to cost, the nature of the investment, the current financial condition of the issuer and its future prospects, the ability to recover to cost in the near term, and management's intent not to sell these securities and it being more likely than not that the Company will not be required to sell these investments before anticipated recovery of fair value to the Company's cost basis.

As of September 30, 2018 and December 31, 2017, of the \$13,437 and \$8,989, respectively, of unrealized losses in unrealized loss positions for a period of twelve or more consecutive months, none of those securities were greater than or equal to 25% of its amortized cost.

The Company regularly monitors its investments that have fair values less than cost or amortized cost for indicators of OTTI, an assessment that requires significant management judgment regarding the evidence known. Such judgments could change in the future as more information becomes known, which could negatively impact the amounts reported.

**(c) Equity Securities**

The fair values of equity securities held by the Company were as follows:

	September 30, 2018	December 31, 2017
Common stock	\$ 40,429	\$ 48,119
Preferred stock	462	2,222
Total	\$ 40,891	\$ 50,341
NGHC	\$ 40,891	\$ 50,341
Reciprocal Exchanges	—	—
Total	\$ 40,891	\$ 50,341



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**(d) Investment Income**

The components of net investment income consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cash and short-term investments	\$ 351	\$ 1,301	\$ 680	\$ 1,452
Debt securities	27,643	25,882	77,469	81,039
Equity securities	182	54	541	220
Other, net (related parties - three months - \$505 and \$(830); nine months - \$550 and \$2,229)	2,924	(236 )	6,577	5,079
Investment income	31,100	27,001	85,267	87,790
Investment expenses	(404 )	(1,851 )	(3,565 )	(6,065 )
Net Investment Income	\$ 30,696	\$ 25,150	\$ 81,702	\$ 81,725
NGHC	\$ 28,352	\$ 22,961	\$ 75,009	\$ 74,505
Reciprocal Exchanges	2,344	2,189	6,693	7,220
Net Investment Income	\$ 30,696	\$ 25,150	\$ 81,702	\$ 81,725

**(e) Net Realized Gains (Losses)**

Purchases and sales of investments are recorded on a trade date basis. Realized gains and losses are determined based on the specific identification method. The table below indicates realized gains and losses and OTTI.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Debt securities, available-for-sale:				
Gross gains	\$ 2,563	\$ 46,313	\$ 4,651	\$ 57,033
Gross losses	(743 )	(276 )	(22,388 )	(2,647 )
Net realized gain (loss) on debt securities, available-for-sale	1,820	46,037	(17,737 )	54,386
Debt securities, trading	—	1,715	—	(2,351 )
Equity securities	(1,376 )	(950 )	(7,203 )	(10,041 )
OTTI on investments	(3,000 )	—	(3,000 )	(25 )
Foreign exchange and other investments, net	(614 )	803	5,184	2,049
Net realized gain (loss) on investments	\$(3,170 )	\$ 47,605	\$(22,756 )	\$ 44,018
NGHC	\$(3,003 )	\$ 47,659	\$(21,490 )	\$ 37,885
Reciprocal Exchanges	(167 )	(54 )	(1,266 )	6,133
Net realized gain (loss) on investments	\$(3,170 )	\$ 47,605	\$(22,756 )	\$ 44,018

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Net gains and losses recognized during the reporting period on equity securities and debt securities classified as trading still held at the reporting date were as follows:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	Equity Securities and Debt Securities	Equity Securities and Debt Securities	Equity Securities and Debt Securities	Equity Securities and Debt Securities
Net gains (losses) recognized during the period	\$(1,376)	\$(2,004)	\$(7,203)	\$(19,816)
Less: Net gains (losses) recognized during the period on securities sold during the period	—	(5,888)	(108)	(7,745)
Net gains (losses) recognized during the reporting period on securities still held at the reporting date	\$(1,376)	\$3,884	\$(7,095)	\$(12,071)

**(f) Credit Quality of Investments**

The tables below summarize the credit quality of the Company's debt securities and preferred stock securities, as rated by Standard & Poor's ("S&P"). If a security is not rated by S&P, an S&P equivalent is determined based on ratings from similar rating agencies. Securities that are not rated are included in the "BB+ and lower" category.

September 30, 2018	NGHC				Reciprocal Exchanges			
	Cost or Amortized Cost	Fair Value	Percentage		Cost or Amortized Cost	Fair Value	Percentage	
U.S. Treasury	\$28,085	\$28,339	0.9	%	\$12,751	\$12,644	4.1	%
AAA	464,099	461,686	15.4	%	19,207	18,807	6.0	%
AA, AA+, AA-	1,370,257	1,321,184	43.9	%	153,501	149,411	48.0	%
A, A+, A-	559,958	550,054	18.3	%	125,243	122,032	39.2	%
BBB, BBB+, BBB-	606,804	600,738	20.0	%	8,960	8,556	2.7	%
BB+ and lower	45,486	45,076	1.5	%	32	32	—	%
Total	\$3,074,689	\$3,007,077	100.0	%	\$319,694	\$311,482	100.0	%
December 31, 2017	NGHC				Reciprocal Exchanges			
	Cost or Amortized Cost	Fair Value	Percentage		Cost or Amortized Cost	Fair Value	Percentage	
U.S. Treasury	\$30,244	\$31,026	1.1	%	\$5,992	\$5,967	2.0	%
AAA	255,132	259,506	9.1	%	29,540	28,961	9.5	%
AA, AA+, AA-	1,399,287	1,382,191	48.7	%	133,250	133,316	43.7	%
A, A+, A-	531,185	534,298	18.8	%	135,682	136,657	44.8	%
BBB, BBB+, BBB-	574,456	581,406	20.5	%	—	—	—	%
BB+ and lower	47,542	48,759	1.8	%	34	33	—	%
Total	\$2,837,846	\$2,837,186	100.0	%	\$304,498	\$304,934	100.0	%

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The tables below summarize the investment quality of the Company's corporate bond holdings and industry concentrations.

September 30, 2018	AA+,			BBB+, BB+		Fair Value	% of Corporate Bonds Portfolio
	AAA	AA, AA-	A+,A,A-	BBB, BBB-	or Lower		
Financial Institutions	— %	3.6 %	24.6 %	14.1 %	1.1 %	\$487,398	43.4 %
Industrials	0.5 %	5.8 %	22.0 %	25.2 %	0.6 %	607,721	54.1 %
Utilities/Other	— %	— %	2.0 %	0.5 %	— %	27,852	2.5 %
Total	0.5 %	9.4 %	48.6 %	39.8 %	1.7 %	\$1,122,971	100.0 %
NGHC	— %	4.7 %	37.8 %	39.2 %	1.7 %	\$936,224	83.4 %
Reciprocal Exchanges	0.5 %	4.7 %	10.8 %	0.6 %	— %	186,747	16.6 %
Total	0.5 %	9.4 %	48.6 %	39.8 %	1.7 %	\$1,122,971	100.0 %

  

December 31, 2017	AA+,			BBB+, BB+		Fair Value	% of Corporate Bonds Portfolio
	AAA	AA, AA-	A+,A,A-	BBB, BBB-	or Lower		
Financial Institutions	2.9 %	7.8 %	31.7 %	11.9 %	— %	\$575,746	54.3 %
Industrials	0.7 %	3.0 %	16.9 %	21.8 %	0.5 %	454,764	42.9 %
Utilities/Other	— %	— %	1.3 %	1.5 %	— %	30,388	2.8 %
Total	3.6 %	10.8 %	49.9 %	35.2 %	0.5 %	\$1,060,898	100.0 %
NGHC	2.9 %	3.4 %	37.1 %	35.2 %	0.5 %	\$839,615	79.1 %
Reciprocal Exchanges	0.7 %	7.4 %	12.8 %	— %	— %	221,283	20.9 %
Total	3.6 %	10.8 %	49.9 %	35.2 %	0.5 %	\$1,060,898	100.0 %

**(g) Cash and Cash Equivalents, Restricted Cash and Restricted Investments**

The Company, in order to conduct business in certain states, is required to maintain letters of credit or assets on deposit to support state mandated regulatory requirements and certain third party agreements. The Company also utilizes trust accounts to collateralize business with its reinsurance counterparties. These assets are held primarily in the form of cash or certain high grade securities.

The Company's cash, cash equivalents, and restricted cash are as follows:

	September 30, 2018	December 31, 2017
Cash and cash equivalents	\$ 395,070	\$ 292,282
Restricted cash and cash equivalents	39,860	65,202
Cash, cash equivalents and restricted cash	\$ 434,930	\$ 357,484

The fair values of the Company's restricted investments are as follows:

	September 30, 2018	December 31, 2017
State deposits, at fair value	\$ 73,429	\$ 76,996
Restricted investments to trusts, at fair value	79,192	110,314
Total	\$ 152,621	\$ 187,310



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*(h) Short-term and Other Investments*

Short-term investments include investments with maturities between 91 days and less than one year at the date of acquisition. Short-term investments also consist of commercial paper, U.S. Treasury bills and money market funds that are held within our longer term investment portfolios.

The table below summarizes the composition of other investments:

	September 30, December 31,	
	2018	2017
Equity method investments (related parties - \$105,487 and \$221,375)	\$ 161,644	\$ 256,321
Note receivable - related party See Note 14, "Related Party Transactions"	127,692	126,173
Long-term Certificates of Deposit (CDs), at cost	20,252	20,339
Investments, at fair value	9,843	10,791
Investments, at cost or amortized cost	7,668	7,668
Total	\$ 327,099	\$ 421,292

Equity method investments represent limited liability companies and limited partnership investments in real estate. Investments at fair value, primarily represent the Company's right to receive the excess servicing spread related to servicing rights, for which the Company has elected the fair value option with changes in fair value recorded in earnings. Investments at cost or amortized cost, represent limited partnerships, loans and trusts. The Company believes its exposure to risk associated with these investments is generally limited to the investment carrying amounts.

The Company's other investments are assessed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment might not be recoverable. For both the three and nine months ended September 30, 2018 and 2017, the Company recorded OTTI on other investments of \$3,000 and \$0, respectively.

*Equity Method Investments - Related Parties*

The significant shareholder of the Company has an ownership interest in AmTrust Financial Services, Inc. ("AmTrust") and ACP Re Ltd. ("ACP Re").

The following entities formed with related parties are considered by the Company to be Variable Interest Entities ("VIE"), for which the Company is not the primary beneficiary. The Company accounts for these entities using the equity method of accounting. In determining whether it is the primary beneficiary of a VIE, the Company considers qualitative and quantitative factors, including, but not limited to, activities that most significantly impact the VIE's economic performance and which party controls such activities. The Company does not have the ability to direct the activities that most significantly impact a VIE's economic performance. The Company believes its exposure to risk associated with these investments is generally limited to the investment carrying amounts.

*LSC Entities*

The Company has a 50% ownership interest in two entities (collectively, the "LSC Entities") initially formed to acquire life settlement contracts, with AmTrust owning the remaining 50%. The LSC Entities used the contributed capital to pay premiums and purchase policies. A life settlement contract is a contract between the owner of a life insurance policy and a third party who obtains the ownership and beneficiary rights of the underlying life insurance policy. The

LSC Entities account for these life settlement contracts using the fair value method.

On December 28, 2017, the LSC Entities contributed 136 life settlement contracts to a limited partnership managed and operated by an unrelated third party. The consideration for the transaction included \$217,831 cash (including an advance of \$39,724 on future payments from the limited partnership) and the right to receive certain contingent earn-out payments. Since December 28, 2017, the LSC Entities have a 30% non-controlling equity interest in the limited partnership. The carrying value of their investment in the limited partnership was \$68,085. As of September 30, 2018 and December 31, 2017, the LSC Entities directly held one and six life settlement contracts, respectively.



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The Company's equity interest in the LSC Entities as of September 30, 2018 and December 31, 2017, was \$47,299 and \$160,683, respectively. For the three months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from the LSC Entities of \$(858) and \$(462), respectively, made contributions of \$0 and \$0, respectively, and received distributions of \$0 and \$45,127, respectively. For the nine months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from the LSC Entities of \$651 and \$3,213, respectively, made contributions of \$2,000 and \$21,040, respectively, and received distributions of \$116,035 and \$45,127, respectively.

*800 Superior, LLC*

The Company holds an investment in 800 Superior, LLC, a limited liability company that owns an office building in Cleveland, Ohio, with AmTrust. AmTrust has been appointed managing member of 800 Superior, LLC. The Company and AmTrust each have a 50% ownership interest in 800 Superior, LLC. Additionally, the Company entered into an office lease with 800 Superior, LLC. The Company paid 800 Superior, LLC \$722 and \$703 in rent for the three months ended September 30, 2018 and 2017, respectively. The Company paid 800 Superior, LLC \$2,167 and \$2,109 in rent for the nine months ended September 30, 2018 and 2017, respectively. The Company's equity interest in 800 Superior, LLC as of September 30, 2018 and December 31, 2017 was \$430 and \$1,405, respectively. For the three months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from 800 Superior, LLC of \$287 and \$(156), respectively. For the nine months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from 800 Superior, LLC of \$(975) and \$(307), respectively.

*East Ninth & Superior, LLC*

The Company holds an investment in East Ninth & Superior, LLC and 800 Superior NMTC Investment Fund II, LLC with AmTrust (collectively "East Ninth & Superior"). The Company and AmTrust each have a 50% ownership interest in East Ninth and Superior, LLC and a 24.5% ownership interest in 800 Superior NMTC Investment Fund II, LLC. The Company's equity interest in East Ninth & Superior as of September 30, 2018 and December 31, 2017 was \$4,304 and \$4,251, respectively. For the three months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from East Ninth & Superior of \$18 and \$12, respectively. For the nine months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from East Ninth & Superior of \$53 and \$49, respectively.

*North Dearborn Building Company, L.P.*

The Company holds an investment in North Dearborn Building Company, L.P. ("North Dearborn"), a limited partnership that owns an office building in Chicago, Illinois. AmTrust is also a limited partner in North Dearborn, and the general partner is NA Advisors GP LLC ("NA Advisors"), a related party, owned by Karfunkel family members which is managed by an unrelated third party. The Company and AmTrust each hold a 45% limited partnership interest in North Dearborn, while NA Advisors holds a 10% general partnership interest and a 10% profit interest, which NA Advisors pays to the unrelated third party manager. North Dearborn appointed NA Advisors as the general manager to oversee the day-to-day operations of the office building. The Company's equity interest in North Dearborn as of September 30, 2018 and December 31, 2017 was \$6,144 and \$7,582, respectively. For the three months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from North Dearborn of \$(148) and \$185, respectively, and received distributions of \$0 and \$0, respectively. For the nine months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from North Dearborn of \$(313) and \$(555),

respectively, and received distributions of \$1,125 and \$0, respectively.

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*4455 LBJ Freeway, LLC*

The Company holds an investment in 4455 LBJ Freeway, LLC, a limited liability company that owns an office building in Dallas, Texas, with AmTrust. AmTrust has been appointed managing member of 4455 LBJ Freeway, LLC. The Company and AmTrust each have a 50% ownership interest in 4455 LBJ Freeway, LLC. Additionally, the Company entered into a lease agreement with 4455 LBJ Freeway, LLC. The Company paid 4455 LBJ Freeway, LLC \$551 and \$587 in rent for the three months ended September 30, 2018 and 2017, respectively. The Company paid 4455 LBJ Freeway, LLC \$1,675 and \$1,717 in rent for the nine months ended September 30, 2018 and 2017, respectively. The Company's equity interest in 4455 LBJ Freeway, LLC as of September 30, 2018 and December 31, 2017 was \$755 and \$740, respectively. For the three months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from 4455 LBJ Freeway, LLC of \$26 and \$(487), respectively. For the nine months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from 4455 LBJ Freeway, LLC of \$15 and \$(274), respectively.

*Illinois Center Building, L.P.*

The Company holds an investment in Illinois Center Building, L.P. ("Illinois Center"), a limited partnership that owns an office building in Chicago, Illinois. AmTrust and ACP Re are also limited partners in Illinois Center and the general partner is NA Advisors. The Company and AmTrust each hold a 37.5% limited partnership interest in Illinois Center, while ACP Re holds a 15.0% limited partnership interest. NA Advisors holds a 10.0% general partnership interest and a 10.0% profit interest, which NA Advisors pays to the unrelated third party manager. Illinois Center appointed NA Advisors as the general manager to oversee the day-to-day operations of the office building. The Company's equity interest in Illinois Center as of September 30, 2018 and December 31, 2017 was \$46,555 and \$46,715, respectively. For the three months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from Illinois Center of \$0 and \$(1,089), respectively, and made contributions of \$0 and \$938, respectively. For the nine months ended September 30, 2018 and 2017, the Company recorded equity in earnings (losses) from Illinois Center of \$(2,410) and \$(3,384), respectively, and made contributions of \$2,250 and \$2,813, respectively.

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**5. Fair Value of Financial Instruments**

The Company carries certain financial instruments at fair value. Assets and liabilities recorded at fair value in the condensed consolidated balance sheets are measured and classified in accordance with a fair value hierarchy consisting of three “levels” based on the observability of valuation inputs:

*Level 1* - Inputs are quoted prices in active markets for identical assets or liabilities as of the measurement date. Additionally, the entity must have the ability to access the active market and the quoted prices cannot be adjusted by the entity.

*Level 2* - Inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs that are observable or can be corroborated by observable market data by correlation or other means for substantially the full term of the assets or liabilities.

*Level 3* - Unobservable inputs are supported by little or no market activity. The unobservable inputs represent management’s best assumptions of how market participants would price the assets or liabilities. Generally, Level 3 assets and liabilities are valued using pricing models, discounted cash flow methodologies, or similar techniques that require significant judgment or estimation.

The following describes the valuation techniques used by the Company to determine the fair value measurements on a recurring basis of financial instruments held as of September 30, 2018 and December 31, 2017. The Company utilizes a pricing service (“pricing service”) to estimate fair value measurements for all its debt and equity securities.

Level 1 measurements:

• U.S. Treasury and federal agencies. The fair values of U.S. government securities are based on quoted market prices in active markets. The Company believes the market for U.S. government securities is an actively traded market given the high level of daily trading volume.

• Common stock. The pricing service utilizes market quotations for equity securities that have quoted market prices in active markets and their respective quoted prices are provided at fair value.

• Short-term investments. Comprised of money market funds that are traded in active markets and fair values are based on quoted market prices.

Level 2 measurements:

• States and political subdivision bonds, and foreign government. The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active.

• Corporate bonds. Comprised of bonds issued by corporations, public and privately placed. The fair values of short-term corporate bonds are priced using the spread above the London Interbank Offering Rate (“LIBOR”) yield curve, and the fair value of long-term corporate bonds are priced using the spread above the risk-free yield curve. The spreads are sourced from broker dealers, trade prices and the new issue market. Where pricing is unavailable from pricing services, the Company obtains non-binding quotes from broker-dealers. The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active.

• Residential and commercial mortgage-backed securities, asset-backed securities and structured securities. The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active,

contractual cash flows, benchmark yields, prepayment speeds, collateral performance and credit spreads.

Preferred stock. The pricing service also provides fair value estimates for certain equity securities whose fair value is based on observable market information rather than market quotes.

Level 3 measurements:

- States and political subdivision bonds. The Company holds certain municipal bonds that finance economic development, infrastructure and environmental projects which do not have an active market. These bonds are valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable.

Foreign government bonds. The Company holds certain foreign government bonds that are valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable.

Corporate bonds. The Company holds certain structured notes and term loans that do not have an active market. These bonds are valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable.

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Residential and commercial mortgage-backed securities and structured securities. The Company holds certain mortgage and structured securities valued based on non-binding broker quotes received from brokers who are familiar with the investments and where the inputs have not been corroborated to be market observable.

Common stock and preferred stock. From time to time, the Company also holds certain equity securities that are issued by privately-held entities or direct equity investments that do not have an active market. The Company estimates the fair value of these securities primarily based on inputs such as third-party broker quotes, issuers' book value, market multiples, and other inputs. These bonds are valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable.

Other investments, at fair value. Comprised of the Company's right to receive the Excess Servicing Spread ("ESS") related to servicing rights. The Company uses a discounted cash flow method to estimate their fair value. The key inputs used in the estimation of ESS include prepayment speed and discount rate. Changes in the fair value of the ESS are recorded in earnings.

