National General Holdings Corp.
Form 10-K
February 25, 2019
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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**FORM 10-K**

**x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the Fiscal Year Ended December 31, 2018**
**OR**
**o 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** |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| **59 Maiden Lane, 38th Floor, New York, New York** | **10038** |
| (Address of Principal Executive Offices) | (Zip Code) |

**(212) 380-9500**
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

| **Title of Each Class** | **Name of Each Exchange on Which Registered** |
|---|---|
| Common Stock, par value $0.01 per share | The Nasdaq Stock Market LLC |
| 7.50% Non-Cumulative Preferred Stock, Series A | The Nasdaq Stock Market LLC |
| Depositary Shares, each Representing 1/40th of a Share of 7.50% Non-Cumulative Preferred Stock, Series B | The Nasdaq Stock Market LLC |
| Depositary Shares, each Representing 1/40th of a Share of 7.50% Non-Cumulative Preferred Stock, Series C | The Nasdaq Stock Market LLC |
| 7.625% Subordinated Notes due 2055 | The Nasdaq Stock Market LLC |

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

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

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

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 x No o

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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 x | Accelerated Filer o |
| Non-Accelerated Filer o | Smaller Reporting Company o |
| | Emerging Growth Company o |

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. o

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

As of June 29, 2018, the last business day of the registrant's most recently completed second quarter, the aggregate market value of the common stock held by non-affiliates was $1,569,279,980. As of February 20, 2019, the number of common shares of the registrant outstanding was 112,952,595.

Documents incorporated by reference: Portions of the Proxy Statement for the 2019 Annual Meeting of Shareholders of the Registrant to be filed subsequently with the SEC are incorporated by reference into Part III of this report.

**NATIONAL GENERAL HOLDINGS CORP.**
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**PART I**

**Note on Forward-Looking Statements**

*This Form 10-K 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, 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 vendors or third party agencies, 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" in this Annual Report on Form 10-K. 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.*

**Item 1. Business**

**Legal Organization**

National General Holdings Corp., a Delaware corporation, is a specialty personal lines insurance holding company. References to “National General,” “the Company,” “we,” “us” or “our” in this Annual Report on Form 10-K and in other statements and information publicly disseminated by National General Holdings Corp. refer to National General Holdings Corp. and all of its consolidated subsidiaries unless the context requires otherwise.

**Business Overview**

We are a specialty personal lines insurance holding company that, through our subsidiaries, provides 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.

Our automobile insurance products protect our customers against losses due to physical damage to their motor vehicles, bodily injury and liability to others for personal injury or property damage arising from auto accidents. Our homeowners and umbrella insurance products protect our customers against losses to dwellings and their contents from a variety of perils, as well as coverage for personal liability. We offer our property and casualty (“P&C”) insurance products through a network of approximately 31,270 independent agents, a number of affinity partners and through direct-response marketing programs and retail storefronts. We have approximately 4.1 million P&C policyholders.

Our accident and health (“A&H”) business provides accident and health insurance products not subject to the Patient Protection and Affordable Care Act (“PPACA”) and targets uninsured or underinsured individuals and employers who are interested in an alternative to PPACA-compliant major medical coverage or who are looking for supplemental insurance options to help cover out of pocket costs. We market our and other carriers’ A&H insurance products through a multi-pronged distribution platform that includes a network of over 49,900 independent agents, our in-house agencies, direct-to-consumer marketing, wholesaling, worksite marketing and the internet.

We are licensed to operate in 50 states and the District of Columbia, but focus on niche markets. Approximately 76.1% of our P&C premium written is originated in ten core states: North Carolina, California, New York, Florida, Texas, New Jersey, Virginia, Louisiana, Michigan and Alabama.

For the years ended December 31, 2018, 2017 and 2016, our gross premium written was $5,417 million, $4,756 million and $3,501 million, net premium written was $3,828 million, $3,578 million and $3,073 million and total consolidated revenues were $4,608 million, $4,422 million and $3,569 million, respectively.