Assets measured at fair value on a recurring basis are as follows:

	September 30, 2018			
	Level 1	Level 2	Level 3	Total
Available-for-sale debt securities:				
U.S. Treasury	\$40,983	\$—	\$—	\$40,983
Federal agencies	33,202	—	—	33,202
States and political subdivision bonds	—	264,697	3,596	268,293
Foreign government	—	44,839	—	44,839
Corporate bonds	—	1,109,800	13,171	1,122,971
Residential mortgage-backed securities	—	935,106	—	935,106
Commercial mortgage-backed securities	—	517,870	—	517,870
Asset-backed securities	—	62,589	—	62,589
Structured securities	—	292,244	—	292,244
Total available-for-sale debt securities	74,185	3,227,145	16,767	3,318,097
Equity securities:				
Common stock	36,680	—	3,749	40,429
Preferred stock	—	182	280	462
Total equity securities	36,680	182	4,029	40,891
Short-term investments	177,447	—	—	177,447
Other investments	—	—	9,843	9,843
Total	\$288,312	\$3,227,327	\$30,639	\$3,546,278
NGHC	\$265,520	\$2,929,782	\$30,639	\$3,225,941
Reciprocal Exchanges	22,792	297,545	—	320,337
Total	\$288,312	\$3,227,327	\$30,639	\$3,546,278

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	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Available-for-sale debt securities:				
U.S. Treasury	\$36,993	\$—	\$—	\$36,993
Federal agencies	20,689	—	—	20,689
States and political subdivision bonds	—	415,000	4,081	419,081
Foreign government	—	58,254	—	58,254
Corporate bonds	—	1,036,344	24,545	1,060,889
Residential mortgage-backed securities	—	1,004,739	—	1,004,739
Commercial mortgage-backed securities	—	144,043	—	144,043
Asset-backed securities	—	414	—	414
Structured securities	—	394,787	—	394,787
Total available-for-sale debt securities	57,682	3,053,581	28,626	3,139,889
Equity securities:				
Common stock	43,067	—	5,052	48,119
Preferred stock	—	1,952	270	2,222
Total equity securities	43,067	1,952	5,322	50,341
Short-term investments	38,266	—	—	38,266
Other investments	—	9	10,782	10,791
Total	\$139,015	\$3,055,542	\$44,730	\$3,239,287
NGHC	\$110,769	\$2,756,575	\$44,730	\$2,912,074
Reciprocal Exchanges	28,246	298,967	—	327,213
Total	\$139,015	\$3,055,542	\$44,730	\$3,239,287

The following tables provide a reconciliation of recurring fair value measurements of the Company's Level 3 financial assets:

	Total gains (losses) included in:					Net transfers into (out of) Level 3	Balance as of September 30, 2018	Net gains (losses) included in net income on instruments held at end of period
	Balance as of January 1, 2018	Net income	Other comprehensive income	Purchases	Sales			
States and political subdivision bonds	\$4,081	\$—	\$ (485 )	\$ —	\$—	\$ —	\$ 3,596	\$ —
Corporate bonds	24,545	—	(11,374 )	—	—	—	13,171	—
Common stock	5,052	(1,303 )	—	—	—	—	3,749	(1,303 )
Preferred stock	270	10	—	—	—	—	280	10
Other investments <sup>(1)</sup>	10,782	802	—	—	(1,741 )	—	9,843	802
Total	\$44,730	\$(491 )	\$(11,859 )	\$ —	—\$(1,741 )	\$ —	\$ 30,639	\$( 491 )

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	Total gains (losses) included in:							Net gains (losses) included in net income on instruments held at end of period
	Balance as of January 1, 2017	Net income	Other comprehensive income	Purchases	Sales	Net transfers into (out of) Level 3	Balance as of September 30, 2017	
States and political subdivision bonds	\$4,732	\$—	\$ —	\$ —	\$—	\$(2 )	\$ 4,730	\$ —
Foreign government	1,910	—	—	—	—	(1,910 )	—	—
Corporate bonds	36,044	—	119	—	(9,725 )	(1,787 )	24,651	—
Residential mortgage-backed securities	7,423	—	—	—	(1 )	(7,422 )	—	—
Commercial mortgage-backed securities	4,849	—	—	—	—	(4,849 )	—	—
Structured securities	9,055	—	—	—	(2,001 )	(7,054 )	—	—
Common stock	6,297	—	1,663	4,119	(6,297 )	1	5,783	—
Preferred stock	—	—	(5 )	—	—	275	270	—
Other investments <sup>(1)</sup>	9,427	(299 )	—	3,986	(2,104 )	—	11,010	(299 )
Total	\$79,737	\$(299 )	\$ 1,777	\$ 8,105	\$(20,128 )	\$(22,748 )	\$ 46,444	\$( 299 )

<sup>(1)</sup> Other investments gains and losses recognized in net income are reported within net investment income in the condensed consolidated statements of income.

During the nine months ended September 30, 2018, there were no transfers between Level 1 and Level 2 or between Level 2 and Level 3.

During the nine months ended September 30, 2017, there were no transfers between Level 1 and Level 2. During the nine months ended September 30, 2017, the Company transferred \$23,024 out of Level 3 into Level 2, due to changes in broker quotes where the inputs included quoted prices for identical or similar assets in markets that are not active resulting in the securities being classified as Level 2; and \$276 out of Level 2 into Level 3, due to changes in broker quotes where the inputs had not been corroborated to be market observable resulting in the securities being classified as Level 3.

The Company's policy is to recognize transfers between levels as of the end of each reporting period, consistent with the date of determination of fair value.

At September 30, 2018 and December 31, 2017, the carrying values of the Company's cash and cash equivalents, premiums and other receivables, and accounts payable approximate the fair value given their short-term nature and were classified as Level 1.

*Fair value information about financial instruments not measured at fair value*

**Debt** - The amount reported in the accompanying condensed consolidated balance sheets for these financial instruments represents the carrying value of the debt. See Note 9, "Debt" for additional information.

As of September 30, 2018 and December 31, 2017, the Company's 7.625% Notes are publicly traded and were classified as Level 2.



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As of September 30, 2018, the Company's 6.75% Notes, the Subordinated Debentures and the Credit Agreement were not publicly traded and were classified as Level 3. As of December 31, 2017, the Company's 6.75% Notes, the Subordinated Debentures, the Imperial Surplus Notes, the SPCIC Surplus Notes and the Credit Agreement were not publicly traded and were classified as Level 3.

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The following table presents the carrying amount and fair value estimates of debt not carried at fair value:

	September 30, 2018		December 31, 2017	
	Carrying amount	Fair value	Carrying amount	Fair value
7.625% Notes	\$96,821	\$102,400	\$96,756	\$101,640
6.75% Notes	346,274	346,914	345,786	366,131
Subordinated Debentures	72,168	72,104	72,168	72,101
Imperial Surplus Notes	—	—	5,000	4,984
SPCIC Surplus Notes	—	—	4,000	3,996
Credit Agreement	160,000	164,334	190,000	195,420
Total	\$675,263	\$685,752	\$713,710	\$744,272

## 6. Deferred Acquisition Costs

The following table reflects the amounts of policy acquisition costs deferred and amortized:

	Nine Months Ended September 30,					
	2018			2017		
	Property and Casualty	Accident and Health	Total	Property and Casualty	Accident and Health	Total
Balance at beginning of the period	\$198,283	\$18,106	\$216,389	\$207,597	\$13,325	\$220,922
Additions	399,610	16,985	416,595	399,436	62,791	462,227
Amortization	(369,634 )	(13,858 )	(383,492 )	(394,515 )	(60,914 )	(455,429 )
Change in DAC	29,976	3,127	33,103	4,921	1,877	6,798
Balance at end of the period	\$228,259	\$21,233	\$249,492	\$212,518	\$15,202	\$227,720
NGHC	\$208,982	\$21,233	\$230,215	\$173,582	\$15,202	\$188,784
Reciprocal Exchanges	19,277	—	19,277	38,936	—	38,936
Balance at end of the period	\$228,259	\$21,233	\$249,492	\$212,518	\$15,202	\$227,720

## 7. Unpaid Losses and Loss Adjustment Expense Reserves

The unpaid losses and loss adjustment expense (“LAE”) reserves are the result of ongoing analysis of recent loss development trends and emerging historical experience. Original estimates are increased or decreased as additional information becomes known regarding individual claims. In setting its reserves, the Company reviews its loss data to estimate expected loss development. Management believes that its use of standard actuarial methodology applied to its analyses of its historical experience provides a reasonable estimate of future losses. However, actual future losses may differ from the Company’s estimate, and future events beyond the control of management, such as changes in law, judicial interpretations of law and inflation, may favorably or unfavorably impact the ultimate settlement of the Company’s losses and LAE.

The anticipated effect of inflation is implicitly considered when estimating liabilities for losses and LAE. In addition to inflation, the average severity of claims is affected by a number of factors that may vary by types and features of policies written. Future average severities are projected from historical trends, adjusted for implemented changes in

underwriting standards and policy provisions, and general economic trends. These estimated trends are monitored and revised as necessary based on actual development.

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The table below shows the rollforward of loss reserves on a gross and net of reinsurance basis, reflecting changes in losses incurred and paid losses:

	Nine Months Ended September 30,					2017				
	2018				Total	Property and Casualty	Accident and Health	NGHC	Reciprocal Exchanges	Total
Unpaid losses and LAE, gross of related reinsurance recoverable at beginning of the period	\$ 2,270,551	\$ 249,653	\$ 2,520,204	\$ 143,353	\$ 2,663,557	\$ 1,936,391	\$ 200,400	\$ 2,136,791	\$ 137,075	\$ 2,273,866
Less: Reinsurance recoverable at beginning of the period	(1,067,495 )	(9,840 )	(1,077,335 )	(52,408 )	(1,129,743 )	(827,672 )	(10,933 )	(838,605 )	(42,192 )	(880,797 )
Net balance at beginning of the period	1,203,056	239,813	1,442,869	90,945	1,533,814	1,108,719	189,467	1,298,186	94,883	1,393,069
Incurred losses and LAE related to:										
Current year	1,596,337	276,987	1,873,324	124,914	1,998,238	1,634,876	248,433	1,883,309	90,220	1,973,529
Prior year	(13,318 )	(24,623 )	(37,941 )	1,507	(36,434 )	7,177	(10,106 )	(2,929 )	(1,444 )	(4,373 )
Total incurred	1,583,019	252,364	1,835,383	126,421	1,961,804	1,642,053	238,327	1,880,380	88,776	1,969,156
Paid losses and LAE related to:										
Current year	(883,969 )	(108,686 )	(992,655 )	(81,526 )	(1,074,181 )	(925,021 )	(110,570 )	(1,035,591 )	(59,858 )	(1,095,449 )
Prior year	(622,468 )	(114,045 )	(736,513 )	(34,079 )	(770,592 )	(610,139 )	(88,111 )	(698,250 )	(34,352 )	(732,602 )
Total paid	(1,506,437 )	(222,731 )	(1,729,168 )	(115,605 )	(1,844,773 )	(1,535,160 )	(198,681 )	(1,733,841 )	(94,210 )	(1,828,051 )
Effect of foreign exchange rates	—	(8,302 )	(8,302 )	—	(8,302 )	—	6,903	6,903	—	6,903
Net balance at end of the period	1,279,638	261,144	1,540,782	101,761	1,642,543	1,215,612	236,016	1,451,628	89,449	1,541,077
Plus reinsurance recoverable at end of the period	1,120,630	17,778	1,138,408	74,184	1,212,592	966,155	8,836	974,991	50,369	1,025,360
Gross balance at end of period	\$ 2,400,268	\$ 278,922	\$ 2,679,190	\$ 175,945	\$ 2,855,135	\$ 2,181,767	\$ 244,852	\$ 2,426,619	\$ 139,818	\$ 2,566,437

*Prior year loss development, net of reinsurance*

Prior year development is based upon numerous estimates by line of business and accident year. No additional premiums or return premiums have been accrued as a result of the prior year effects.

*2018.* Loss and LAE for the nine months ended September 30, 2018 included \$36,434 of favorable development on prior accident year loss and LAE reserves. The \$11,811 of favorable development in the property and casualty segment (including \$1,507 of unfavorable development for the Reciprocal Exchanges) was driven by favorable development in the Company's auto physical damage and homeowners products, while the \$24,623 of favorable development in the accident and health segment was primarily driven by favorable development in the Company's domestic products.

*2017.* Loss and LAE for the nine months ended September 30, 2017 included \$4,373 of favorable development on prior accident year loss and LAE reserves. The \$5,733 of unfavorable development in the property and casualty segment (including \$1,444 of favorable development for the Reciprocal Exchanges) was primarily driven by unfavorable development in the Company's auto liability business, while \$10,106 of favorable development in the

accident and health products was primarily driven by favorable development in the Company's domestic products.

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**8. Reinsurance**

The Company's insurance subsidiaries utilize reinsurance agreements to transfer portions of the underlying risk of the business the Company writes to various affiliated and third-party reinsurance companies. Reinsurance does not discharge or diminish the Company's obligation to pay claims covered by the insurance policies it issues; however, it does permit the Company to recover certain incurred losses from its reinsurers and the Company's reinsurance recoveries reduce the maximum loss that it may incur as a result of a covered loss event. The Company's reinsurers generally carry at least an A.M. Best Company, Inc. rating of "A-" (Excellent) or are fully collateralized at the time they enter into the Company's reinsurance agreements. The Company also enters into reinsurance relationships with third-party captives formed by agents as a mechanism for sharing risk and profit. The total amount, cost and limits relating to the reinsurance coverage the Company purchases may vary from year to year based upon a variety of factors, including the availability of quality reinsurance at an acceptable price and the level of risk that the Company chooses to retain for its own account.

The Company assumes and cedes insurance risks under various reinsurance agreements, on both a pro rata basis and excess of loss basis. The Company purchases reinsurance to mitigate the volatility of direct and assumed business, which may be caused by the aggregate value or the concentration of written exposures in a particular geographic area or business segment and may arise from catastrophes or other events. The Company pays a premium as consideration for ceding the risk.

The Company's reinsurance recoverable summary is as follows:

	September 30, 2018	December 31, 2017
Reinsurance recoverable on paid losses	\$ 314,448	\$ 164,422
Reinsurance recoverable on unpaid losses	1,212,592	1,129,743
Reinsurance recoverable	\$ 1,527,040	\$ 1,294,165

The following is the effect of reinsurance on unpaid loss and LAE reserves and unearned premiums:

	September 30, 2018		December 31, 2017	
	Assumed	Ceded	Assumed	Ceded
Unpaid Loss and LAE reserves	\$ 87,437	\$ 1,212,592	\$ 134,246	\$ 1,129,743
Unearned premiums	29,762	680,754	45,182	517,122

The following is a summary of the effect of reinsurance on premiums and losses:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018		2017		2018		2017	
Premium:	Written	Earned	Written	Earned	Written	Earned	Written	Earned
Direct	\$ 1,330,259	\$ 1,296,717	\$ 1,179,169	\$ 1,101,356	\$ 4,055,044	\$ 3,744,321	\$ 3,496,086	\$ 3,086,648
Assumed	25,412	29,078	25,142	43,621	74,206	89,627	95,517	202,827
Total Gross Premium	1,355,671	1,325,795	1,204,311	1,144,977	4,129,250	3,833,948	3,591,603	3,289,475
Ceded	(432,647 )	(386,268 )	(582,757 )	(280,676 )	(1,209,608 )	(1,045,977 )	(852,996 )	(524,938 )
Net Premium	\$ 923,024	\$ 939,527	\$ 621,554	\$ 864,301	\$ 2,919,642	\$ 2,787,971	\$ 2,738,607	\$ 2,764,537

Three Months Ended September 30,      Nine Months Ended September 30,

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	2018		2017	
	Assumed	Ceded	Assumed	Ceded
Loss and LAE	\$7,479	\$289,726	\$39,719	\$268,506
	\$16,487	\$712,277	\$95,021	\$451,512

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*Quota Share Agreements*

Effective July 1, 2017, the Company entered into an Auto Quota Share Agreement (the “Auto Quota Share Agreement”) covering the Company’s auto lines of business, under which the Company cedes 15.0% of net liability under auto policies in force as of the effective date and new and renewal policies issued during the two-year term of the agreement to an unaffiliated third-party reinsurance provider. Under the Auto Quota Share Agreement, the Company receives a 31.2% provisional ceding commission on premiums ceded to the reinsurer during the term of the Auto Quota Share Agreement, subject to a sliding scale adjustment to a maximum of 32.8% if the loss ratio for the reinsured business is 63.4% or less and a minimum of 29.6% if the loss ratio is 66.6% or higher. The liability of the reinsurer is capped at \$5,000 per risk or \$70,000 per event. The Company retains the flexibility, under certain conditions, to increase the cession percentage up to a maximum cession percentage of 30.0% and to decrease the cession percentage to a minimum cession of 10.0% during 2018 and 5.0% during 2019.

Effective July 1, 2017, the Company entered into a Homeowners Quota Share Agreement (the “HO Quota Share Agreement”) covering the Company’s homeowners line of business, under which the Company cedes 29.6% of net liability under homeowners policies, including lender-placed property policies, in force as of the effective date and new and renewal policies issued during the two-year term of the agreement to unaffiliated third-party reinsurance providers. Under the HO Quota Share Agreement, the Company receives a 42.5% ceding commission on premiums ceded to the reinsurers during the term of the HO Quota Share Agreement. The liability of the reinsurers is capped at \$5,000 per risk or \$70,000 per event. Effective May 1, 2018, the Company cedes an additional 12.4% of net liability (for a total cession of 42.0%) and receives a 38.0% ceding commission on the additional 12.4% in ceded premiums.

*Catastrophe Reinsurance*

As of May 1, 2017, the Company’s reinsurance property catastrophe excess of loss program went into effect protecting the Company against catastrophic events and other large losses. The property catastrophe program provides a total of \$575,000 in coverage with a \$70,000 retention, with one reinstatement. Effective July 1, 2017, the casualty program provides \$45,000 in coverage in excess of a \$5,000 retention. The Company pays a premium as consideration for ceding the risk. The Company renewed its property catastrophe excess of loss program under the same coverages effective May 1, 2018.

As of July 1, 2017, a reinsurance property catastrophe excess of loss program went into effect protecting the Reciprocal Exchanges against accumulations of losses resulting from a catastrophic event. The property catastrophe program provided a total of \$375,000 in coverage with a \$20,000 retention, with one reinstatement. Effective July 1, 2018, the Reciprocal Exchanges renewed their property catastrophe excess of loss program providing a total of \$475,000 in coverage with a \$20,000 retention, with one reinstatement.

**9. Debt**

*7.625% Subordinated Notes due 2055*

The Company previously issued \$100,000 aggregate principal amount of the Company’s 7.625% subordinated notes due 2055 (the “7.625% Notes”) in a public offering. The net proceeds the Company received from the issuance were approximately \$96,550, after deducting the underwriting discount, commissions and expenses. The 7.625% Notes bear interest at a rate equal to 7.625% per year, payable quarterly in arrears on March 15, June 15, September 15 and



December 15 of each year. The 7.625% Notes are the Company's subordinated unsecured obligations and rank (i) senior in right of payment to any future junior subordinated debt, (ii) equal in right of payment with any unsecured, subordinated debt that the Company incurs in the future that ranks equally with the 7.625% Notes, and (iii) subordinate in right of payment to any of the Company's existing and future senior debt, including amounts outstanding under the Company's revolving credit facility, the Company's 6.75% notes and certain of the Company's other obligations. In addition, the 7.625% Notes are structurally subordinated to all existing and future indebtedness, liabilities and other obligations of the Company's subsidiaries. The 7.625% Notes mature on September 15, 2055, unless earlier redeemed or purchased by the Company. Interest expense on the 7.625% Notes for the three months ended September 30, 2018 and 2017, was \$1,906 and \$1,922, respectively. Interest expense on the 7.625% Notes for the nine months ended September 30, 2018 and 2017, was \$5,719 and \$5,703, respectively.

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The indenture contains customary covenants, such as reporting of annual and quarterly financial results, and restrictions on certain mergers and consolidations. The indenture also includes covenants relating to the incurrence of debt if the Company's consolidated leverage ratio would exceed 0.35 to 1.00, a limitation on liens, a limitation on the disposition of stock of certain of the Company's subsidiaries and a limitation on transactions with certain of the Company's affiliates. The Company was in compliance with all of the covenants contained in the indenture as of September 30, 2018.

*6.75% Notes due 2024*

The Company previously issued \$350,000 aggregate principal amount of the Company's 6.75% notes due 2024 (the "6.75% Notes") to certain purchasers in two private placements. The net proceeds the Company received from the issuances were approximately \$343,850, after deducting issuance expenses. The 6.75% Notes bear interest at a rate equal to 6.75% per year, payable semiannually in arrears on May 15 and November 15 of each year. The 6.75% Notes are the Company's general unsecured obligations and rank equally in right of payment with its other existing and future senior unsecured indebtedness and senior in right of payment to any of its indebtedness that is contractually subordinated to the 6.75% Notes. The 6.75% Notes are also effectively subordinated to any of the Company's existing and future secured indebtedness to the extent of the value of the collateral securing such indebtedness and are structurally subordinated to the existing and future indebtedness of the Company's subsidiaries (including trade payables). The 6.75% Notes mature on May 15, 2024, unless earlier redeemed or purchased by the Company. Interest expense on the 6.75% Notes for the three months ended September 30, 2018 and 2017, was \$5,906 and \$5,955, respectively. Interest expense on the 6.75% Notes for the nine months ended September 30, 2018 and 2017, was \$17,719 and \$17,670, respectively.

The indenture contains customary covenants, such as reporting of annual and quarterly financial results, and restrictions on certain mergers and consolidations. The indenture also includes covenants relating to the incurrence of debt if the Company's consolidated leverage ratio would exceed 0.35 to 1.00, a limitation on liens, a limitation on the disposition of stock of certain of the Company's subsidiaries and a limitation on transactions with certain of the Company's affiliates. The Company was in compliance with all of the covenants contained in the indenture as of September 30, 2018.

*Subordinated Debentures*

The Company's subsidiary, Direct General Corporation, is the issuer of junior subordinated debentures (the "Subordinated Debentures") relating to an issuance of trust preferred securities. The Subordinated Debentures require interest-only payments to be made on a quarterly basis, with principal due at maturity. The Subordinated Debentures' principal amounts of \$41,238 and \$30,930 mature on 2035 and 2037, respectively, and bear interest at an annual rate equal to LIBOR plus 3.40% and LIBOR plus 4.25%, respectively. The Subordinated Debentures are redeemable by the Company at a redemption price equal to 100% of their principal amount. Interest expense on the Subordinated Debentures for the three months ended September 30, 2018 and 2017, was \$1,144 and \$925, respectively. Interest expense on the Subordinated Debentures for the nine months ended September 30, 2018 and 2017, was \$3,227 and \$2,835, respectively.

*Imperial-related Debt*

The Company's subsidiary, Imperial Fire and Casualty Insurance Company, was the issuer of \$5,000 principal amount of Surplus Notes due 2034 ("Imperial Surplus Notes"). The notes bore interest at an annual rate equal to LIBOR plus

4.05%, payable quarterly. On May 15, 2018, the Company redeemed the Imperial Surplus Notes. Interest expense on the Imperial Surplus Notes for the three months ended September 30, 2018 and 2017, was \$0 and \$68, respectively. Interest expense on the Imperial Surplus Notes for the nine months ended September 30, 2018 and 2017, was \$108 and \$196, respectively.

*SPCIC-related Debt*

The Company's subsidiary, Standard Property and Casualty Insurance Company, was the issuer of \$4,000 principal amount of Surplus Notes due 2033 ("SPCIC Surplus Notes"). The notes bore interest at an annual rate equal to LIBOR plus 4.15%, payable quarterly. On April 2, 2018, the Company redeemed the SPCIC Surplus Notes. Interest expense on the SPCIC Surplus Notes for the three months ended September 30, 2018 and 2017, was \$0 and \$56, respectively. Interest expense on the SPCIC Surplus Notes for the nine months ended September 30, 2018 and 2017, was \$58 and \$161, respectively.

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*Revolving Credit Agreement*

On January 25, 2016, the Company entered into a credit agreement (the “Credit Agreement”), among JPMorgan Chase Bank, N.A., as Administrative Agent, KeyBank National Association as Syndication Agent, and Associated Bank, National Association and First Niagara Bank, N.A., as Co-Documentation Agents, and the various lending institutions party thereto. The credit facility is a \$245,000 base revolving credit facility with a letter of credit sublimit of \$112,500 and an expansion feature not to exceed \$50,000. Proceeds of borrowings under the Credit Agreement may be used for working capital, acquisitions and general corporate purposes. The Credit Agreement has a maturity date of January 25, 2020.

The Credit Agreement contains certain restrictive covenants customary for facilities of this type (subject to negotiated exceptions and baskets), including restrictions on indebtedness, liens, acquisitions and investments, restricted payments and dispositions. There are also financial covenants that require the Company to maintain a minimum consolidated net worth, a maximum consolidated leverage ratio, a minimum fixed charge coverage ratio, a minimum risk-based capital and a minimum statutory surplus. The Credit Agreement also provides for customary events of default, with grace periods where customary, including failure to pay principal when due, failure to pay interest or fees within three business days after becoming due, failure to comply with covenants, breaches of representations and warranties, default under certain other indebtedness, certain insolvency or receivership events affecting the Company and its subsidiaries, the occurrence of certain material judgments, or a change in control of the Company. Upon the occurrence and during the continuation of an event of default, the administrative agent, upon the request of the requisite percentage of the lenders, may terminate the obligations of the lenders to make loans and to issue letters of credit under the Credit Agreement, declare the Company’s obligations under the Credit Agreement to become immediately due and payable and/or exercise any and all remedies and other rights under the Credit Agreement.

Borrowings under the Credit Agreement bear interest at either the Alternate Base Rate (“ABR”) or LIBOR. ABR borrowings (which are borrowings bearing interest at a rate determined by reference to the ABR) under the Credit Agreement will bear interest at the greatest of (a) the prime rate in effect on such day, (b) the federal funds effective rate on such day plus 0.5 percent or (c) the adjusted LIBOR for a one-month interest period on such day plus 1.0 percent. Eurodollar borrowings under the Credit Agreement will bear interest at the adjusted LIBOR for the interest period in effect. Fees payable by the Company under the Credit Agreement include a letter of credit participation fee (the margin applicable to Eurodollar borrowings), a letter of credit fronting fee with respect to each letter of credit (0.125%) and a commitment fee on the available commitments of the lenders (a range of 0.20% to 0.30% based on the Company’s consolidated leverage ratio, and which rate was 0.25% as of September 30, 2018).

As of September 30, 2018, there was \$160,000 outstanding under the Credit Agreement. The weighted average interest rate on the amount outstanding as of September 30, 2018 was 4.50%. Interest payments are due the last day of the interest period in intervals of three months duration, commencing on the date of such borrowing. Interest expense on the Credit Agreement for the three months ended September 30, 2018 and 2017, was \$1,950 and \$1,311, respectively. Interest expense on the Credit Agreement for the nine months ended September 30, 2018 and 2017, was \$5,700 and \$2,855, respectively. The Company was in compliance with all of the covenants under the Credit Agreement as of September 30, 2018.

Maturities of the Company’s debt for the years subsequent to September 30, 2018 are as follows:

2018	2019	2020	2021	2022	2023	Thereafter	Total
(remaining three							

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	months)							
7.625% Notes	\$	—\$	—\$—	\$	—\$	—\$	—\$100,000	\$100,000
6.75% Notes	—	—	—	—	—	—	350,000	350,000
Subordinated Debentures	—	—	—	—	—	—	72,168	72,168
Credit Agreement	—	—	160,000	—	—	—	—	160,000
Total principal amount of debt	\$	—\$	—\$160,000	\$	—\$	—\$	—\$522,168	\$682,168
Less: Unamortized debt issuance costs and unamortized discount								(6,905 )
Carrying amount of debt								\$675,263

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**10. Income Taxes**

The Company files a consolidated federal income tax return. The Reciprocal Exchanges are not included in the Company's consolidated tax return as the Company does not have an ownership interest in the Reciprocal Exchanges, and they are not a part of the consolidated tax sharing agreement.

The Tax Cuts and Jobs Act was enacted on December 22, 2017 (the "Act"). The Act reduces the U.S. federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, creates new taxes on certain foreign sourced earnings, and revises the tax treatment of certain items for property and casualty insurers. As of September 30, 2018, the Company has not completed the accounting for the tax effects of enactment of the Act and additional information and analysis is required; however, under the guidance, Staff Accounting Bulletin No. 118 ("SAB 118"), in certain cases, as described below, the Company has made a reasonable estimate of the effects on the existing deferred tax balances. For the items for which the Company was able to determine a reasonable estimate, the Company recognized a provisional expense (benefit) of \$25,783 for NGHC and \$(5,194) for the Reciprocal Exchanges during 2017. These amounts are primarily related to the restatement of deferred taxes from 35% to the newly enacted 2018 rate of 21%, and were recorded to income tax expense for the year ended December 31, 2017. No changes to these provisional amounts were recorded during the nine months ended September 30, 2018. The Company will continue to make and refine calculations as additional analysis is completed. In addition, the Company's estimates may also be affected as the Company gains a more thorough understanding of the tax law and/or as regulations are promulgated.

The Company uses the estimated annual effective tax rate method. Certain items, including those deemed to be unusual, infrequent or that cannot be reliably estimated, are excluded from the estimated annual effective tax rate. In these cases, the actual tax expense or benefit is reported in the same period as the related item. Certain tax effects are also not reflected in the estimated annual effective tax rate, primarily certain changes in the realizability of deferred tax assets and uncertain tax positions.

The following tables provide a reconciliation of the difference in the Company's income tax expense compared to the federal statutory rate of 21% and 35% for September 30, 2018 and 2017, respectively.

	Three Months Ended September 30,					
	2018			2017		
	NGHC	Reciprocal Exchanges	Total	NGHC	Reciprocal Exchanges	Total
Income (loss) before provision for income taxes	\$84,808	\$(13,061)	\$71,747	\$75,289	\$2,142	\$77,431
Tax at federal statutory rate	\$17,810	\$(2,743)	\$15,067	\$26,352	\$750	\$27,102
Tax effects resulting from:						
Exempt foreign income	(1,089)	—	(1,089)	(550)	—	(550)
Statutory equalization reserves	—	—	—	(4,856)	—	(4,856)
Other	(295)	1,835	1,540	(3,302)	81	(3,221)
Total income tax reported	\$16,426	\$(908)	\$15,518	\$17,644	\$831	\$18,475
Effective tax rate	19.4	% 7.0	% 21.6	% 23.4	% 38.8	% 23.9

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	Nine Months Ended September 30,					
	2018			2017		
	NGHC	Reciprocal Exchanges	Total	NGHC	Reciprocal Exchanges	Total
Income (loss) before provision for income taxes	\$225,577	\$(38,157 )	\$187,420	\$149,996	\$(6,318 )	\$143,678
Tax at federal statutory rate	\$47,371	\$(8,013 )	\$39,358	\$52,499	\$(2,211 )	\$50,288
Tax effects resulting from:						
Exempt foreign income	(3,291 )	—	(3,291 )	(5,393 )	—	(5,393 )
Statutory equalization reserves	—	—	—	(8,319 )	—	(8,319 )
Other	359	1,835	2,194	3,309	866	4,175
Total income tax reported	\$44,439	\$(6,178 )	\$38,261	\$42,096	\$(1,345 )	\$40,751
Effective tax rate	19.7 %	16.2 %	20.4 %	28.1 %	21.3 %	28.4 %

The Company's consolidated effective tax rate decreased from 28.4% for the nine months ended September 30, 2017 to 20.4% for the nine months ended September 30, 2018. The decrease was primarily driven by the change of the federal statutory rate.

All tax liabilities are payable to the Internal Revenue Service ("IRS") and various state and local taxing agencies. The Company's subsidiaries are currently open to audit by the IRS for the year ended December 31, 2015, and open to years thereafter for federal tax purposes. For state and local tax purposes, the Company is open to audit for tax years ended December 31, 2014 forward, depending on jurisdiction.

## 11. Stockholders' Equity

On July 11, 2018, the Company completed a private placement of 120 shares of a new series of preferred stock, par value \$0.01 per share, designated as its Fixed/Floating Rate Non-Cumulative Convertible Preferred Stock, Series D (the "Series D Preferred Stock"), with a liquidation preference of \$250,000 per share, for aggregate proceeds of \$30,000. Holders of Series D Preferred Stock will be entitled to receive, when, as and if declared by the Company's board of directors, non-cumulative cash dividends per share at the per annum rate of 7.00% prior to July 15, 2023, and thereafter at the annual rate of six-month LIBOR plus 5.4941%. Dividends will be payable semi-annually in arrears on the 15th day of January and July of each year, commencing on January 15, 2019. On or after July 15, 2023 (or in the event of a fundamental change of the Company, at any time), the Series D Preferred Stock may be converted at the holder's option into shares of the Company's common stock at a conversion rate of 6,578.9474 shares of common stock for each share of Series D Preferred Stock, subject to adjustment, which equates to an initial conversion price of \$38 per share. In lieu of converting any shares of Series D Preferred Stock, the Company may, at its option, redeem such shares as described herein.

On or after July 15, 2023 (or in the event of a fundamental change of the Company at any time), the Company will have the right to redeem the Series D Preferred Stock in whole or from time to time in part at a cash redemption price equal to the redemption amount specified in the Certificate of Designations governing the Series D Preferred Stock plus the sum of declared and unpaid dividends for prior dividend periods, if any, and accrued but unpaid dividends for the then-current dividend period (whether or not declared) to the redemption date. In addition, if the Company fails to pay a declared dividend on the Series D Preferred Stock when due and payable, a holder of the Series D Preferred Stock may require the Company to redeem its Series D Preferred Stock in whole or in part. In the case of any redemption, the redemption amount will equal the liquidation preference of the shares of Series D Preferred Stock to

be redeemed unless (i) the accumulated earned premium produced under the business collaboration agreement entered into between the Company and the purchaser of the Series D Preferred Stock equals or exceeds \$50,000 at the time of redemption and (ii) the trading price of the Company's common stock equals or exceeds the then-applicable conversion price of the Series D Preferred Stock. In such case, the redemption amount will be a cash amount equal to the conversion value of the shares issuable upon conversion of the Series D Preferred Stock. The Series D Preferred Stock ranks senior to the common stock and on parity with the Company's Series A, B and C preferred stock and all other parity classes of preferred stock that may be issued by the Company in the future.



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**12. Share-Based Compensation**

The Company currently has two equity incentive plans (the “Plans”). The Plans authorize up to an aggregate of 7,435,000 shares of Company stock for awards of options to purchase shares of the Company’s common stock, stock appreciation rights, restricted stock, restricted stock units (“RSU”), unrestricted stock and other performance awards. The aggregate number of shares of common stock for which awards may be issued may not exceed 7,435,000 shares, subject to the authority of the Company’s Board of Directors to adjust this amount in the event of a consolidation, reorganization, stock dividend, recapitalization or similar transaction affecting the Company’s common stock. As of September 30, 2018, 521,311 shares of the Company’s common stock remained available for grants under the Plans.

A summary of the Company’s stock option awards is shown below:

Nine Months Ended September 30, 2018	Shares Subject to Options Outstanding			Aggregate Intrinsic Value <sup>(1)</sup>
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	
Outstanding at beginning of period	3,450,585	\$ 9.37		
Exercised	(215,458 )	7.66		
Outstanding and exercisable at end of period	3,235,127	\$ 9.48	4.3	\$ 56,161

<sup>(1)</sup> The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying stock option awards and the closing price of the Company’s common stock of \$26.84, as reported on the Nasdaq Global Select Market on September 28, 2018.

No options were granted, forfeited or expired during the nine months ended September 30, 2018. The total intrinsic value of the options exercised for the three months ended September 30, 2018 and 2017 was \$322 and \$0, respectively, and for the nine months ended September 30, 2018 and 2017 was \$3,953 and \$1,532, respectively. The total fair value of stock options vested for the three months ended September 30, 2018 and 2017 was \$19 and \$306, respectively, and for the nine months ended September 30, 2018 and 2017 was \$652 and \$1,957, respectively.

A summary of the Company’s RSUs is shown below:

Nine Months Ended September 30, 2018	RSUs	
	Number of RSUs	Weighted-Average Grant Date Fair Value
Non-vested at beginning of period	845,459	\$ 21.83
Granted	458,850	21.36
Vested	(342,164 )	20.07
Forfeited	(13,600 )	19.92
Non-vested at end of period	948,545	\$ 22.26

The weighted-average grant date fair value of RSUs granted for the nine months ended September 30, 2018 and 2017 was \$21.36 and \$24.06, respectively. The total fair value of the RSUs vested for the three months ended September 30, 2018 and 2017 was \$1,348 and \$1,477, respectively, and for the nine months ended September 30, 2018 and 2017 was \$6,869 and \$3,426, respectively.

Compensation expense, included in general and administrative expenses, for all share-based compensation plans was \$2,283 and \$1,794 for the three months ended September 30, 2018 and 2017, respectively, and \$6,793 and \$6,281 for

the nine months ended September 30, 2018 and 2017, respectively.

As of September 30, 2018, the Company had approximately \$16,302 of unrecognized share-based compensation expense, all of which was related to RSUs. This unrecognized compensation expense is expected to be recognized over a weighted-average period of approximately 1.6 years based on vesting under the award service conditions.

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**13. Earnings Per Share**

The following is a summary of the elements used in calculating basic and diluted earnings per common share:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Numerator:				
Net income attributable to NGHC	\$68,382	\$ 57,645	\$181,138	\$ 107,900
Less: Dividends on preferred stock	(7,875 )	(7,875 )	(23,625 )	(23,625 )
Net income attributable to NGHC common stockholders	\$60,507	\$ 49,770	\$157,513	\$ 84,275
Denominator:				
Weighted average number of common shares outstanding – basic	107,101,837	106,645,601	106,944,461	106,556,662
Potentially dilutive securities:				
Employee stock options	2,108,233	1,772,419	2,067,054	1,967,337
RSUs	353,322	102,944	304,265	166,140
Weighted average number of common shares outstanding – diluted	109,563,392	108,520,964	109,315,780	108,690,139
Basic earnings per share attributable to NGHC common stockholders	\$0.56	\$ 0.47	\$1.47	\$ 0.79
Diluted earnings per share attributable to NGHC common stockholders	\$0.55	\$ 0.46	\$1.44	\$ 0.78

**14. Related Party Transactions**

The significant shareholder of the Company has an ownership interest in AmTrust, Maiden Holdings Ltd. (“Maiden”) and ACP Re. The Company provides and receives services to and from these related entities as follows:

*Agreements with AmTrust*

*Asset Management Agreement*

Pursuant to an asset management agreement among the Company and AmTrust, the Company paid AmTrust a fee for managing the Company’s investment portfolio. The asset management agreement was terminated effective May 1, 2018. Prior to the termination of this agreement, AmTrust provided investment management services for a quarterly fee of 0.0375% of the average value of assets under management if the average value of the account for the previous calendar quarter was greater than \$1 billion. The amounts charged for such expenses were \$0 and \$1,272 for the three months ended September 30, 2018 and 2017, respectively, and \$2,155 and \$3,467 for the nine months ended September 30, 2018 and 2017, respectively. As of September 30, 2018 and December 31, 2017, there was a payable to AmTrust related to these services in the amount of \$0 and \$1,208, respectively.

*Asset Purchase and Master Services Agreements*

On September 13, 2017, the Company entered into an asset purchase and license agreement (the “Agreement”) with AmTrust, pursuant to which the Company acquired ownership of a policy management system and the related intellectual property, as well as a non-exclusive perpetual license to certain software programs used by the system (the

“System”), for a purchase price of \$200,000, including license fees which would have been payable for use of the System during the third quarter 2017. The purchase price is payable in three equal installments in the amount of \$66,667, with the first payment made upon the execution of the Agreement, the second payment made upon the 6-month anniversary of the Agreement, and the third payment payable upon the later of the completion of the full separation and transfer of the System to the Company’s operating environment and the 18-month anniversary of the Agreement. In addition, the Company will be required to pay AmTrust costs for the implementation of the

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System within the Company's technology environment (up to \$5,000).

The Agreement also terminated the existing master services agreement between the Company and AmTrust. AmTrust will continue to provide printing and mailing services, and management of the premium receipts from its lockbox facilities during a transition period pursuant to the Agreement under the same terms as those provided under the master services agreement. The Company recorded expenses related to this agreement of \$729 and \$13,742 for the three months ended September 30, 2018 and 2017, respectively, and \$9,819 and \$44,802 for the nine months ended September 30, 2018 and 2017, respectively.

*NGHC Quota Share Agreement*

The Company participated in a quota share reinsurance treaty with ACP Re, Maiden and AmTrust, whereby the Company ceded 50% of the total net earned premiums, net of a ceding commission, and net incurred losses and LAE on business with effective dates after March 1, 2010 ("NGHC Quota Share"). In August 2013, the Company terminated the NGHC Quota Share agreement on a run-off basis. The net reinsurance recoverable is \$9,076 and \$15,688 at September 30, 2018 and December 31, 2017, respectively. The net recovery under the agreement was \$1,090 and \$3,358 for the three months ended September 30, 2018 and 2017, respectively, and \$1,524 and \$6,354 for the nine months ended September 30, 2018 and 2017, respectively.

The agreement also stipulates that if the Company would be denied full statutory credit for reinsurance ceded pursuant to the credit for reinsurance laws or regulations in any applicable jurisdiction, the reinsurers will secure an amount equal to that obligation through a letter of credit, assets held in trust for the benefit of the Company or cash. ACP Re and Maiden held assets in trust in the amount of \$4,762 and \$9,667, respectively, as of September 30, 2018 and \$6,530 and \$13,834, respectively, as of December 31, 2017.

*Equity Method Investments*

The Company has ownership interests in LSC Entities, limited liability companies and limited partnerships with related parties. See Note 4, "Investments - Equity Method Investments - Related Parties" for additional information.

*Credit Agreement with ACP Re*

In 2014, the Company entered into a credit agreement (the "ACP Re Credit Agreement") by and among AmTrust, as administrative agent, ACP Re, as borrower, ACP Re Holdings, LLC, parent company of ACP Re, as guarantor, and AmTrust and the Company, as lenders, pursuant to which the lenders made a \$250,000 loan (\$125,000 made by each Lender) to the borrowers on the terms and conditions contained within the ACP Re Credit Agreement.

In 2016, the parties entered into a restatement agreement (the "Restatement Agreement") to the ACP Re Credit Agreement. Under the restated terms, the borrower became ACP Re Holdings, LLC, a Delaware limited liability company owned by a related-party trust, the Michael Karfunkel Family 2005 Trust (the "Trust"). The Trust will cause ACP Re Holdings, LLC to maintain assets having a value greater than 115% of the value of the then outstanding loan balance, and if there is a shortfall, the Trust will make a contribution to ACP Re Holdings, LLC of assets having a market value of at least the shortfall (the "Maintenance Covenant"). The amounts borrowed are secured by equity interests, cash and cash equivalents, other investments held by ACP Re Holdings, LLC and proceeds of the foregoing in an amount equal to the requirements of the Maintenance Covenant. The maturity date of the loan is September 20, 2036. The interest rate on the outstanding principal balance of \$250,000 is a fixed annual rate of 3.7%, provided that

up to 1.2% thereof may be paid in kind. Commencing on September 20, 2026, and for each year thereafter, two percent of the then outstanding principal balance of the loan (inclusive of any amounts previously paid in kind) is due and payable. A change of control of greater than 50% and an uncured breach of the Maintenance Covenant are included as events of default.

As of September 30, 2018 and December 31, 2017 there was a receivable related to the ACP Re Credit Agreement of \$127,692 and \$126,173, respectively. The Company recorded interest income of \$1,181 and \$1,167 for the three months ended September 30, 2018 and 2017, respectively, and \$3,529 and \$3,487 for the nine months ended September 30, 2018 and 2017, respectively, under the ACP Re Credit Agreement. Management evaluates the loan for impairment on a quarterly basis, including the adequacy of the Company's reserve position based on collateral levels maintained. Management determined no reserve was needed for the carrying value of the loan at September 30, 2018 and December 31, 2017.