Our company was formed in 2009 to acquire the private passenger auto business of the U.S. consumer property and casualty insurance segment of General Motors Acceptance Corporation (“GMAC,” now known as Ally Financial Inc.), which operations date back to 1939. We acquired this business on March 1, 2010.

Our wholly-owned subsidiaries include twenty-one regulated domestic insurance companies, of which nineteen write primarily P&C insurance and two write A&H insurance. Our insurance subsidiaries have an “A-” (Excellent) 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 and Sweden.

Two of our wholly-owned subsidiaries that we acquired in 2014 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.

**Business Segments**

We are a specialty national carrier with regional focuses. We manage our business through two segments:

- **Property and Casualty -** Our P&C segment operates its business through three primary distribution channels: agency, affinity and direct. Our agency channel focuses primarily on writing standard, preferred and nonstandard auto coverage and homeowners and umbrella coverage through our network of approximately 31,270 independent agents. In our affinity channel, we partner with a number of affinity groups and membership organizations to deliver insurance products tailored to the needs of our affinity partners' members or customers under our affinity partners' brand name or label, which we refer to as selling on a "white label" basis. A primary focus of a number of our affinity relationships is providing recreational vehicle coverage, of which we believe we are one of the top writers in the U.S. Our direct channel is operated through approximately 460 store fronts, web/mobile, phone sales centers and kiosks. In addition, we operate our lender-placed services through long-term distribution agreements with certain mortgage lenders.
- **Accident and Health -** Our A&H segment provides accident and non-major medical health insurance products targeting our existing policyholders and uninsured or underinsured individuals. Through a number of acquisitions of both carriers and general agencies, including VelaPoint, LLC, our call center general agency ("Velapoint"), National Health Insurance Company, a life and health insurance carrier ("NHIC"), Euro Accident Health & Care Insurance Aktiebolag, our European group life and health insurance managing general agent ("EHC"), Quotit Corporation, an application service provider for health insurance, HealthCompare Insurance Services, Inc., a call center agency, Healthcare Solutions Team, LLC, a healthcare insurance managing general agency ("HST"), and North Star Marketing Corporation, a proprietary small group sales channel, we have assembled a multi-pronged distribution platform that includes direct-to-consumer marketing through our call center agency, selling through approximately 49,900 independent agents, wholesaling insurance products through large general agencies/program managers and, through our affinity relationships, worksite marketing through employers and the internet.

**P&C Segment**

**Distribution and Marketing**

***Agency Distribution Channel***

Our agency channel focuses on writing automobile insurance, including standard, preferred and nonstandard insurance, as well as preferred homeowners and umbrella insurance, through independent insurance agents and brokers. We have established a broad geographic presence throughout the United States and have a significant market presence in our ten largest states, namely North Carolina, California, New York, Florida, Texas, New Jersey, Virginia, Louisiana, Michigan and Alabama.

*Relationships with our Independent Agents.* We have built a strong network of approximately 31,270 independent insurance agents and brokers and provide them with competitive compensation, a user-friendly technology platform and superior service. In order to provide quick and responsive service to our agents, we operate an agency customer service call center staffed by experienced and highly-trained employees. Our focus on building and maintaining a strong agency network has created an effective variable cost distribution platform and is integral to the long-term success of our agency channel.

*Our North Carolina Business.* We are the largest writer of nonstandard auto insurance sold through independent agents in North Carolina, with over 50% market share. For the year ended December 31, 2018, in North Carolina, we generated $729.4 million of gross premium written.

The North Carolina nonstandard auto insurance market is serviced by a small number of carriers with most liability insurance ceded to the state-controlled North Carolina Reinsurance Facility, the NCRF. We are not subject to any underwriting liability risk on the NCRF business written because losses are incurred by the NCRF. As a servicing carrier

to the state facility, we receive a ceding commission from the NCRF to help offset operating expenses for providing the coverage to North Carolina residents.