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*Other Related Party Transactions*

*Lease Agreements*

The Company leases office space at 59 Maiden Lane in New York, New York from 59 Maiden Lane Associates LLC, an entity that is wholly-owned by the Karfunkel family. The lease term is through 2022. The Company paid \$207 and \$201 in rent for the three months ended September 30, 2018 and 2017, respectively, and \$622 and \$576 for the nine months ended September 30, 2018 and 2017, respectively.

The Company leases office space at 30 North LaSalle Street, Chicago, Illinois from 30 North LaSalle Street Partners LLC, an entity that is wholly-owned by the Karfunkel family. The lease term is through 2020. The Company paid \$76 and \$75 in rent for the three months ended September 30, 2018 and 2017, respectively, and \$226 and \$222 for the nine months ended September 30, 2018 and 2017, respectively.

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**15. Segment Information**

The Company currently operates two business segments, “Property and Casualty” and “Accident and Health.” The “Corporate and Other” column represents the activities of the holding company, as well as income from the Company’s investment portfolio. The Company evaluates segment performance based on segment profit separately from the results of the Company’s investment portfolio. Other operating expenses allocated to the segments are called “General and administrative expenses” which are allocated on an actual basis except corporate salaries and benefits where management’s judgment is applied. In determining total assets by segment, the Company identifies those assets that are attributable to a particular segment such as premiums, deferred acquisition costs, reinsurance recoverable, prepaid reinsurance premiums, intangible assets and goodwill, while the remaining assets are allocated to Corporate and Other.

The Property and Casualty segment, which includes the Reciprocal Exchanges and the management companies, reports the management fees earned by the Company from the Reciprocal Exchanges for underwriting, investment management and other services as service and fee income. The effects of these transactions between the Company and the Reciprocal Exchanges are eliminated in consolidation to derive consolidated net income. However, the management fee income is reported in net income attributable to NGHC and included in the basic and diluted earnings per share.

The following tables summarize the results of operations of the Company’s operating segments:

	Three Months Ended September 30, 2018			
	Property and Casualty	Accident and Health	Corporate and Other	Total
Underwriting revenue:				
Gross premium written	\$1,211,723	\$143,948	\$—	\$1,355,671
Ceded premiums	(412,275 )	(20,372 )	—	(432,647 )
Net premium written	799,448	123,576	—	923,024
Change in unearned premium	(15,267 )	31,770	—	16,503
Net earned premium	784,181	155,346	—	939,527
Ceding commission income	58,831	269	—	59,100
Service and fee income	96,232	46,458	—	142,690
Total underwriting revenues	939,244	202,073	—	1,141,317
Underwriting expenses:				
Loss and loss adjustment expense	584,658	72,652	—	657,310
Acquisition costs and other underwriting expenses	146,696	44,774	—	191,470
General and administrative expenses	185,208	50,525	—	235,733
Total underwriting expenses	916,562	167,951	—	1,084,513
Underwriting income	22,682	34,122	—	56,804
Net investment income	—	—	30,696	30,696
Net loss on investments	—	—	(3,170 )	(3,170 )
Interest expense	—	—	(12,583 )	(12,583 )
Provision for income taxes	—	—	(15,518 )	(15,518 )
Net (income) loss attributable to non-controlling interest	—	—	12,153	12,153
Net income attributable to NGHC	\$22,682	\$34,122	\$11,578	\$68,382





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	Three Months Ended September 30, 2017			
	Property and Casualty	Accident and Health	Corporate and Other	Total
Underwriting revenue:				
Gross premium written	\$1,083,045	\$121,266	\$—	\$1,204,311
Ceded premiums	(571,688 )	(11,069 )	—	(582,757 )
Net premium written	511,357	110,197	—	621,554
Change in unearned premium	217,217	25,530	—	242,747
Net earned premium	728,574	135,727	—	864,301
Ceding commission income	49,876	226	—	50,102
Service and fee income	90,034	32,492	—	122,526
Total underwriting revenues	868,484	168,445	—	1,036,929
Underwriting expenses:				
Loss and loss adjustment expense	555,731	83,414	—	639,145
Acquisition costs and other underwriting expenses	129,759	33,826	—	163,585
General and administrative expenses	175,664	38,463	—	214,127
Total underwriting expenses	861,154	155,703	—	1,016,857
Underwriting income	7,330	12,742	—	20,072
Net investment income	—	—	25,150	25,150
Net gain on investments	—	—	47,605	47,605
Other expense	—	—	(3,901 )	(3,901 )
Interest expense	—	—	(11,495 )	(11,495 )
Provision for income taxes	—	—	(18,475 )	(18,475 )
Net (income) attributable to non-controlling interest	—	—	(1,311 )	(1,311 )
Net income attributable to NGHC	\$7,330	\$12,742	\$37,573	\$57,645

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	Nine Months Ended September 30, 2018			
	Property and Casualty	Accident and Health	Corporate and Other	Total
Underwriting revenue:				
Gross premium written	\$3,594,690	\$534,560	\$—	\$4,129,250
Ceded premiums	(1,161,235 )	(48,373 )	—	(1,209,608 )
Net premium written	2,433,455	486,187	—	2,919,642
Change in unearned premium	(110,875 )	(20,796 )	—	(131,671 )
Net earned premium	2,322,580	465,391	—	2,787,971
Ceding commission income	158,187	789	—	158,976
Service and fee income	280,727	134,586	—	415,313
Total underwriting revenues	2,761,494	600,766	—	3,362,260
Underwriting expenses:				
Loss and loss adjustment expense	1,709,440	252,364	—	1,961,804
Acquisition costs and other underwriting expenses	405,541	136,499	—	542,040
General and administrative expenses	542,902	148,265	—	691,167
Total underwriting expenses	2,657,883	537,128	—	3,195,011
Underwriting income	103,611	63,638	—	167,249
Net investment income	—	—	81,702	81,702
Net loss on investments	—	—	(22,756 )	(22,756 )
Interest expense	—	—	(38,775 )	(38,775 )
Provision for income taxes	—	—	(38,261 )	(38,261 )
Net (income) loss attributable to non-controlling interest	—	—	31,979	31,979
Net income attributable to NGHC	\$103,611	\$63,638	\$13,889	\$181,138

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	Nine Months Ended September 30, 2017			
	Property and Casualty	Accident and Health	Corporate and Other	Total
Underwriting revenue:				
Gross premium written	\$3,147,408	\$444,195	\$—	\$3,591,603
Ceded premiums	(818,361 )	(34,635 )	—	(852,996 )
Net premium written	2,329,047	409,560	—	2,738,607
Change in unearned premium	35,985	(10,055 )	—	25,930
Net earned premium	2,365,032	399,505	—	2,764,537
Ceding commission income	90,820	784	—	91,604
Service and fee income	265,836	107,808	—	373,644
Total underwriting revenues	2,721,688	508,097	—	3,229,785
Underwriting expenses:				
Loss and loss adjustment expense	1,730,829	238,327	—	1,969,156
Acquisition costs and other underwriting expenses	415,025	112,075	—	527,100
General and administrative expenses	558,288	122,518	—	680,806
Total underwriting expenses	2,704,142	472,920	—	3,177,062
Underwriting income	17,546	35,177	—	52,723
Net investment income	—	—	81,725	81,725
Net gain on investments	—	—	44,018	44,018
Other expense	—	—	(198 )	(198 )
Interest expense	—	—	(34,590 )	(34,590 )
Provision for income taxes	—	—	(40,751 )	(40,751 )
Net (income) loss attributable to non-controlling interest	—	—	4,973	4,973
Net income attributable to NGHC	\$17,546	\$35,177	\$55,177	\$107,900

The following tables summarize the total assets of the Company's operating segments:

	September 30, 2018			
	Property and Casualty	Accident and Health	Corporate and Other	Total
Premiums and other receivables, net	\$1,322,760	\$134,990	\$3,582	\$1,461,332
Deferred acquisition costs	228,259	21,233	—	249,492
Reinsurance recoverable	1,508,481	18,559	—	1,527,040
Prepaid reinsurance premiums	680,754	—	—	680,754
Intangible assets, net and Goodwill	448,496	118,690	—	567,186
Prepaid and other assets	23,833	19,803	100,375	144,011
Corporate and other assets	—	—	4,619,273	4,619,273
Total assets	\$4,212,583	\$313,275	\$4,723,230	\$9,249,088

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	December 31, 2017			
	Property and Casualty	Accident and Health	Corporate and Other	Total
Premiums and other receivables, net	\$ 1,177,350	\$ 117,000	\$ 29,971	\$ 1,324,321
Deferred acquisition costs	198,283	18,106	—	216,389
Reinsurance recoverable	1,284,325	9,840	—	1,294,165
Prepaid reinsurance premiums	517,122	—	—	517,122
Intangible assets, net and Goodwill	464,153	114,070	—	578,223
Prepaid and other assets	21,141	35,608	99,081	155,830
Corporate and other assets	—	—	4,353,693	4,353,693
Total assets	\$ 3,662,374	\$ 294,624	\$ 4,482,745	\$ 8,439,743

The following tables show an analysis of the Company's premiums by geographical location:

	Three Months Ended September 30,					
	2018			2017		
	NGHC	Reciprocal Exchanges	Total	NGHC	Reciprocal Exchanges	Total
Gross premium written - North America	\$ 1,230,492	\$ 121,351	\$ 1,351,843	\$ 1,093,828	\$ 104,406	\$ 1,198,234
Gross premium written - Europe	3,828	—	3,828	6,077	—	6,077
Total	\$ 1,234,320	\$ 121,351	\$ 1,355,671	\$ 1,099,905	\$ 104,406	\$ 1,204,311
Net premium written - North America	\$ 921,456	\$ 14,814	\$ 936,270	\$ 571,944	\$ 43,533	\$ 615,477
Net premium written - Europe	(13,246 )	—	(13,246 )	6,077	—	6,077
Total	\$ 908,210	\$ 14,814	\$ 923,024	\$ 578,021	\$ 43,533	\$ 621,554
Net earned premium - North America	\$ 878,367	\$ 43,151	\$ 921,518	\$ 791,289	\$ 41,978	\$ 833,267
Net earned premium - Europe	18,009	—	18,009	31,034	—	31,034
Total	\$ 896,376	\$ 43,151	\$ 939,527	\$ 822,323	\$ 41,978	\$ 864,301
	Nine Months Ended September 30,					
	2018			2017		
	NGHC	Reciprocal Exchanges	Total	NGHC	Reciprocal Exchanges	Total
Gross premium written - North America	\$ 3,666,594	\$ 337,021	\$ 4,003,615	\$ 3,210,509	\$ 285,779	\$ 3,496,288
Gross premium written - Europe	125,635	—	125,635	95,315	—	95,315
Total	\$ 3,792,229	\$ 337,021	\$ 4,129,250	\$ 3,305,824	\$ 285,779	\$ 3,591,603
Net premium written - North America	\$ 2,678,841	\$ 132,240	\$ 2,811,081	\$ 2,506,815	\$ 136,477	\$ 2,643,292
Net premium written - Europe	108,561	—	108,561	95,315	—	95,315
Total	\$ 2,787,402	\$ 132,240	\$ 2,919,642	\$ 2,602,130	\$ 136,477	\$ 2,738,607
Net earned premium - North America	\$ 2,559,409	\$ 141,009	\$ 2,700,418	\$ 2,556,275	\$ 123,266	\$ 2,679,541
Net earned premium - Europe	87,553	—	87,553	84,996	—	84,996
Total	\$ 2,646,962	\$ 141,009	\$ 2,787,971	\$ 2,641,271	\$ 123,266	\$ 2,764,537



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The following tables show an analysis of the Company's premium by product type:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
Gross Premium Written	2018	2017	2018	2017
Property and Casualty				
Personal Auto	\$661,126	\$599,306	\$2,017,996	\$1,760,913
Homeowners	192,349	153,853	523,308	419,525
RV/Packaged	54,964	49,928	164,427	147,280
Small Business Auto	75,218	79,296	246,448	246,562
Lender-placed insurance	94,462	84,447	259,995	251,091
Other	12,253	11,809	45,495	36,258
Property and Casualty	\$1,090,372	\$978,639	\$3,257,669	\$2,861,629
Accident and Health	143,948	121,266	534,560	444,195
NGHC Total	\$1,234,320	\$1,099,905	\$3,792,229	\$3,305,824

Reciprocal Exchanges				
Personal Auto	\$40,240	\$39,040	\$116,602	\$102,420
Homeowners	80,070	64,240	217,486	180,616
Other	1,041	1,126	2,933	2,743
Reciprocal Exchanges Total	\$121,351	\$104,406	\$337,021	\$285,779

Total	\$1,355,671	\$1,204,311	\$4,129,250	\$3,591,603
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	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
Net Premium Written	2018	2017	2018	2017
Property and Casualty				
Personal Auto	\$502,964	\$318,773	\$1,542,685	\$1,387,024
Homeowners	112,390	(18,881)	255,290	217,590
RV/Packaged	54,627	49,547	162,934	146,256
Small Business Auto	53,155	43,505	181,314	195,577
Lender-placed insurance	56,529	70,581	134,630	229,938
Other	4,969	4,299	24,362	16,185
Property and Casualty	\$784,634	\$467,824	\$2,301,215	\$2,192,570
Accident and Health	123,576	110,197	486,187	409,560
NGHC Total	\$908,210	\$578,021	\$2,787,402	\$2,602,130

Reciprocal Exchanges				
Personal Auto	\$12,845	\$12,533	\$40,860	\$51,240
Homeowners	2,002	30,497	90,826	83,887
Other	(33)	) 503	554	1,350
Reciprocal Exchanges Total	\$14,814	\$43,533	\$132,240	\$136,477

Total	\$923,024	\$621,554	\$2,919,642	\$2,738,607
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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net Earned Premium				
Property and Casualty				
Personal Auto	\$496,139	\$428,112	\$1,436,793	\$1,377,752
Homeowners	80,308	68,042	242,161	282,741
RV/Packaged	51,229	45,742	145,911	129,706
Small Business Auto	59,636	60,013	178,302	193,578
Lender-placed insurance	48,466	79,048	162,629	241,990
Other	5,252	5,639	15,775	15,999
Property and Casualty	\$741,030	\$686,596	\$2,181,571	\$2,241,766
Accident and Health	155,346	135,727	465,391	399,505
NGHC Total	\$896,376	\$822,323	\$2,646,962	\$2,641,271
Reciprocal Exchanges				
Personal Auto	\$13,353	\$15,167	\$38,812	\$48,523
Homeowners	29,698	26,382	101,578	73,533
Other	100	429	619	1,210
Reciprocal Exchanges Total	\$43,151	\$41,978	\$141,009	\$123,266
Total	\$939,527	\$864,301	\$2,787,971	\$2,764,537

## 16. Subsequent Event

In October 2018, Hurricane Michael impacted the Southeastern U.S. The Company's initial assessment of the impact is approximately \$7,000 - \$10,000 in losses, net of quota share reinsurance.

## Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this Form 10-Q.*

### Note on Forward-Looking Statements

*This Form 10-Q contains certain forward-looking statements that are intended to be covered by the safe harbors created by The Private Securities Litigation Reform Act of 1995. When we use words such as “anticipate,” “intend,” “plan,” “believe,” “estimate,” “expect,” or similar expressions, we do so to identify forward-looking statements. Examples of forward-looking statements include the plans and objectives of management for future operations, including those relating to future growth of our business activities and availability of funds, and are based on current expectations that involve assumptions that are difficult or impossible to predict accurately and many of which are beyond our control. There can be no assurance that actual developments will be those anticipated by us. Actual results may differ materially from those expressed or implied in these statements as a result of significant risks and uncertainties, including, but not limited to, non-receipt of expected payments from insureds or reinsurers, changes in interest rates, a downgrade in the financial strength ratings of our insurance subsidiaries, the effect of the performance of financial markets on our investment portfolio, our ability to accurately underwrite and price our products and to maintain and establish accurate loss reserves, estimates of the fair value of our investments, development of claims and the effect on loss reserves, the cost and availability of reinsurance coverage, the effects of emerging claim and coverage issues, the effect of unpredictable catastrophic losses, changes in the demand for our products, our degree of success in integrating acquired businesses, the effect of general economic conditions, state and federal legislation, the effects of tax reform, regulations and regulatory investigations into industry practices, risks associated with conducting business outside the United States, developments relating to existing agreements, disruptions to our business relationships with our vendors or other counterparties, breaches in data security or other disruptions with our technology, heightened competition, changes in pricing environments, and changes in asset valuations. Additional information about these risks and uncertainties, as well as others that may cause actual results to differ materially from those projected, is contained in Item 1A, “Risk Factors” included in our Annual Report on Form 10-K for the year ended December 31, 2017, and our quarterly reports on Form 10-Q. The projections and statements in this report speak only as of the date of this report and we undertake no obligation to update or revise any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.*

### Overview

We are a specialty personal lines insurance holding company. Through our subsidiaries, we provide a variety of insurance products, including personal and small business automobile, homeowners, umbrella, recreational vehicle, motorcycle, lender-placed, supplemental health and other niche insurance products. We sell insurance products with a focus on underwriting profitability through a combination of our customized and predictive analytics and our technology driven low cost infrastructure.

We manage our business through two segments: Property and Casualty (“P&C”) and Accident and Health (“A&H”). We transact business primarily through our twenty-one regulated domestic insurance subsidiaries: Integon Casualty Insurance Company, Integon General Insurance Corporation, Integon Indemnity Corporation, Integon National Insurance Company (“Integon National”), Integon Preferred Insurance Company, New South Insurance Company, MIC General Insurance Corporation, National General Insurance Company, National General Assurance Company, National General Insurance Online, Inc., National Health Insurance Company, National General Premier Insurance

Company, Imperial Fire and Casualty Insurance Company, Agent Alliance Insurance Company, Century-National Insurance Company, Standard Property and Casualty Insurance Company, Direct General Insurance Company, Direct General Insurance Company of Mississippi, Direct General Life Insurance Company, Direct Insurance Company and Direct National Insurance Company. Our insurance subsidiaries have an “A-” (Excellent) group rating by A.M. Best Company, Inc. (“A.M. Best”). We currently conduct a limited amount of business outside the United States, primarily in Bermuda, Luxembourg and Sweden.

Two of our wholly-owned subsidiaries are management companies that act as attorneys-in-fact for Adirondack Insurance Exchange, a New York reciprocal insurer, and New Jersey Skylands Insurance Association, a New Jersey reciprocal insurer (together, the “Reciprocal Exchanges” or “Exchanges”). We do not own the Reciprocal Exchanges but are paid a fee to manage their business operations through our wholly-owned management companies. The Reciprocal Exchanges are included in our P&C segment.

The operating results of property and casualty insurance companies are subject to quarterly and yearly fluctuations due to the effect of competition on pricing, the frequency and severity of losses, the effect of weather and natural disasters on losses, general economic conditions, the general regulatory environment in states in which an insurer operates, state regulation of premium rates, changes in fair value of investments, and other factors such as changes in tax laws. The property and casualty industry has been highly cyclical with periods of high premium rates and shortages of underwriting capacity followed by periods of severe price competition and excess capacity. While these cycles can have a large impact on a company's ability to grow and retain business, we have sought to focus on niche markets and regions where we are able to maintain premium rates at generally consistent levels and maintain underwriting discipline throughout these cycles. We believe that the nature of our P&C insurance products, including their relatively low limits, the relatively short duration of time between when claims are reported and when they are settled, and the broad geographic distribution of our customers, have allowed us to grow and retain our business throughout these cycles. In addition, we have limited our exposure to catastrophe losses through reinsurance. With regard to seasonality, we tend to experience higher claims and claims expense in our P&C segment during periods of severe or inclement weather.

We evaluate our operations by monitoring key measures of growth and profitability, including net combined ratio (non-GAAP) and operating leverage. We target a net combined ratio (non-GAAP) in the low-to-mid 90s while seeking to maintain optimal operating leverage in our insurance subsidiaries commensurate with our A.M. Best rating objectives. To achieve our targeted net combined ratio (non-GAAP) we continually seek ways to reduce our operating costs and lower our expense ratio. For the nine months ended September 30, 2018, our annualized operating leverage (the ratio of net earned premium to average total stockholders' equity) was 1.9x, which was within our planned target operating leverage of between 1.5x and 2.0x.

Investment income is also an important part of our business. Because we often do not settle claims until several months or longer after we receive the original policy premiums, we are able to invest cash from premiums for significant periods of time. We invest our capital and surplus in accordance with state and regulatory guidelines. Our net investment income was \$81.7 million and \$81.7 million for the nine months ended September 30, 2018 and 2017, respectively. We held 10.1% and 8.9% of total invested assets in cash, cash equivalents and restricted cash as of September 30, 2018 and December 31, 2017, respectively.

Our most significant balance sheet liability is our unpaid loss and loss adjustment expense reserves. As of September 30, 2018 and December 31, 2017, our reserves, net of reinsurance recoverable on unpaid losses, were \$1.6 billion and \$1.5 billion, respectively. We record reserves for estimated losses under insurance policies that we write and for loss adjustment expenses related to the investigation and settlement of policy claims. Our reserves for loss and loss adjustment expenses represent the estimated cost of all reported and unreported loss and loss adjustment expenses incurred and unpaid at any given point in time based on known facts and circumstances. Reserves are based on estimates of the most likely ultimate cost of individual claims. These estimates are inherently uncertain. Judgment is required to determine the relevance of our historical experience and industry information under current facts and circumstances. The interpretation of this historical and industry data can be impacted by external forces, principally frequency and severity of future claims, length of time to achieve ultimate settlement of claims, inflation of medical costs and wages, insurance policy coverage interpretations, jury determinations and legislative changes. Accordingly, our reserves may prove to be inadequate to cover our actual losses. If we change our estimates, such changes would be reflected in our results of operations during the period in which they are made, with increases in our reserves resulting in decreases in our earnings.



## Principal Revenue and Expense Items

*Gross premium written.* Gross premium written represents premium from each insurance policy that we write, including as a servicing carrier for assigned risk plans, during a reporting period based on the effective date of the individual policy, prior to ceding reinsurance to third parties.

*Net premium written.* Net premium written is gross premium written less that portion of premium that we cede to third-party reinsurers under reinsurance agreements. The amount ceded under these reinsurance agreements is based on a contractual formula contained in the individual reinsurance agreement.

*Change in unearned premium.* Change in unearned premium is the change in the balance of the portion of premium that we have written but have yet to earn during the relevant period because the policy is unexpired.

*Net earned premium.* Net earned premium is the earned portion of our net premium written. We generally earn insurance premium on a pro rata basis over the term of the policy. At the end of each reporting period, premium written that is not earned is classified as unearned premium, which is earned in subsequent periods over the remaining term of the policy. Our policies typically have a term of six months or one year. For a six-month policy written on January 1, 2018, we would earn half of the premium in the first quarter of 2018 and the other half in the second quarter of 2018.

*Ceding commission income.* Ceding commission income is commission we receive based on the earned premium ceded to third-party reinsurers to reimburse us for our acquisition, underwriting and other operating expenses. We earn commissions on reinsurance premium ceded in a manner consistent with the recognition of the earned premium on the underlying insurance policies, generally on a pro rata basis over the terms of the policies reinsured. The portion of ceding commission revenue which represents reimbursement of successful acquisition costs related to the underlying policies is recorded as an offset to acquisition costs and other underwriting expenses.

*Service and fee income.* We also generate policy service and fee income from installment fees, late payment fees, and other finance and processing fees related to policy cancellation, policy reinstatement, and insufficient fund check returns. These fees are generally designed to offset expenses incurred in the administration of our insurance business, and are generated as follows. Installment fees are charged to permit a policyholder to pay premiums in installments rather than in a lump sum. Late payment fees are charged when premiums are remitted after the due date and any applicable grace periods. Policy cancellation fees are charged to policyholders when a policy is terminated by the policyholder prior to the expiration of the policy's term or renewal term, as applicable. Reinstatement fees are charged to reinstate a policy that has lapsed, generally as a result of non-payment of premiums. Insufficient fund fees are charged when the customer's payment is returned by the financial institution.

All fee income is recognized as follows. An installment fee is recognized at the time each policy installment bill is due. A late payment fee is recognized when the customer's payment is not received after the listed due date and any applicable grace period. A policy cancellation fee is recognized at the time the customer's policy is canceled. A policy reinstatement fee is recognized when the customer's policy is reinstated. An insufficient fund fee is recognized when the customer's payment is returned by the financial institution. The amounts charged are primarily intended to compensate us for the administrative costs associated with processing and administering policies that generate insurance premium; however, the amounts of fees charged are not dependent on the amount or period of insurance coverage provided and do not entail any obligation to return any portion of those funds. The direct and indirect costs associated with generating fee income are not separately tracked.

We also collect service fees in the form of commissions and general agent fees by selling policies issued by third-party insurance companies. Commission income and general agent fees are recognized, net of an allowance for

estimated policy cancellations, as of the effective date of the insurance policy. The allowance for estimated third-party cancellations is periodically evaluated and adjusted as necessary.

*Net investment income.* We invest our statutory surplus funds and the funds supporting our insurance liabilities primarily in cash and cash equivalents, debt and equity securities. Our net investment income includes interest and dividends earned on our invested assets and earnings or losses on our equity method investments.

*Net gains and losses on investments.* Net realized gains occur when we sell our investment securities for more than their costs or amortized costs, as applicable. Net realized losses occur when we sell our investment securities for less than their costs or amortized costs, as applicable, or we write down the investment securities as a result of other-than-temporary impairment loss. We report net unrealized gains (losses) on debt securities classified as available for sale within accumulated other comprehensive income (loss) in our balance sheet. Additionally, we have a small portfolio of equity securities and debt securities classified as trading. We report all gains (losses) on equity securities and debt securities classified as trading within net gains (losses) on investments in our statement of income. Net gains and losses on investments also include foreign exchange gains and losses which are generated by the remeasurement of our subsidiaries' financial statements that are denominated or stated in another currency into the Company's functional currency.

*Loss and loss adjustment expenses.* Loss and LAE represent our largest expense item and, for any given reporting period, include estimates of future claim payments, changes in those estimates from prior reporting periods and costs associated with investigating, defending and servicing claims. These expenses fluctuate based on the amount and types of risks we insure. We record loss and LAE related to estimates of future claim payments based on case-by-case valuations and statistical analyses. We seek to establish all reserves at the most likely ultimate exposure based on our historical claims experience. It is typical for our more serious bodily injury claims to take several years to settle, and we revise our estimates as we receive additional information about the condition of claimants and the costs of their medical treatment. Our ability to estimate loss and LAE accurately at the time of pricing our insurance policies is a critical factor in our profitability.

*Acquisition costs and other underwriting expenses.* Acquisition costs and other underwriting expenses consist of policy acquisition and marketing expenses, salaries and benefits expenses. Policy acquisition expenses comprise commissions directly attributable to those agents, wholesalers or brokers that produce premiums written on our behalf and promotional fees directly attributable to our affinity relationships. Acquisition costs also include costs that are related to the successful acquisition of new or renewal insurance contracts including comprehensive loss underwriting exchange reports, motor vehicle reports, credit score checks, and policy issuance costs.

*General and administrative expenses.* General and administrative expenses are composed of all other operating expenses, including various departmental salaries and benefits expenses for employees that are directly involved in the maintenance of policies, information systems, and accounting for insurance transactions, and other insurance expenses such as federal excise tax, postage, telephones and internet access charges, as well as legal and auditing fees and board and bureau charges. In addition, general and administrative expenses include those charges that are related to the amortization of tangible and intangible assets and non-insurance activities in which we engage.

*Interest expense.* Interest expense represents amounts we incur on our outstanding indebtedness and interest credited on funds held balances at the applicable interest rates.

*Income tax expense.* We incur federal, state and local income tax expenses as well as income tax expenses in certain foreign jurisdictions in which we operate.

*Net operating expense.* These expenses consist of the sum of general and administrative expenses and acquisition costs and other underwriting expenses less ceding commission income and service and fee income.

*Underwriting income.* Underwriting income is a measure of an insurance company's overall operating profitability before items such as investment income, interest expense and income taxes. Underwriting income is calculated as net earned premium plus ceding commission income and service and fee income less loss and LAE, acquisition costs and other underwriting expenses, and general and administrative expenses.





## Insurance Ratios

*Net combined ratio (non-GAAP).* The net combined ratio (non-GAAP) is a measure of an insurance company's overall underwriting profit. This is the sum of the net loss ratio and net operating expense ratio (non-GAAP). If the net combined ratio (non-GAAP) is at or above 100 percent, an insurance company cannot be profitable without investment income, and may not be profitable if investment income is insufficient. Our definition of net loss ratio and net operating expense ratio is as follows:

*Net loss ratio.* The net loss ratio is a measure of the underwriting profitability of an insurance company's business. Expressed as a percentage, this is the ratio of loss and LAE incurred to net earned premium.

*Net operating expense ratio (non-GAAP).* The net operating expense ratio (non-GAAP) is one component of an insurance company's operational efficiency in administering its business. Expressed as a percentage, this is the ratio of net operating expense to net earned premium.

Net operating expense ratio and net combined ratio are considered non-GAAP financial measures under applicable SEC rules because a component of those ratios, net operating expense, is calculated by offsetting acquisition costs and other underwriting expenses and general and administrative expenses by ceding commission income and service and fee income, and is therefore a non-GAAP measure. Management uses net operating expense ratio (non-GAAP) and net combined ratio (non-GAAP) to evaluate financial performance against historical results and establish targets on a consolidated basis. We believe this presentation enhances the understanding of our results by eliminating what we believe are volatile and unusual events and presenting the ratios with what we believe are the underlying run rates of the business. Other companies may calculate these measures differently, and, therefore, their measures may not be comparable to those used by the Company's management. For a reconciliation showing the total amounts by which acquisition costs and other underwriting expenses and general and administrative expenses were offset by ceding commission income and service and fee income in the calculation of net operating expense, see "Results of Operations - Consolidated Results of Operations" below.

## Critical Accounting Policies

Our discussion and analysis of our results of operations, financial condition and liquidity are based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the amounts of assets and liabilities, revenues and expenses and disclosure of contingent assets and liabilities as of the date of the financial statements. As more information becomes known, these estimates and assumptions could change, which would have an impact on actual results that may differ materially from these estimates and judgments under different assumptions. We have not made any changes in estimates or judgments that have had a significant effect on the reported amounts as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017.

For more information related to recent accounting pronouncements that we adopted during the nine months ended September 30, 2018, see Note 2, "Recent Accounting Pronouncements" in the notes to our condensed consolidated financial statements.

**Results of Operations**

***Consolidated Results of Operations for the Three Months Ended September 30, 2018 and 2017 (Unaudited)***

	Three Months Ended September 30, 2018				2017				
	NGHC	Reciprocal Exchanges	Eliminations	Total	NGHC	Reciprocal Exchanges	Eliminations	Total	
	<i>(amounts in thousands)</i>								
Gross premium written	\$ 1,234,320	\$ 121,351	\$ —	\$ 1,355,671	\$ 1,100,706	\$ 104,406	\$ (801 )	\$ 1,204,311	
Ceded premiums	(326,110 )	(106,537 )	—	(432,647 )	(522,685 )	(60,873 )	801	(582,757 )	
Net premium written	\$ 908,210	\$ 14,814	\$ —	\$ 923,024	\$ 578,021	\$ 43,533	\$ —	\$ 621,554	
Change in unearned premium	(11,834 )	28,337	—	16,503	244,302	(1,555 )	—	242,747	
Net earned premium	\$ 896,376	\$ 43,151	\$ —	\$ 939,527	\$ 822,323	\$ 41,978	\$ —	\$ 864,301	
Ceding commission income	44,513	14,587	—	59,100	30,901	19,201	—	50,102	
Service and fee income	160,425	1,575	(19,310 )	142,690	133,057	4,084	(14,615 )	122,526	
Total underwriting revenues	\$ 1,101,314	\$ 59,313	\$ (19,310 )	\$ 1,141,317	\$ 986,281	\$ 65,263	\$ (14,615 )	\$ 1,036,929	
Underwriting expenses:									
Loss and loss adjustment expense	617,098	40,212	—	657,310	612,289	26,856	—	639,145	
Acquisition costs and other underwriting expenses	180,180	11,290	—	191,470	146,469	17,116	—	163,585	
General and administrative expenses	234,626	20,417	(19,310 )	235,733	209,923	18,819	(14,615 )	214,127	
Total underwriting expenses	\$ 1,031,904	\$ 71,919	\$ (19,310 )	\$ 1,084,513	\$ 968,681	\$ 62,791	\$ (14,615 )	\$ 1,016,857	
Underwriting income	\$ 69,410	\$ (12,606 )	\$ —	\$ 56,804	\$ 17,600	\$ 2,472	\$ —	\$ 20,072	
Net investment income	30,984	2,344	(2,632 )	30,696	25,426	2,189	(2,465 )	25,150	
Net gain (loss) on investments	(3,003 )	(167 )	—	(3,170 )	47,659	(54 )	—	47,605	
Other expense	—	—	—	—	(3,901 )	—	—	(3,901 )	
Interest expense	(12,583 )	(2,632 )	2,632	(12,583 )	(11,495 )	(2,465 )	2,465	(11,495 )	
Income (loss) before provision (benefit) for income taxes	\$ 84,808	\$ (13,061 )	\$ —	\$ 71,747	\$ 75,289	\$ 2,142	\$ —	\$ 77,431	
Less: Provision (benefit) for income taxes	16,426	(908 )	—	15,518	17,644	831	—	18,475	
Net income (loss)	\$ 68,382	\$ (12,153 )	\$ —	\$ 56,229	\$ 57,645	\$ 1,311	\$ —	\$ 58,956	
Less: Net (income) loss attributable to non-controlling interest	—	12,153	—	12,153	—	(1,311 )	—	(1,311 )	
Net income attributable to NGHC	\$ 68,382	\$ —	\$ —	\$ 68,382	\$ 57,645	\$ —	\$ —	\$ 57,645	
Net loss ratio	68.8	% 93.2	%	70.0	% 74.5	% 64.0	%	73.9	%
Net operating expense ratio (non-GAAP)	23.4	% 36.0	%	24.0	% 23.4	% 30.1	%	23.7	%
Net combined ratio (non-GAAP)	92.2	% 129.2	%	94.0	% 97.9	% 94.1	%	97.6	%

	Three Months Ended September 30, 2018				2017			
	NGHC	Reciprocal Exchanges	Eliminations	Total	NGHC	Reciprocal Exchanges	Eliminations	Total
	<i>(amounts in thousands)</i>							
Total expenses	\$ 1,044,487	\$ 74,551	\$ (21,942 )	\$ 1,097,096	\$ 980,176	\$ 65,256	\$ (17,080 )	\$ 1,028,352
Less: Loss and loss adjustment expense	617,098	40,212	—	657,310	612,289	26,856	—	639,145
Less: Interest expense	12,583	2,632	(2,632 )	12,583	11,495	2,465	(2,465 )	11,495
Less: Ceding commission income	44,513	14,587	—	59,100	30,901	19,201	—	50,102
Less: Service and fee income	160,425	1,575	(19,310 )	142,690	133,057	4,084	(14,615 )	122,526
Net operating expense	\$ 209,868	\$ 15,545	\$ —	\$ 225,413	\$ 192,434	\$ 12,650	\$ —	\$ 205,084
Net earned premium	\$ 896,376	\$ 43,151	\$ —	\$ 939,527	\$ 822,323	\$ 41,978	\$ —	\$ 864,301

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Net operating expense ratio (non-GAAP)	23.4	%	36.0	%	24.0	%	23.4	%	30.1	%	23.7	%
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**Consolidated Results of Operations for the Nine Months Ended September 30, 2018 and 2017 (Unaudited)**

	Nine Months Ended September 30, 2018				2017				
	NGHC	Reciprocal Exchanges	Eliminations	Total	NGHC	Reciprocal Exchanges	Eliminations	Total	
	<i>(amounts in thousands)</i>								
Gross premium written	\$ 3,793,830	\$ 337,021	\$ (1,601 )	\$ 4,129,250	\$ 3,308,226	\$ 285,779	\$ (2,402 )	\$ 3,591,603	
Ceded premiums	(1,006,428 )	(204,781 )	1,601	(1,209,608 )	(706,096 )	(149,302 )	2,402	(852,996 )	
Net premium written	\$ 2,787,402	\$ 132,240	\$ —	\$ 2,919,642	\$ 2,602,130	\$ 136,477	\$ —	\$ 2,738,607	
Change in unearned premium	(140,440 )	8,769	—	(131,671 )	39,141	(13,211 )	—	25,930	
Net earned premium	\$ 2,646,962	\$ 141,009	\$ —	\$ 2,787,971	\$ 2,641,271	\$ 123,266	\$ —	\$ 2,764,537	
Ceding commission income	119,453	39,523	—	158,976	37,047	54,557	—	91,604	
Service and fee income	463,293	4,466	(52,446 )	415,313	406,482	7,658	(40,496 )	373,644	
Total underwriting revenues	\$ 3,229,708	\$ 184,998	\$ (52,446 )	\$ 3,362,260	\$ 3,084,800	\$ 185,481	\$ (40,496 )	\$ 3,229,785	
Underwriting expenses:									
Loss and loss adjustment expense	1,835,383	126,421	—	1,961,804	1,880,380	88,776	—	1,969,156	
Acquisition costs and other underwriting expenses	509,088	32,952	—	542,040	480,264	46,836	—	527,100	
General and administrative expenses	681,581	62,032	(52,446 )	691,167	658,871	62,431	(40,496 )	680,806	
Total underwriting expenses	\$ 3,026,052	\$ 221,405	\$ (52,446 )	\$ 3,195,011	\$ 3,019,515	\$ 198,043	\$ (40,496 )	\$ 3,177,062	
Underwriting income (loss)	\$ 203,656	\$ (36,407 )	\$ —	\$ 167,249	\$ 65,285	\$ (12,562 )	\$ —	\$ 52,723	
Net investment income	82,186	6,693	(7,177 )	81,702	81,614	7,220	(7,109 )	81,725	
Net gain (loss) on investments	(21,490 )	(1,266 )	—	(22,756 )	37,885	6,133	—	44,018	
Other expense	—	—	—	—	(198 )	—	—	(198 )	
Interest expense	(38,775 )	(7,177 )	7,177	(38,775 )	(34,590 )	(7,109 )	7,109	(34,590 )	
Income (loss) before provision (benefit) for income taxes	\$ 225,577	\$ (38,157 )	\$ —	\$ 187,420	\$ 149,996	\$ (6,318 )	\$ —	\$ 143,678	
Less: Provision (benefit) for income taxes	44,439	(6,178 )	—	38,261	42,096	(1,345 )	—	40,751	
Net income (loss)	\$ 181,138	\$ (31,979 )	\$ —	\$ 149,159	\$ 107,900	\$ (4,973 )	\$ —	\$ 102,927	
Less: Net (income) loss attributable to non-controlling interest	—	31,979	—	31,979	—	4,973	—	4,973	
Net income attributable to NGHC	\$ 181,138	\$ —	\$ —	\$ 181,138	\$ 107,900	\$ —	\$ —	\$ 107,900	
Net loss ratio	69.3	% 89.7	%	70.4	% 71.2	% 72.0	%	71.2	%
Net operating expense ratio (non-GAAP)	23.0	% 36.2	%	23.6	% 26.3	% 38.2	%	26.9	%
Net combined ratio (non-GAAP)	92.3	% 125.9	%	94.0	% 97.5	% 110.2	%	98.1	%

	Nine Months Ended September 30, 2018				2017				
	NGHC	Reciprocal Exchanges	Eliminations	Total	NGHC	Reciprocal Exchanges	Eliminations	Total	
	<i>(amounts in thousands)</i>								
Total expenses	\$ 3,064,827	\$ 228,582	\$ (59,623 )	\$ 3,233,786	\$ 3,054,105	\$ 205,152	\$ (47,605 )	\$ 3,211,652	
Less: Loss and loss adjustment expense	1,835,383	126,421	—	1,961,804	1,880,380	88,776	—	1,969,156	
Less: Interest expense	38,775	7,177	(7,177 )	38,775	34,590	7,109	(7,109 )	34,590	
Less: Ceding commission income	119,453	39,523	—	158,976	37,047	54,557	—	91,604	
Less: Service and fee income	463,293	4,466	(52,446 )	415,313	406,482	7,658	(40,496 )	373,644	
Net operating expense	\$ 607,923	\$ 50,995	\$ —	\$ 658,918	\$ 695,606	\$ 47,052	\$ —	\$ 742,658	
Net earned premium	\$ 2,646,962	\$ 141,009	\$ —	\$ 2,787,971	\$ 2,641,271	\$ 123,266	\$ —	\$ 2,764,537	
Net operating expense ratio (non-GAAP)	23.0	% 36.2	%	23.6	% 26.3	% 38.2	%	26.9	%



Effective July 1, 2017, we entered into auto and homeowners quota share agreements (collectively, the “Quota Shares”). Pursuant to the auto quota share agreement, we cede 15.0% of net liability under our auto policies and pursuant to our homeowners quota share agreement, we cede 29.6% of net liability under homeowners policies, in each case to third party reinsurers. Effective May 1, 2018, we cede an additional 12.4% (the “Additional Cession”) of net liability (for total cession of 42.0%) under the homeowners quota share agreement.

Ceded written premium under the Quota Shares includes the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	<i>(amounts in thousands)</i>			
Ceded premium current period - Quota Shares	\$184,071	\$151,336	\$556,207	\$151,336
Ceded premium - unearned premium transfer as of July 1, 2017	—	265,894	—	265,894
Ceded premium current period - Additional Cession	28,189	—	47,660	—
Ceded premium - unearned premium transfer as of May 1, 2018	—	—	49,970	—
Total	\$212,260	\$417,230	\$653,837	\$417,230

For more information on our reinsurance agreements, refer to our Annual Report on Form 10-K for the year ended December 31, 2017, and Note 8, “Reinsurance” in the notes to our condensed consolidated financial statements.

As a result of the Quota Shares, comparisons between the three and nine months ended September 30, 2018 and 2017 results will be less meaningful. This transaction impacted our P&C segment only.

***Consolidated Results of Operations for the Three Months Ended September 30, 2018 Compared to the Three Months Ended September 30, 2017 (Unaudited)***

***Gross premium written.*** Gross premium written increased by \$151.4 million, or 12.6%, from \$1,204.3 million for the three months ended September 30, 2017 to \$1,355.7 million for the three months ended September 30, 2018, due to an increase of \$128.7 million from the P&C segment as a result of organic growth (\$111.7 million) and growth in the Reciprocal Exchanges (\$16.9 million); and an increase of \$22.7 million from the A&H segment primarily as a result of domestic organic growth.

***Net premium written.*** Net premium written increased by \$301.5 million, or 48.5%, from \$621.6 million for the three months ended September 30, 2017 to \$923.0 million for the three months ended September 30, 2018. Net premium written for the P&C segment increased by \$288.1 million for the three months ended September 30, 2018 compared to the same period in 2017, primarily as a result of organic growth (\$111.8 million) and a decrease in ceded written premium to the Quota Shares (\$205.0 million), with the third quarter of 2017 net premium written being impacted by the unearned premium transfer. Net premium written for the A&H segment increased by \$13.4 million for the three months ended September 30, 2018 compared to the same period in 2017, primarily as a result of domestic organic growth.

***Net earned premium.*** Net earned premium increased by \$75.2 million, or 8.7%, from \$864.3 million for the three months ended September 30, 2017 to \$939.5 million for the three months ended September 30, 2018. The change by segment was: P&C increased by \$55.6 million and A&H increased by \$19.6 million. The increase in the P&C segment was mainly attributable to organic growth (\$120.7 million), partially offset by premium ceded to the Quota Shares (\$66.3 million). The increase in the A&H segment was primarily due to domestic organic growth.

***Ceding commission income.*** Ceding commission income increased by \$9.0 million, or 18.0%, from \$50.1 million for the three months ended September 30, 2017 to \$59.1 million for the three months ended September 30, 2018,

primarily driven by an increase in P&C ceded earned premium.

*Service and fee income.* Service and fee income increased by \$20.2 million, or 16.5%, from \$122.5 million for the three months ended September 30, 2017 to \$142.7 million for the three months ended September 30, 2018. Service and fee income is discussed in more detail in the segment discussions that follow.



The components of service and fee income are as follows:

	Three Months Ended September 30,			
	2018	2017	Change	% Change
	<i>(amounts in thousands)</i>			
Commission revenue	\$43,278	\$35,507	\$7,771	21.9 %
Finance and processing fees	30,739	26,190	4,549	17.4 %
Installment fees	23,841	20,938	2,903	13.9 %
Group health administrative fees	18,364	15,611	2,753	17.6 %
Late payment fees	8,183	7,366	817	11.1 %
Other service and fee income	18,285	16,914	1,371	8.1 %
Total	\$142,690	\$122,526	\$20,164	16.5 %

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE increased by \$18.2 million, from \$639.1 million for the three months ended September 30, 2017 to \$657.3 million for the three months ended September 30, 2018, due to organic growth (\$46.5 million) and growth in the Reciprocal Exchanges (\$13.4 million), partially offset by losses ceded to the Quota Shares (\$41.6 million). The changes by segment were: P&C - increased by \$28.9 million and A&H - decreased by \$10.8 million.

Loss and LAE for the three months ended September 30, 2018 included \$2.4 million of favorable development on prior accident year loss and LAE reserves. This development was composed of \$10.8 million of unfavorable development in the P&C segment (including \$3.6 million of unfavorable development for the Reciprocal Exchanges) primarily driven by unfavorable development in our auto liability products, and \$13.2 million of favorable development in the A&H segment. Loss and LAE for the three months ended September 30, 2017 included \$9.1 million of unfavorable development on prior accident year loss and LAE reserves. This development was composed of \$6.3 million of unfavorable development in the P&C segment (including \$1.4 million of unfavorable development for the Reciprocal Exchanges) primarily driven by unfavorable development in our auto liability business, and \$2.7 million of unfavorable development in the A&H segment primarily driven by unfavorable development in our international products.

Our consolidated net loss ratio decreased from 73.9% for the three months ended September 30, 2017 to 70.0% for the three months ended September 30, 2018. Net loss ratio is discussed in more detail in the segment discussions that follow.

*Acquisition costs and other underwriting expenses.* Acquisition costs and other underwriting expenses increased by \$27.9 million, or 17.0%, from \$163.6 million for the three months ended September 30, 2017 to \$191.5 million for the three months ended September 30, 2018, mainly due to an increase of \$16.9 million in the P&C segment, primarily as a result of organic growth (\$33.0 million), partially offset by the Quota Shares (\$10.2 million).

*General and administrative expenses.* General and administrative expenses increased by \$21.6 million, or 10.1%, from \$214.1 million for the three months ended September 30, 2017 to \$235.7 million for the three months ended September 30, 2018, primarily due to an increase of \$12.1 million in the A&H segment.

*Net operating expense; net operating expense ratio (non-GAAP).* Net operating expense increased by \$20.3 million, from \$205.1 million for the three months ended September 30, 2017 to \$225.4 million for the three months ended September 30, 2018, due to an increase of \$11.3 million in the P&C segment and an increase of \$9.0 million in the A&H segment.

The consolidated net operating expense ratio increased from 23.7% for the three months ended September 30, 2017 to 24.0% for the three months ended September 30, 2018. Excluding the Reciprocal Exchanges, the net operating expense ratio was 23.4% and 23.4% for the three months ended September 30, 2018 and 2017, respectively. The Reciprocal Exchanges' net operating expense ratio was 36.0% and 30.1% for the three months ended September 30, 2018 and 2017, respectively. Net operating expense and net operating expense ratio is discussed in more detail in the segment discussions that follow.

*Net investment income.* Net investment income increased by \$5.5 million, or 22.1%, from \$25.2 million for the three months ended September 30, 2017 to \$30.7 million for the three months ended September 30, 2018. The increase was primarily due to higher investment income from our debt securities portfolio.

*Net gain (loss) on investments.* Net gain on investments decreased by \$50.8 million, from a \$47.6 million gain for the three months ended September 30, 2017 to a \$3.2 million loss for the three months ended September 30, 2018. The decrease was mainly attributable to fewer sales of securities in the third quarter of 2018.

***Consolidated Results of Operations for the Nine Months Ended September 30, 2018 Compared to the Nine Months Ended September 30, 2017 (Unaudited)***

*Gross premium written.* Gross premium written increased by \$537.6 million, or 15.0%, from \$3,591.6 million for the nine months ended September 30, 2017 to \$4,129.3 million for the nine months ended September 30, 2018, due to an increase of \$447.3 million from the P&C segment as a result of organic growth (\$396.0 million) and growth in the Reciprocal Exchanges (\$51.2 million); and an increase of \$90.4 million from the A&H segment as a result of organic growth, both domestic and international.

*Net premium written.* Net premium written increased by \$181.0 million, or 6.6%, from \$2,738.6 million for the nine months ended September 30, 2017 to \$2,919.6 million for the nine months ended September 30, 2018. Net premium written for the P&C segment increased by \$104.4 million for the nine months ended September 30, 2018 compared to the same period in 2017, primarily as a result of organic growth (\$345.3 million), partially offset by premium ceded to the Quota Shares (\$236.6 million). Net premium written for the A&H segment increased by \$76.6 million for the nine months ended September 30, 2018 compared to the same period in 2017, as a result of organic growth, both domestic and international.

*Net earned premium.* Net earned premium increased by \$23.4 million, or 0.8%, from \$2,764.5 million for the nine months ended September 30, 2017 to \$2,788.0 million for the nine months ended September 30, 2018. The change by segment was: P&C decreased by \$42.5 million and A&H increased by \$65.9 million. The decrease in the P&C segment was attributable to increased ceded earned premium to the Quota Shares (\$414.0 million), with the third quarter of 2018 net earned premium being impacted by the additional cession, partially offset by organic growth (\$353.8 million) and growth in the Reciprocal Exchanges (\$17.7 million). The increase in the A&H segment was primarily due to organic growth, both domestic and international.

*Ceding commission income.* Ceding commission income increased by \$67.4 million, or 73.5%, from \$91.6 million for the nine months ended September 30, 2017 to \$159.0 million for the nine months ended September 30, 2018, primarily driven by an increase in P&C ceded earned premium.

*Service and fee income.* Service and fee income increased by \$41.7 million, or 11.2%, from \$373.6 million for the nine months ended September 30, 2017 to \$415.3 million for the nine months ended September 30, 2018. The increase was primarily attributable to our A&H segment (\$26.8 million), due to growth in our domestic business. Service and fee income is discussed in more detail in the segment discussions that follow.

The components of service and fee income are as follows:

	Nine Months Ended September 30,			
	2018	2017	Change	% Change
	<i>(amounts in thousands)</i>			
Commission revenue	\$ 119,737	\$ 118,357	\$ 1,380	1.2 %
Finance and processing fees	94,899	79,108	15,791	20.0 %
Installment fees	68,928	59,623	9,305	15.6 %
Group health administrative fees	57,461	45,619	11,842	26.0 %

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Late payment fees	24,429	20,872	3,557	17.0 %
Other service and fee income	49,859	50,065	(206 )	(0.4 )%
Total	\$415,313	\$373,644	\$41,669	11.2 %

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE decreased by \$7.4 million, from \$1,969.2 million for the nine months ended September 30, 2017 to \$1,961.8 million for the nine months ended September 30, 2018, reflecting losses ceded to the Quota Shares (\$261.2 million), partially offset by organic growth (\$216.2 million) and growth in the Reciprocal Exchanges (\$37.6 million). The changes by segment were: P&C - decreased by \$21.4 million and A&H - increased by \$14.0 million.

Loss and LAE for the nine months ended September 30, 2018 included \$36.4 million of favorable development on prior accident year loss and LAE reserves. This development was composed of \$11.8 million of favorable development in the P&C segment (including \$1.5 million of unfavorable development for the Reciprocal Exchanges) primarily driven by favorable development in our auto physical damage and homeowners products, and \$24.6 million of favorable development in the A&H segment. Loss and LAE for the nine months ended September 30, 2017 included \$4.4 million of favorable development on prior accident year loss and LAE reserves. This development was composed of \$5.7 million of unfavorable development in the P&C segment (including \$1.4 million of favorable development for the Reciprocal Exchanges) primarily driven by unfavorable development in our auto liability business, and \$10.1 million of favorable development in the A&H segment primarily driven by favorable development in our domestic products.

Our consolidated net loss ratio decreased from 71.2% for the nine months ended September 30, 2017 to 70.4% for the nine months ended September 30, 2018. Net loss ratio is discussed in more detail in the segment discussions that follow.

*Acquisition costs and other underwriting expenses.* Acquisition costs and other underwriting expenses increased by \$14.9 million, from \$527.1 million for the nine months ended September 30, 2017 to \$542.0 million for the nine months ended September 30, 2018, due to a decrease of \$9.5 million in the P&C segment offset by an increase of \$24.4 million in the A&H segment.

*General and administrative expenses.* General and administrative expenses increased by \$10.4 million, from \$680.8 million for the nine months ended September 30, 2017 to \$691.2 million for the nine months ended September 30, 2018, with a decrease of \$15.4 million in the P&C segment, partially offset by an increase of \$25.7 million in the A&H segment.

*Net operating expense; net operating expense ratio (non-GAAP).* Net operating expense decreased by \$83.7 million, or 11.3%, from \$742.7 million for the nine months ended September 30, 2017 to \$658.9 million for the nine months ended September 30, 2018, due to a decrease of \$107.1 million in the P&C segment, partially offset by an increase of \$23.4 million in the A&H segment. The decrease in the P&C segment was primarily driven by ceding commission revenue from the Quota Shares.

The consolidated net operating expense ratio decreased from 26.9% for the nine months ended September 30, 2017 to 23.6% for the nine months ended September 30, 2018. Excluding the Reciprocal Exchanges, the net operating expense ratio was 23.0% and 26.3% for the nine months ended September 30, 2018 and 2017, respectively. The Reciprocal Exchanges' net operating expense ratio was 36.2% and 38.2% for the nine months ended September 30, 2018 and 2017, respectively. Net operating expense and net operating expense ratio is discussed in more detail in the segment discussions that follow.

*Net gain (loss) on investments.* Net gain on investments decreased by \$66.8 million, from a \$44.0 million gain for the nine months ended September 30, 2017 to a \$22.8 million loss for the nine months ended September 30, 2018. The decrease was mainly attributable to sales from repositioning our debt securities portfolio.

**P&C Segment - Results of Operations for the Three Months Ended September 30, 2018 and 2017 (Unaudited)**

	Three Months Ended September 30, 2018				2017				
	NGHC	Reciprocal Exchanges	Eliminations	Total	NGHC	Reciprocal Exchanges	Eliminations	Total	
	<i>(amounts in thousands)</i>								
Gross premium written	\$ 1,090,372	\$ 121,351	\$ —	\$ 1,211,723	\$ 979,440	\$ 104,406	\$ (801 )	\$ 1,083,045	
Ceded premiums	(305,738 )	(106,537 )	—	(412,275 )	(511,616 )	(60,873 )	801	(571,688 )	
Net premium written	\$ 784,634	\$ 14,814	\$ —	\$ 799,448	\$ 467,824	\$ 43,533	\$ —	\$ 511,357	
Change in unearned premium	(43,604 )	28,337	—	(15,267 )	218,772	(1,555 )	—	217,217	
Net earned premium	\$ 741,030	\$ 43,151	\$ —	\$ 784,181	\$ 686,596	\$ 41,978	\$ —	\$ 728,574	
Ceding commission income	44,244	14,587	—	58,831	30,675	19,201	—	49,876	
Service and fee income	113,967	1,575	(19,310 )	96,232	100,565	4,084	(14,615 )	90,034	
Total underwriting revenues	\$ 899,241	\$ 59,313	\$ (19,310 )	\$ 939,244	\$ 817,836	\$ 65,263	\$ (14,615 )	\$ 868,484	
Underwriting expenses:									
Loss and loss adjustment expense	544,446	40,212	—	584,658	528,875	26,856	—	555,731	
Acquisition costs and other underwriting expenses	135,406	11,290	—	146,696	112,643	17,116	—	129,759	
General and administrative expenses	184,101	20,417	(19,310 )	185,208	171,460	18,819	(14,615 )	175,664	
Total underwriting expenses	\$ 863,953	\$ 71,919	\$ (19,310 )	\$ 916,562	\$ 812,978	\$ 62,791	\$ (14,615 )	\$ 861,154	
Underwriting income (loss)	\$ 35,288	\$ (12,606 )	\$ —	\$ 22,682	\$ 4,858	\$ 2,472	\$ —	\$ 7,330	
Net loss ratio	73.5	% 93.2	%	74.6	% 77.0	% 64.0	%	76.3	%
Net operating expense ratio (non-GAAP)	21.8	% 36.0	%	22.6	% 22.3	% 30.1	%	22.7	%
Net combined ratio (non-GAAP)	95.3	% 129.2	%	97.2	% 99.3	% 94.1	%	99.0	%

	Three Months Ended September 30, 2018				2017				
	NGHC	Reciprocal Exchanges	Eliminations	Total	NGHC	Reciprocal Exchanges	Eliminations	Total	
	<i>(amounts in thousands)</i>								
<i>Reconciliation of net operating expense ratio (non-GAAP):</i>									
Total underwriting expenses	\$ 863,953	\$ 71,919	\$ (19,310 )	\$ 916,562	\$ 812,978	\$ 62,791	\$ (14,615 )	\$ 861,154	
Less: Loss and loss adjustment expense	544,446	40,212	—	584,658	528,875	26,856	—	555,731	
Less: Ceding commission income	44,244	14,587	—	58,831	30,675	19,201	—	49,876	
Less: Service and fee income	113,967	1,575	(19,310 )	96,232	100,565	4,084	(14,615 )	90,034	
Net operating expense	\$ 161,296	\$ 15,545	\$ —	\$ 176,841	\$ 152,863	\$ 12,650	\$ —	\$ 165,513	
Net earned premium	\$ 741,030	\$ 43,151	\$ —	\$ 784,181	\$ 686,596	\$ 41,978	\$ —	\$ 728,574	
Net operating expense ratio (non-GAAP)	21.8	% 36.0	%	22.6	% 22.3	% 30.1	%	22.7	%

***P&C Segment - Results of Operations for the Nine Months Ended September 30, 2018 and 2017 (Unaudited)***

	Nine Months Ended September 30, 2018				2017				
	NGHC	Reciprocal Exchanges	Eliminations	Total	NGHC	Reciprocal Exchanges	Eliminations	Total	
	<i>(amounts in thousands)</i>								
Gross premium written	\$ 3,259,270	\$ 337,021	\$ (1,601 )	\$ 3,594,690	\$ 2,864,031	\$ 285,779	\$ (2,402 )	\$ 3,147,408	
Ceded premiums	(958,055 )	(204,781 )	1,601	(1,161,235 )	(671,461 )	(149,302 )	2,402	(818,361 )	
Net premium written	\$ 2,301,215	\$ 132,240	\$ —	\$ 2,433,455	\$ 2,192,570	\$ 136,477	\$ —	\$ 2,329,047	
Change in unearned premium	(119,644 )	8,769	—	(110,875 )	49,196	(13,211 )	—	35,985	
Net earned premium	\$ 2,181,571	\$ 141,009	\$ —	\$ 2,322,580	\$ 2,241,766	\$ 123,266	\$ —	\$ 2,365,032	
Ceding commission income	118,664	39,523	—	158,187	36,263	54,557	—	90,820	
Service and fee income	328,707	4,466	(52,446 )	280,727	298,674	7,658	(40,496 )	265,836	
Total underwriting revenues	\$ 2,628,942	\$ 184,998	\$ (52,446 )	\$ 2,761,494	\$ 2,576,703	\$ 185,481	\$ (40,496 )	\$ 2,721,688	
Underwriting expenses:									
Loss and loss adjustment expense	1,583,019	126,421	—	1,709,440	1,642,053	88,776	—	1,730,829	
Acquisition costs and other underwriting expenses	372,589	32,952	—	405,541	368,189	46,836	—	415,025	
General and administrative expenses	533,316	62,032	(52,446 )	542,902	536,353	62,431	(40,496 )	558,288	
Total underwriting expenses	\$ 2,488,924	\$ 221,405	\$ (52,446 )	\$ 2,657,883	\$ 2,546,595	\$ 198,043	\$ (40,496 )	\$ 2,704,142	
Underwriting income (loss)	\$ 140,018	\$ (36,407 )	\$ —	\$ 103,611	\$ 30,108	\$ (12,562 )	\$ —	\$ 17,546	
Net loss ratio	72.6	% 89.7	%	73.6	% 73.2	% 72.0	%	73.2	%
Net operating expense ratio (non-GAAP)	21.0	% 36.2	%	21.9	% 25.4	% 38.2	%	26.1	%
Net combined ratio (non-GAAP)	93.6	% 125.9	%	95.5	% 98.6	% 110.2	%	99.3	%

<i>Reconciliation of net operating expense ratio (non-GAAP):</i>	Nine Months Ended September 30, 2018				2017				
	NGHC	Reciprocal Exchanges	Eliminations	Total	NGHC	Reciprocal Exchanges	Eliminations	Total	
	<i>(amounts in thousands)</i>								
Total underwriting expenses	\$ 2,488,924	\$ 221,405	\$ (52,446 )	\$ 2,657,883	\$ 2,546,595	\$ 198,043	\$ (40,496 )	\$ 2,704,142	
Less: Loss and loss adjustment expense	1,583,019	126,421	—	1,709,440	1,642,053	88,776	—	1,730,829	
Less: Ceding commission income	118,664	39,523	—	158,187	36,263	54,557	—	90,820	
Less: Service and fee income	328,707	4,466	(52,446 )	280,727	298,674	7,658	(40,496 )	265,836	
Net operating expense	\$ 458,534	\$ 50,995	\$ —	\$ 509,529	\$ 569,605	\$ 47,052	\$ —	\$ 616,657	
Net earned premium	\$ 2,181,571	\$ 141,009	\$ —	\$ 2,322,580	\$ 2,241,766	\$ 123,266	\$ —	\$ 2,365,032	
Net operating expense ratio (non-GAAP)	21.0	% 36.2	%	21.9	% 25.4	% 38.2	%	26.1	%

***P&C Segment Results of Operations for the Three Months Ended September 30, 2018 Compared to the Three Months Ended September 30, 2017 (Unaudited)***

*Gross premium written.* Gross premium written increased by \$128.7 million, or 11.9%, from \$1,083.0 million for the three months ended September 30, 2017 to \$1,211.7 million for the three months ended September 30, 2018, as a result of organic growth (\$111.7 million) and growth in the Reciprocal Exchanges (\$16.9 million).

*Net premium written.* Net premium written increased by \$288.1 million, or 56.3%, from \$511.4 million for the three months ended September 30, 2017 to \$799.4 million for the three months ended September 30, 2018, primarily as a result of organic growth (\$111.8 million) and a decrease in ceded written premium to the Quota Shares (\$205.0 million), with the third quarter of 2017 net premium written being impacted by the unearned premium transfer.

*Net earned premium.* Net earned premium increased by \$55.6 million, or 7.6%, from \$728.6 million for the three months ended September 30, 2017 to \$784.2 million for the three months ended September 30, 2018, mainly attributable to organic growth (\$120.7 million), partially offset by premium ceded to the Quota Shares (\$66.3 million).



*Ceding commission income.* Ceding commission income increased by \$9.0 million, or 18.0%, from \$49.9 million for the three months ended September 30, 2017 to \$58.8 million for the three months ended September 30, 2018, primarily driven by an increase in ceded earned premium to the Quota Shares (\$16.0 million).

*Service and fee income.* Service and fee income increased by \$6.2 million, from \$90.0 million for the three months ended September 30, 2017 to \$96.2 million for the three months ended September 30, 2018.

The components of service and fee income are as follows:

	Three Months Ended September 30,			%
	2018	2017	Change	Change
	<i>(amounts in thousands)</i>			
Finance and processing fees	\$29,804	\$24,294	\$5,510	22.7 %
Commission revenue	25,404	24,454	\$950	3.9 %
Installment fees	23,841	20,938	2,903	13.9 %
Late payment fees	8,164	7,337	827	11.3 %
Other service and fee income	9,019	13,011	(3,992 )	(30.7)%
Total	\$96,232	\$90,034	\$6,198	6.9 %

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE increased by \$28.9 million, from \$555.7 million for the three months ended September 30, 2017 to \$584.7 million for the three months ended September 30, 2018, due to organic growth (\$57.2 million) and growth in the Reciprocal Exchanges (\$13.4 million), partially offset by losses ceded to the Quota Shares (\$41.6 million).

Our P&C segment net loss ratio, which includes the Reciprocal Exchanges, decreased from 76.3% for the three months ended September 30, 2017 to 74.6% for the three months ended September 30, 2018. Excluding the Reciprocal Exchanges, the net loss ratio was 73.5% and 77.0% for the three months ended September 30, 2018 and 2017, respectively. The Reciprocal Exchanges' net loss ratio was 93.2% and 64.0% for the three months ended September 30, 2018 and 2017, respectively.

*Acquisition costs and other underwriting expenses.* Acquisition costs and other underwriting expenses increased by \$16.9 million, or 13.1%, from \$129.8 million for the three months ended September 30, 2017 to \$146.7 million for the three months ended September 30, 2018, primarily as a result of organic growth (\$33.0 million), partially offset by the Quota Shares (\$10.2 million).

*General and administrative expenses.* General and administrative expenses increased by \$9.5 million, from \$175.7 million for the three months ended September 30, 2017 to \$185.2 million for the three months ended September 30, 2018.

*Net operating expense; net operating expense ratio (non-GAAP).* Net operating expense increased by \$11.3 million, from \$165.5 million for the three months ended September 30, 2017 to \$176.8 million for the three months ended September 30, 2018. Our P&C segment net operating expense ratio decreased from 22.7% for the three months ended September 30, 2017 to 22.6% for the three months ended September 30, 2018.

*Underwriting income; net combined ratio (non-GAAP).* Underwriting income increased from \$7.3 million for the three months ended September 30, 2017 to \$22.7 million for the three months ended September 30, 2018. Our P&C segment net combined ratio decreased from 99.0% for the three months ended September 30, 2017 to 97.2% for the three months ended September 30, 2018.



***P&C Segment Results of Operations for the Nine Months Ended September 30, 2018 Compared to the Nine Months Ended September 30, 2017 (Unaudited)***

*Gross premium written.* Gross premium written increased by \$447.3 million, or 14.2%, from \$3,147.4 million for the nine months ended September 30, 2017 to \$3,594.7 million for the nine months ended September 30, 2018, as a result of organic growth (\$396.0 million) and growth in the Reciprocal Exchanges (\$51.2 million).

*Net premium written.* Net premium written increased by \$104.4 million, or 4.5%, from \$2,329.0 million for the nine months ended September 30, 2017 to \$2,433.5 million for the nine months ended September 30, 2018, primarily as a result of organic growth (\$345.3 million), partially offset by premium ceded to the Quota Shares (\$236.6 million).

*Net earned premium.* Net earned premium decreased by \$42.5 million, or 1.8%, from \$2,365.0 million for the nine months ended September 30, 2017 to \$2,322.6 million for the nine months ended September 30, 2018, attributable to increased ceded earned premium to the Quota Shares (\$414.0 million), with the third quarter of 2018 net earned premium being impacted by the additional cession, partially offset by organic growth (\$353.8 million) and growth in the Reciprocal Exchanges (\$17.7 million).

*Ceding commission income.* Ceding commission income increased by \$67.4 million, or 74.2%, from \$90.8 million for the nine months ended September 30, 2017 to \$158.2 million for the nine months ended September 30, 2018, primarily driven by an increase in ceded earned premium to the Quota Shares (\$86.5 million).

*Service and fee income.* Service and fee income increased by \$14.9 million, from \$265.8 million for the nine months ended September 30, 2017 to \$280.7 million for the nine months ended September 30, 2018.

The components of service and fee income are as follows:

	Nine Months Ended September 30,			
	2018	2017	Change	% Change
	<i>(amounts in thousands)</i>			
Finance and processing fees	\$91,676	\$72,907	\$18,769	25.7 %
Installment fees	68,928	59,623	9,305	15.6 %
Commission revenue	68,547	74,215	(5,668 )	(7.6 )%
Late payment fees	24,360	20,775	3,585	17.3 %
Other service and fee income	27,216	38,316	(11,100 )	(29.0)%
Total	\$280,727	\$265,836	\$14,891	5.6 %

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE decreased by \$21.4 million, from \$1,730.8 million for the nine months ended September 30, 2017 to \$1,709.4 million for the nine months ended September 30, 2018, reflecting losses ceded to the Quota Shares (\$261.2 million), partially offset by organic growth (\$202.2 million) and growth in the Reciprocal Exchanges (\$37.6 million).

Our P&C segment net loss ratio, which includes the Reciprocal Exchanges, increased from 73.2% for the nine months ended September 30, 2017 to 73.6% for the nine months ended September 30, 2018. Excluding the Reciprocal Exchanges, the net loss ratio was 72.6% and 73.2% for the nine months ended September 30, 2018 and 2017, respectively. The Reciprocal Exchanges' net loss ratio was 89.7% and 72.0% for the nine months ended September 30, 2018 and 2017, respectively.

*Acquisition costs and other underwriting expenses.* Acquisition costs and other underwriting expenses decreased by

\$9.5 million, from \$415.0 million for the nine months ended September 30, 2017 to \$405.5 million for the nine months ended September 30, 2018.

*General and administrative expenses.* General and administrative expenses decreased by \$15.4 million, from \$558.3 million for the nine months ended September 30, 2017 to \$542.9 million for the nine months ended September 30, 2018. The decrease was primarily due to lower amortization of intangible assets in 2018.

*Net operating expense; net operating expense ratio (non-GAAP).* Net operating expense decreased by \$107.1 million, or 17.4%, from \$616.7 million for the nine months ended September 30, 2017 to \$509.5 million for the nine months ended September 30, 2018. Our P&C segment net operating expense ratio decreased from 26.1% for the nine months ended September 30, 2017 to 21.9% for the nine months ended September 30, 2018. Decreases in net operating expense and net operating expense ratio were primarily as a result of an increase in ceding commission revenue, service and fee income and lower amortization of intangible assets in 2018.

*Underwriting income; net combined ratio (non-GAAP).* Underwriting income increased by \$86.1 million, from \$17.5 million for the nine months ended September 30, 2017 to \$103.6 million for the nine months ended September 30, 2018. Our P&C segment net combined ratio decreased from 99.3% for the nine months ended September 30, 2017 to 95.5% for the nine months ended September 30, 2018. The increase in underwriting income and the decrease in net combined ratio were primarily as a result of an increase in ceding commission revenue, service and fee income and lower amortization of intangible assets in 2018.

**A&H Segment - Results of Operations for the Three and Nine Months Ended September 30, 2018 and 2017 (Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2018	2017	2018	2017	
	<i>(amounts in thousands)</i>				
Gross premium written	\$ 143,948	\$ 121,266	\$ 534,560	\$ 444,195	
Ceded premiums	(20,372 )	(11,069 )	(48,373 )	(34,635 )	
Net premium written	\$ 123,576	\$ 110,197	\$ 486,187	\$ 409,560	
Change in unearned premium	31,770	25,530	(20,796 )	(10,055 )	
Net earned premium	\$ 155,346	\$ 135,727	\$ 465,391	\$ 399,505	
Ceding commission income	269	226	789	784	
Service and fee income	46,458	32,492	134,586	107,808	
Total underwriting revenues	\$ 202,073	\$ 168,445	\$ 600,766	\$ 508,097	
Underwriting expenses:					
Loss and loss adjustment expense	72,652	83,414	252,364	238,327	
Acquisition costs and other underwriting expenses	44,774	33,826	136,499	112,075	
General and administrative expenses	50,525	38,463	148,265	122,518	
Total underwriting expenses	\$ 167,951	\$ 155,703	\$ 537,128	\$ 472,920	
Underwriting income	\$ 34,122	\$ 12,742	\$ 63,638	\$ 35,177	
Net loss ratio	46.8	% 61.5	% 54.2	% 59.7	%
Net operating expense ratio (non-GAAP)	31.3	% 29.2	% 32.1	% 31.5	%
Net combined ratio (non-GAAP)	78.1	% 90.7	% 86.3	% 91.2	%

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2018	2017	2018	2017	
	<i>(amounts in thousands)</i>				
<i>Reconciliation of net operating expense ratio (non-GAAP):</i>					
Total underwriting expenses	\$ 167,951	\$ 155,703	\$ 537,128	\$ 472,920	
Less: Loss and loss adjustment expense	72,652	83,414	252,364	238,327	
Less: Ceding commission income	269	226	789	784	
Less: Service and fee income	46,458	32,492	134,586	107,808	
Net operating expense	\$ 48,572	\$ 39,571	\$ 149,389	\$ 126,001	
Net earned premium	\$ 155,346	\$ 135,727	\$ 465,391	\$ 399,505	
Net operating expense ratio (non-GAAP)	31.3	% 29.2	% 32.1	% 31.5	%

**A&H Segment Results of Operations for the Three Months Ended September 30, 2018 Compared to the Three Months Ended September 30, 2017 (Unaudited)**

*Gross premium written.* Gross premium written increased by \$22.7 million, or 18.7%, from \$121.3 million for the three months ended September 30, 2017 to \$143.9 million for the three months ended September 30, 2018, primarily as a result of domestic organic growth.

*Net premium written.* Net premium written increased by \$13.4 million, or 12.1%, from \$110.2 million for the three months ended September 30, 2017 to \$123.6 million for the three months ended September 30, 2018, primarily as a result of domestic organic growth.

*Net earned premium.* Net earned premium increased by \$19.6 million, or 14.5%, from \$135.7 million for the three

months ended September 30, 2017 to \$155.3 million for the three months ended September 30, 2018, primarily as a result of domestic organic growth.

*Service and fee income.* Service and fee income increased by \$14.0 million, or 43.0%, from \$32.5 million for the three months ended September 30, 2017 to \$46.5 million for the three months ended September 30, 2018.

The components of service and fee income are as follows:

	Three Months Ended September 30,			
	2018	2017	Change	% Change
	<i>(amounts in thousands)</i>			
Group health administrative fees	\$18,364	\$15,611	\$2,753	17.6 %
Commission revenue	17,874	11,053	6,821	61.7 %
Finance and processing fees	935	1,896	(961)	(50.7)%
Late payment fees	19	29	(10)	(34.5)%
Other service and fee income	9,266	3,903	5,363	137.4 %
Total	\$46,458	\$32,492	\$13,966	43.0 %

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE decreased by \$10.8 million, or 12.9%, from \$83.4 million for the three months ended September 30, 2017 to \$72.7 million for the three months ended September 30, 2018. Our A&H net loss ratio decreased from 61.5% for the three months ended September 30, 2017 to 46.8% for the three months ended September 30, 2018. The loss ratio decrease was primarily as a result of favorable development on prior year loss.

*Acquisition costs and other underwriting expenses.* Acquisition costs and other underwriting expenses increased by \$10.9 million, or 32.4%, from \$33.8 million for the three months ended September 30, 2017 to \$44.8 million for the three months ended September 30, 2018, primarily from domestic organic growth.

*General and administrative expenses.* General and administrative expenses increased by \$12.1 million, or 31.4%, from \$38.5 million for the three months ended September 30, 2017 to \$50.5 million for the three months ended September 30, 2018.

*Net operating expense; net operating expense ratio (non-GAAP).* Net operating expense increased by \$9.0 million, or 22.7%, from \$39.6 million for the three months ended September 30, 2017 to \$48.6 million for the three months ended September 30, 2018. Our A&H net operating expense ratio increased from 29.2% for the three months ended September 30, 2017 to 31.3% for the three months ended September 30, 2018.

*Underwriting income; net combined ratio (non-GAAP).* Underwriting income increased from \$12.7 million for the three months ended September 30, 2017 to \$34.1 million for the three months ended September 30, 2018. Our A&H net combined ratio decreased from 90.7% for the three months ended September 30, 2017 to 78.1% for the three months ended September 30, 2018. The net combined ratio decrease was a result of a lower net loss ratio, partially offset by a higher net operating expense ratio.

***A&H Segment Results of Operations for the Nine Months Ended September 30, 2018 Compared to the Nine Months Ended September 30, 2017 (Unaudited)***

*Gross premium written.* Gross premium written increased by \$90.4 million, or 20.3%, from \$444.2 million for the nine months ended September 30, 2017 to \$534.6 million for the nine months ended September 30, 2018, as a result of organic growth, both domestic and international.



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*Net premium written.* Net premium written increased by \$76.6 million, or 18.7%, from \$409.6 million for the nine months ended September 30, 2017 to \$486.2 million for the nine months ended September 30, 2018, as a result of organic growth, both domestic and international.

*Net earned premium.* Net earned premium increased by \$65.9 million, or 16.5%, from \$399.5 million for the nine months ended September 30, 2017 to \$465.4 million for the nine months ended September 30, 2018, as a result of organic growth, both domestic and international.

*Service and fee income.* Service and fee income increased by \$26.8 million, or 24.8%, from \$107.8 million for the nine months ended September 30, 2017 to \$134.6 million for the nine months ended September 30, 2018, primarily due to growth in our domestic business.

The components of service and fee income are as follows:

	Nine Months Ended September 30,		Change	% Change
	2018	2017		
	<i>(amounts in thousands)</i>			
Group health administrative fees	\$57,461	\$45,619	\$11,842	26.0 %
Commission revenue	51,190	44,142	7,048	16.0 %
Finance and processing fees	3,223	6,201	(2,978 )	(48.0)%
Late payment fees	69	97	(28 )	(28.9)%
Other service and fee income	22,643	11,749	10,894	92.7 %
Total	\$134,586	\$107,808	\$26,778	24.8 %

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE increased by \$14.0 million, from \$238.3 million for the nine months ended September 30, 2017 to \$252.4 million for the nine months ended September 30, 2018. Our A&H net loss ratio decreased from 59.7% for the nine months ended September 30, 2017 to 54.2% for the nine months ended September 30, 2018. The loss ratio decrease was primarily as a result of domestic organic growth and favorable development on prior year loss.

*Acquisition costs and other underwriting expenses.* Acquisition costs and other underwriting expenses increased by \$24.4 million, or 21.8%, from \$112.1 million for the nine months ended September 30, 2017 to \$136.5 million for the nine months ended September 30, 2018, primarily from domestic organic growth.

*General and administrative expenses.* General and administrative expenses increased by \$25.7 million, or 21.0%, from \$122.5 million for the nine months ended September 30, 2017 to \$148.3 million for the nine months ended September 30, 2018.

*Net operating expense; net operating expense ratio (non-GAAP).* Net operating expense increased by \$23.4 million, or 18.6%, from \$126.0 million for the nine months ended September 30, 2017 to \$149.4 million for the nine months ended September 30, 2018. Our A&H net operating expense ratio increased from 31.5% for the nine months ended September 30, 2017 to 32.1% for the nine months ended September 30, 2018.

*Underwriting income; net combined ratio (non-GAAP).* Underwriting income increased from \$35.2 million for the nine months ended September 30, 2017 to \$63.6 million for the nine months ended September 30, 2018. Our A&H net combined ratio decreased from 91.2% for the nine months ended September 30, 2017 to 86.3% for the nine months ended September 30, 2018. The net combined ratio decrease was a result of a lower net loss ratio, partially offset by a higher net operating expense ratio.

## Investment Portfolio

Our investment strategy emphasizes, first, the preservation of capital and, second, maximization of an appropriate risk-adjusted return. We seek to maximize investment returns using investment guidelines that stress prudent allocation among cash and cash equivalents, debt securities and, to a lesser extent, equity securities. Cash and cash equivalents include cash on deposit, commercial paper, pooled short-term money market funds and certificates of deposit with an original maturity of 90 days or less. Our debt securities include obligations of the U.S. Treasury or U.S. government agencies, obligations of local and foreign governments, obligations of U.S. and Canadian corporations, mortgages guaranteed by the Federal National Mortgage Association, the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation, Federal Farm Credit entities, commercial mortgage obligations, and structured securities primarily consisting of collateralized loan and debt obligations. Our equity securities include common and preferred stock primarily of U.S. and Canadian corporations.

The average yield on our investment portfolio was 3.1% and 3.2% for the nine months ended September 30, 2018 and 2017, respectively, and the average duration of the portfolio was 4.2 and 3.9 years as of September 30, 2018 and 2017, respectively.

For more information related to our investments, see Note 4, “Investments” in the notes to our condensed consolidated financial statements.

## Liquidity and Capital Resources

We are organized as a holding company with twenty-one domestic insurance company subsidiaries and various foreign insurance and reinsurance subsidiaries, as well as various other non-insurance subsidiaries. Our principal sources of operating funds are premiums, service and fee income, investment income and proceeds from sales and maturities of investments. The primary sources of cash for the management companies of the Reciprocal Exchanges are management fees for acting as the attorneys-in-fact for the exchanges. Our primary uses of operating funds include payments of claims and operating expenses. Currently, we pay claims using cash flow from operations and invest our excess cash primarily in debt securities and, to a lesser extent, equity securities. Except as set forth below, we expect that projected cash flows from operations, as well as the net proceeds from our debt and equity issuances, will provide us with sufficient liquidity to fund our anticipated growth by providing capital to increase the surplus of our insurance subsidiaries, as well as to pay claims and operating expenses, and to pay interest and principal on debt and debt facilities and other holding company expenses for the foreseeable future. However, if our growth attributable to potential acquisitions, internally generated growth, or a combination of these factors, exceeds our expectations, we may have to raise additional capital. If we cannot obtain adequate capital on favorable terms or at all, we may be unable to support future growth or operating requirements and, as a result, our business, financial condition and results of operations could be adversely affected. To support our current and future policy writings, we have raised substantial capital using a combination of debt and equity, and entered into third party quota share reinsurance agreements. We may raise additional capital over the next twelve months or obtain additional capital support in the form of third party quota share reinsurance.

We may generate liquidity through the issuance of debt or equity securities or financing through borrowings under credit facilities, or a combination thereof. We also have a \$245.0 million credit agreement, under which there was \$160.0 million outstanding as of September 30, 2018. The proceeds of borrowings under the credit agreement may be used for working capital, acquisitions and general corporate purposes. See “Revolving Credit Agreement” below.

Our insurance subsidiaries are subject to statutory and regulatory restrictions imposed on insurance companies by their place of domicile which limit the amount of cash dividends or distributions that they may pay to us unless special

permission is received from the insurance regulator of the relevant domicile. The aggregate limit imposed by the various domiciliary regulatory authorities of our insurance subsidiaries was approximately \$353.8 million and \$387.6 million as of September 30, 2018 and December 31, 2017, respectively, taking into account dividends paid in the prior twelve month periods. During the nine months ended September 30, 2018 and 2017, there were \$90.8 million and \$339.4 million, respectively, of dividends or return of capital paid by our insurance subsidiaries to their parent company or to National General Holdings Corp.

We forecast claim payments based on our historical experience. We seek to manage the funding of claim payments by actively managing available cash and forecasting cash flows on both a short-term and long-term basis. Cash payments for claims were \$1.8 billion and \$1.8 billion in the nine months ended September 30, 2018 and 2017, respectively. Historically, we have funded claim payments from cash flow from operations (principally premiums), net of amounts ceded to our third-party reinsurers. We

presently expect to maintain sufficient cash flow from operations to meet our anticipated claim obligations and operating and capital expenditure needs. Our cash and cash equivalents (including restricted cash) and total investments were \$4.3 billion at September 30, 2018 and \$4.0 billion at December 31, 2017. We do not anticipate selling securities in our investment portfolio to pay claims or to fund operating expenses. Should circumstances arise that would require us to do so, we may incur losses on such sales, which would adversely affect our results of operations and financial condition and could reduce investment income in future periods.

Pursuant to a tax allocation agreement by and among us and certain of our direct and indirect subsidiaries, we compute and pay federal income taxes on a consolidated basis. Each subsidiary party to this agreement computes and pays to us its respective share of the federal income tax liability primarily based on separate return calculations.

The following table is a summary of our statement of cash flows:

	Nine Months Ended September 30,			
	2018	2017	Change	% Change
	<i>(amounts in thousands)</i>			
Net cash provided by operating activities	\$460,074	\$290,231	\$169,843	58.5 %
Net cash used in investing activities	(324,681 )	(134,779 )	(189,902 )	140.9 %
Net cash used in financing activities	(46,867 )	(28,435 )	(18,432 )	64.8 %
Effect of exchange rate changes on cash and cash equivalents	(11,080 )	5,938	(17,018 )	nm
Net increase in cash, cash equivalents, and restricted cash	\$77,446	\$132,955	\$(55,509 )	(41.8 )%
nm - not meaningful				

***Comparison of the Nine Months Ended September 30, 2018 and 2017***

Net cash provided by operating activities increased by \$169.8 million, primarily due to higher net income.

Net cash used in investing activities increased by \$189.9 million, primarily reflecting an increase of \$198.2 million in purchases of investments, net of proceeds from sales.

Net cash used in financing activities increased by \$18.4 million, primarily reflecting a decrease of \$47.6 million in proceeds received from debt, net of repayments, partially offset by \$29.9 million in proceeds from issuance of preferred stock.

## Condensed Consolidated Balance Sheets

September 30, 2018

	NGHC	Reciprocal Exchanges	Eliminations	Total
<b>ASSETS</b>				
<b>Investments:</b>				
Debt securities, available-for-sale, at fair value	\$3,006,615	\$311,482	\$—	\$3,318,097
Equity securities, at fair value	40,891	—	—	40,891
Short-term investments	168,592	8,855	—	177,447
Other investments	428,378	—	(101,279 )	327,099
<b>Total investments</b>	<b>3,644,476</b>	<b>320,337</b>	<b>(101,279 )</b>	<b>3,863,534</b>
Cash and cash equivalents	394,991	79	—	395,070
Restricted cash and cash equivalents	39,676	184	—	39,860
Accrued investment income	43,428	2,309	(22,908 )	22,829
Premiums and other receivables, net	1,398,843	64,090	(1,601 )	1,461,332
Deferred acquisition costs	230,215	19,277	—	249,492
Reinsurance recoverable	1,412,251	114,789	—	1,527,040
Prepaid reinsurance premiums	538,770	141,984	—	680,754
Premises and equipment, net	295,719	2,261	—	297,980
Intangible assets, net	379,652	3,550	—	383,202
Goodwill	183,984	—	—	183,984
Prepaid and other assets	135,508	8,503	—	144,011
<b>Total assets</b>	<b>\$8,697,513</b>	<b>\$677,363</b>	<b>\$(125,788 )</b>	<b>\$9,249,088</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>				
<b>Liabilities:</b>				
Unpaid loss and loss adjustment expense reserves	\$2,679,190	\$175,945	\$—	\$2,855,135
Unearned premiums and other revenue	2,067,437	264,418	—	2,331,855
Reinsurance payable	594,460	62,833	(1,601 )	655,692
Accounts payable and accrued expenses	460,498	27,299	(22,908 )	464,889
Debt	675,263	101,279	(101,279 )	675,263
Other liabilities	163,731	59,544	—	223,275
<b>Total liabilities</b>	<b>\$6,640,579</b>	<b>\$691,318</b>	<b>\$(125,788 )</b>	<b>\$7,206,109</b>
<b>Stockholders' equity:</b>				
Common stock	\$1,071	\$—	\$—	\$1,071
Preferred stock	450,000	—	—	450,000
Additional paid-in capital	923,124	—	—	923,124
Accumulated other comprehensive loss	(68,581 )	—	—	(68,581 )
Retained earnings	751,320	—	—	751,320
<b>Total National General Holdings Corp. Stockholders' Equity</b>	<b>2,056,934</b>	<b>—</b>	<b>—</b>	<b>2,056,934</b>
Non-controlling interest	—	(13,955 )	—	(13,955 )
<b>Total stockholders' equity</b>	<b>\$2,056,934</b>	<b>\$(13,955 )</b>	<b>\$—</b>	<b>\$2,042,979</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$8,697,513</b>	<b>\$677,363</b>	<b>\$(125,788 )</b>	<b>\$9,249,088</b>

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December 31, 2017

	NGHC	Reciprocal Exchanges	Eliminations	Total
<b>ASSETS</b>				
<b>Investments:</b>				
Debt securities, available-for-sale, at fair value	\$2,834,955	\$ 304,934	\$ —	\$3,139,889
Equity securities, at fair value	50,341	—	—	50,341
Short-term investments	15,987	22,279	—	38,266
Other investments	510,447	—	(89,155 )	421,292
<b>Total investments</b>	<b>3,411,730</b>	<b>327,213</b>	<b>(89,155 )</b>	<b>3,649,788</b>
Cash and cash equivalents	286,840	5,442	—	292,282
Restricted cash and cash equivalents	64,593	609	—	65,202
Accrued investment income	36,422	1,805	(15,855 )	22,372
Premiums and other receivables, net	1,268,330	56,792	(801 )	1,324,321
Deferred acquisition costs	195,552	20,837	—	216,389
Reinsurance recoverable	1,199,961	94,204	—	1,294,165
Prepaid reinsurance premiums	416,142	100,980	—	517,122
Premises and equipment, net	319,780	4,269	—	324,049
Intangible assets, net	400,385	3,685	—	404,070
Goodwill	174,153	—	—	174,153
Prepaid and other assets	153,567	2,263	—	155,830
<b>Total assets</b>	<b>\$7,927,455</b>	<b>\$ 618,099</b>	<b>\$(105,811 )</b>	<b>\$8,439,743</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>				
<b>Liabilities:</b>				
Unpaid loss and loss adjustment expense reserves	\$2,520,204	\$ 143,353	\$ —	\$2,663,557
Unearned premiums and other revenue	1,807,210	225,395	—	2,032,605
Reinsurance payable	329,772	69,076	(801 )	398,047
Accounts payable and accrued expenses	423,054	24,682	(15,855 )	431,881
Debt	713,710	89,155	(89,155 )	713,710
Other liabilities	204,936	41,582	—	246,518
<b>Total liabilities</b>	<b>\$5,998,886</b>	<b>\$ 593,243</b>	<b>\$(105,811 )</b>	<b>\$6,486,318</b>
<b>Stockholders' equity:</b>				
Common stock	\$1,067	\$ —	\$ —	\$1,067
Preferred stock	420,000	—	—	420,000
Additional paid-in capital	917,751	—	—	917,751
Accumulated other comprehensive loss	(8,112 )	—	—	(8,112 )
Retained earnings	597,863	—	—	597,863
<b>Total National General Holdings Corp. Stockholders' Equity</b>	<b>1,928,569</b>	<b>—</b>	<b>—</b>	<b>1,928,569</b>
Non-controlling interest	—	24,856	—	24,856
<b>Total stockholders' equity</b>	<b>\$1,928,569</b>	<b>\$ 24,856</b>	<b>\$ —</b>	<b>\$1,953,425</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$7,927,455</b>	<b>\$ 618,099</b>	<b>\$(105,811 )</b>	<b>\$8,439,743</b>

**Other Material Changes in Financial Position**

	September 30, 2018	December 31, 2017	Change	% Change
<i>(amounts in thousands)</i>				
Selected Assets:				
Premiums and other receivables, net	\$1,461,332	\$1,324,321	\$137,011	10.3 %
Reinsurance recoverable	1,527,040	1,294,165	232,875	18.0 %
Selected Liabilities:				
Unearned premiums and other revenue	\$2,331,855	\$2,032,605	\$299,250	14.7 %

***Changes in Financial Position During the Nine Months Ended September 30, 2018 Compared to December 31, 2017***

Premiums and other receivables increased by \$137.0 million, driven by growth in our P&C segment (\$145.4 million) and A&H segment (\$18.0 million), offset by a decline in unsettled purchases of securities (\$26.4 million).

Reinsurance recoverable increased by \$232.9 million, driven by growth in our P&C segment (\$224.2 million) and A&H segment (\$8.7 million). Unearned premiums and other revenue increased by \$299.3 million, driven by growth in our P&C segment (\$305.1 million), offset by our A&H segment (\$5.8 million).

**Reinsurance**

Our insurance subsidiaries utilize reinsurance agreements to transfer portions of the underlying risk of the business we write to various affiliated and third-party reinsurance companies. Reinsurance does not discharge or diminish our obligation to pay claims covered by the insurance policies we issue; however, it does permit us to recover certain incurred losses from our reinsurers and our reinsurance recoveries reduce the maximum loss that we may incur as a result of a covered loss event. We believe it is important to ensure that our reinsurance partners are financially strong and they generally carry at least an A.M. Best rating of “A-” (Excellent) or are fully collateralized at the time we enter into our reinsurance agreements. We also enter into reinsurance relationships with third-party captives formed by agents as a mechanism for sharing risk and profit. The total amount, cost and limits relating to the reinsurance coverage we purchase may vary from year to year based upon a variety of factors, including the availability of quality reinsurance at an acceptable price and the level of risk that we choose to retain for our own account.

We assume and cede insurance risks under various reinsurance agreements, on both a pro rata basis and an excess of loss basis. We purchase reinsurance to mitigate the volatility of direct and assumed business, which may be caused by the aggregate value or the concentration of written exposures in a particular geographic area or business segment and may arise from catastrophes or other events. As part of our overall risk and capacity management strategy, we purchase various quota share, excess of loss catastrophic and casualty reinsurance for protection against catastrophic events and other large losses.

For more information on our reinsurance agreements, refer to our Annual Report on Form 10-K for the year ended December 31, 2017, and Note 8, “Reinsurance” in the notes to our condensed consolidated financial statements.



## Debt

### 7.625% Subordinated Notes due 2055

We have \$100.0 million aggregate principal amount outstanding of our 7.625% subordinated notes due 2055 (the “7.625% Notes”). The 7.625% Notes bear interest at a rate equal to 7.625% per year, payable quarterly in arrears on March 15, June 15, September 15 and December 15 of each year. The 7.625% Notes are our subordinated unsecured obligations and are structurally subordinated to all existing and future indebtedness, liabilities and other obligations of our subsidiaries. The 7.625% Notes mature on September 15, 2055, unless earlier redeemed or purchased by us. Interest expense on the 7.625% Notes for the three months ended September 30, 2018 and 2017, was \$1.9 million and \$1.9 million, respectively. Interest expense on the 7.625% Notes for the nine months ended September 30, 2018 and 2017, was \$5.7 million and \$5.7 million, respectively. For more information on the 7.625% Notes, including ranking and restrictive covenants, see Note 9, “Debt” in the notes to our condensed consolidated financial statements.

### 6.75% Notes due 2024

We have \$350.0 million aggregate principal amount outstanding of our 6.75% Notes due 2024 (the “6.75% Notes”). The 6.75% Notes bear interest at a rate equal to 6.75% per year, payable semiannually in arrears on May 15 and November 15 of each year. The 6.75% Notes are our general unsecured obligations and rank equally in right of payment with our other existing and future senior unsecured indebtedness and senior in right of payment to any of our indebtedness that is contractually subordinated to the 6.75% Notes. The 6.75% Notes mature on May 15, 2024, unless earlier redeemed or purchased by us. Interest expense on the 6.75% Notes for the three months ended September 30, 2018 and 2017, was \$5.9 million and \$6.0 million, respectively. Interest expense on the 6.75% Notes for the nine months ended September 30, 2018 and 2017, was \$17.7 million and \$17.7 million, respectively. For more information on the 6.75% Notes, including ranking and restrictive covenants, see Note 9, “Debt” in the notes to our condensed consolidated financial statements.

### Subordinated Debentures

Our subsidiary, Direct General Corporation, is the issuer of junior subordinated debentures (the “Subordinated Debentures”) relating to an issuance of trust preferred securities. The Subordinated Debentures require interest-only payments to be made on a quarterly basis, with principal due at maturity. The Subordinated Debentures’ principal amounts of \$41.2 million and \$30.9 million mature on 2035 and 2037, respectively, and bear interest at an annual rate equal to LIBOR plus 3.40% and LIBOR plus 4.25%, respectively. The Subordinated Debentures are redeemable by us at a redemption price equal to 100% of their principal amount. Interest expense on the Subordinated Debentures for the three months ended September 30, 2018 and 2017, was \$1.1 million and \$0.9 million, respectively. Interest expense on the Subordinated Debentures for the nine months ended September 30, 2018 and 2017, was \$3.2 million and \$2.8 million, respectively.

## Revolving Credit Agreement

On January 25, 2016, we entered into a credit agreement (the “Credit Agreement”), among JPMorgan Chase Bank, N.A., as Administrative Agent, KeyBank National Association as Syndication Agent, and Associated Bank, National Association and First Niagara Bank, N.A., as Co-Documentation Agents, and the various lending institutions party thereto. The credit facility is a \$245.0 million base revolving credit facility with a letter of credit sublimit of \$112.5 million and an expansion feature not to exceed \$50.0 million. Proceeds of borrowings under the Credit Agreement may be used for working capital, acquisitions and general corporate purposes. The Credit Agreement has a maturity date of January 25, 2020.

Borrowings under the Credit Agreement bear interest at either the Alternate Base Rate (“ABR”) or LIBOR. ABR borrowings (which are borrowings bearing interest at a rate determined by reference to the ABR) under the Credit Agreement will bear interest at the greatest of (a) the prime rate in effect on such day, (b) the federal funds effective rate on such day plus 0.5 percent or (c) the adjusted LIBOR for a one-month interest period on such day plus 1.0 percent. Eurodollar borrowings under the Credit Agreement will bear interest at the adjusted LIBOR for the interest period in effect. Fees payable by us under the Credit Agreement include a letter of credit participation fee (the margin applicable to Eurodollar borrowings), a letter of credit fronting fee with respect to each letter of credit (0.125%) and a commitment fee on the available commitments of the lenders (a range of 0.20% to 0.30% based on our consolidated leverage ratio, and which rate was 0.25% as of September 30, 2018).

As of September 30, 2018, there was \$160.0 million outstanding under the Credit Agreement. The weighted average interest rate on the amount outstanding as of September 30, 2018 was 4.50%. Interest payments are due the last day of the interest period in intervals of three months duration, commencing on the date of such borrowing. Interest expense on the Credit Agreement for the three months ended September 30, 2018 and 2017 was \$2.0 million and \$1.3 million, respectively. Interest expense on the Credit Agreement for the nine months ended September 30, 2018 and 2017 was \$5.7 million and \$2.9 million, respectively. For more information on the Credit Agreement, including ranking and restrictive covenants, see Note 9, “Debt” in the notes to our condensed consolidated financial statements.

## Preferred Stock

We have four separate series (Series A through D) of preferred stock outstanding. Two of these series (Series B and C) were issued in offerings using depository shares. Dividends on the Series A, B and C are payable on the liquidation preference amount, on a non-cumulative basis, when, as and if declared by the Company’s Board of Directors, quarterly in arrears on the 15th day of January, April, July and October of each year. Dividends on the Series D are payable on the liquidation preference amount, on a non-cumulative basis, when, as and if declared by the Company’s Board of Directors, semi-annually in arrears on the 15th day of January and July of each year, commencing on January 15, 2019. On or after July 15, 2023 (or in the event of a fundamental change of us, at any time), the Series D Preferred Stock may be converted at the holder’s option into shares of our common stock.

A summary description of the terms of these series of preferred stock is presented in the table below:

Series	Dividend rate per year	Shares of Preferred Stock issued	Depository shares issued	Liquidation preference per share	Aggregate liquidation preference	Net proceeds	Dividends paid during the nine months ended September 30, 2018
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(amounts in thousands)

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A	7.50	%	2,200,000	—	\$ 25	\$55,000	\$53,164	\$ 3,093
B	7.50	%	165,000	6,600,000	\$ 1,000	\$165,000	\$159,802	\$ 9,282
C	7.50	%	200,000	8,000,000	\$ 1,000	\$200,000	\$193,518	\$ 11,250
D	Fixed/ Floating <sup>(1)</sup>		120	—	\$ 250,000	\$30,000	\$29,890	\$ —

<sup>(1)</sup> Dividend rate is fixed at 7.00% prior to July 15, 2023 and floating at six-month LIBOR plus 5.4941% thereafter.

For more information on our preferred stock, refer to our Annual Report on Form 10-K for the year ended December 31, 2017, and Note 11, “Stockholders' Equity” in the notes to our condensed consolidated financial statements.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

*Liquidity Risk.* Liquidity risk represents our potential inability to meet all payment obligations when they become due. We maintain sufficient cash and marketable securities to fund claim payments and operations. We purchase reinsurance coverage to mitigate the risk of an unexpected rise in claims severity or frequency from catastrophic events or a single large loss. The availability, amount and cost of reinsurance depend on market conditions and may vary significantly.

*Credit Risk.* Credit risk is the potential loss arising principally from adverse changes in the financial condition of the issuers of our debt securities and the financial condition of our reinsurers.

We address the credit risk related to the issuers of our debt securities by investing primarily in debt securities that are rated “BBB-” or higher by Standard & Poor’s. We also independently monitor the financial condition of all issuers of our debt securities. To limit our risk exposure, we employ diversification policies that limit the credit exposure to any single issuer or business sector.

We are subject to credit risk with respect to our reinsurers. Although our reinsurers are obligated to reimburse us to the extent we cede risk to them, we are ultimately liable to our policyholders on all risks we have ceded. As a result, reinsurance contracts do not limit our ultimate obligations to pay claims covered under the insurance policies we issue and we might not collect amounts recoverable from our reinsurers. We address this credit risk by selecting reinsurers that generally carry at least an A.M. Best rating of “A-” (Excellent) or are fully collateralized at the time we enter into the agreement and by performing, along with our reinsurance broker, periodic credit reviews of our reinsurers. If one of our reinsurers suffers a credit downgrade, we may consider various options to lessen the risk of asset impairment, including commutation, novation and letters of credit. See Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Reinsurance.”

*Market Risk.* Market risk is the risk of potential economic loss principally arising from adverse changes in the fair value of financial instruments. The major components of market risk affecting us are interest rate risk and equity price risk.

*Interest Rate Risk.* We had debt securities and preferred stock securities with a fair value of \$3.3 billion as of September 30, 2018 that are subject to interest rate risk. Interest rate risk is the risk that we may incur losses due to adverse changes in interest rates. Fluctuations in interest rates have a direct impact on the market valuation of our debt securities. We manage our exposure to interest rate risk through a disciplined asset and liability matching and capital management process. In the management of this risk, the characteristics of duration, credit and variability of cash flows are critical elements. These risks are assessed regularly and balanced within the context of our liability and capital position.

The table below summarizes the interest rate risk by illustrating the sensitivity of the fair value and carrying value of our debt securities as of September 30, 2018 to selected hypothetical changes in interest rates, and the associated impact on our stockholders’ equity. We anticipate that we will continue to meet our obligations out of income. We classify our debt securities primarily as available for sale. Temporary changes in the fair value of our debt securities impact the carrying value of these securities and are reported in our stockholders’ equity as a component of accumulated other comprehensive income, net of taxes.

The selected scenarios with our debt securities (and excluding \$0.5 million of preferred stock securities), in the table below are not predictions of future events, but rather are intended to illustrate the effect such events may have on the fair value and carrying value of our debt securities and on our stockholders’ equity, each as of September 30, 2018.

Hypothetical Change in Interest Rates    Fair Value    Estimated

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	Change in Fair Value	Hypothetical Percentage Increase (Decrease) in Stockholders' Equity
	<i>(amounts in thousands)</i>	
200 basis point increase	\$3,027,830	\$(290,267) (11.2 )%
100 basis point increase	3,172,930	(145,167 ) (5.6 )
No change	3,318,097	— —
100 basis point decrease	3,462,401	144,304 5.6
200 basis point decrease	3,606,473	288,376 11.2

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Changes in interest rates would affect the fair market value of our fixed-rate debt instruments but would not have an impact on our earnings or cash flow. We currently have \$682.2 million principal amount of debt instruments of which \$450.0 million are fixed-rate debt instruments. A fluctuation of 100 basis points in interest on our variable-rate debt instruments, which are tied to LIBOR, would affect our earnings and cash flows by \$2.3 million before income tax, on an annual basis, but would not affect the fair market value of the variable-rate debt.

*Off-Balance Sheet Risk.* As of September 30, 2018 we did not have any off-balance sheet arrangements that have or are likely to have a material effect on our financial condition or results of operations.

## **Item 4. Controls and Procedures**

### **Disclosure Controls and Procedures**

Our management, with the participation and under the supervision of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective in ensuring that information required to be disclosed by us in the reports we file or submit under the Exchange Act is timely recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

### **Changes in Internal Controls Over Financial Reporting**

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

We are routinely involved in legal proceedings arising in the ordinary course of business, in particular in connection with claims adjudication with respect to our policies. We believe we have recorded adequate reserves for these liabilities and that there is no individual case pending that is likely to have a material adverse effect on our financial condition or results of operations.

### Item 1A. Risk Factors

Except as set forth below, there have been no material changes to the Risk Factors described in Part I “Item 1A. Risk Factors” in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017 as filed with the SEC.

*The effects of regulatory inquiries and litigation relating to our collateral protection insurance business are uncertain and could have an adverse effect on us and our business.*

We have been and continue to be subject to inquiries by regulatory and government agencies and class action litigation concerning matters arising from our collateral protection insurance business with Wells Fargo. Although we believe that our actions have at all times been in compliance with applicable requirements and that we have a meritorious defense in the litigation pending against us, there can be no assurance as to the ultimate outcome of these matters and we may be subject to fines, penalties or damages. Additionally, negative publicity relating to these claims, or unfavorable outcomes in these matters, could adversely affect our business and results of operations and damage our reputation.

### Item 6. Exhibits

#### INDEX TO EXHIBITS

The following documents are filed as exhibits to this report:

Exhibit No.	Description
3.1	<u>Certificate of Designations of Fixed/Floating Rate Non-Cumulative Convertible Preferred Stock, Series D (incorporated by reference to Exhibit 3.1 to the Company’s Current Report on Form 8-K filed on July 9, 2018)</u>
31.1	<u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u>
31.2	<u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u>
32.1	<u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)</u>
32.2	<u>Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)</u>
101.INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document (filed herewith)



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- 101.SCH XBRL Taxonomy Extension Schema Document (filed herewith)
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document (filed herewith)
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document (filed herewith)
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document (filed herewith)
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document (filed herewith)

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**NATIONAL GENERAL  
HOLDINGS CORP.**

October 30, 2018

By: /s/ Barry Karfunkel  
Name: Barry Karfunkel  
Title: Chief Executive Officer  
*(Principal Executive Officer)*

By: /s/ Michael Weiner  
Name: Michael Weiner  
Title: Chief Financial Officer  
*(Principal Financial Officer)*