***Affinity Distribution Channel***

Through the affinity distribution channel of our P&C insurance business we are a leader in affinity marketing and have been in operation since 1953, relying on best-in-class marketing strategies and analytics to maximize the value of our longstanding relationships. Our affinity relationships are generally long-term in nature. In general, an affinity partner relationship consists of a partnership agreement between a sponsoring organization and an insurance company entered into to address the specific insurance needs of the sponsor organization's members or customers. Through the affinity relationship, the insurance company receives an endorsement that positions it favorably among the sponsoring organizations' members or customers. In exchange for the endorsement, the affinity customer receives access to a quality insurer, advantageous pricing and customized products. A primary focus of our affinity channel is to provide recreational vehicle, or RV, insurance, of which we believe we are one of the largest writers in the U.S.

***Direct Distribution Channel***

Through our acquisition of Direct General Corporation ("Direct General") in 2016, we obtained a direct distribution channel that primarily sells nonstandard auto policies. Our direct channel includes approximately 460 retail store fronts, web/mobile capabilities, phone contact centers and kiosks. The diversity of the channel supports growth through changing customer preferences, and gives National General a foothold in the industry's fastest growing channel. Local retail stores placed in high traffic areas are central to the omni-channel strategy, and are a key component to the marketing and brand awareness efforts in our direct distribution channel. The omni-channel approach also creates a seamless customer experience, regardless of the channel or device that is used.

***Lender-placed Insurance Business***

We offer lender-placed insurance products and related services to mortgage lenders and servicers ("LPI Business").

**P&C Product Overview**

In our P&C segment, we operate in niche businesses and offer a broad range of products employing multiple channels of distribution. Through our agency channel, we primarily sell nonstandard automobile insurance through independent agents and brokers and also offer standard and preferred auto, motorcycle, small business vehicle, homeowners and umbrella products. Through our affinity channel, we primarily underwrite and market standard and preferred auto and RV insurance.

- **Standard and preferred automobile insurance**. These policies provide coverage designed for drivers with greater financial resources and a less risky driving and claims history and have higher renewal retention than nonstandard policies.
- **Nonstandard automobile insurance**. These policies provide coverage for liability and physical damage and are designed for drivers who represent a higher-than-normal level of risk as a result of several factors, including their driving record, limited driving experience and claims history, among other factors, and consequently their premiums are generally higher than those for drivers who qualify for standard or preferred coverage.
- **Homeowners insurance**. Our homeowners policies are generally multiple-peril policies, providing property and liability coverages for one- and two-family, owner-occupied residences. We also offer additional personal umbrella coverage to the homeowner.
- **Recreational vehicle insurance**. Unlike many of our competitors, our policies carry RV-specific endorsements tailored to these vehicles, including automatic personal effects coverage, optional replacement cost coverage, RV

storage coverage and full-time liability coverage. We also bundle coverage for RVs and passenger cars in a single policy for which the customer is billed on a combined statement.

- **Small business automobile insurance**. These policies include liability and physical damage coverage for light-to-medium duty commercial vehicles, focused on artisan vehicles, with an average of two vehicles per policy.

- **Motorcycle insurance**. We provide coverage for most types of motorcycles, as well as golf carts and all-terrain vehicles. Our policy coverage offers flexibility to permit the customer to select the type (e.g., liability) and limit of insurance (e.g., $100,000/$250,000/$500,000), and to include other risks, such as add-on equipment and towing.
- **Lender-placed insurance**. Through the lender-placed insurance platform, we offer a full suite of lender-placed insurance products to customers, including fire, home and flood products, as well as collateral protection insurance and guaranteed asset protection products for automobiles.

**Fee Income**

In addition to traditional insurance premiums, we generate revenue by charging policy service fees to policyholders. These fees include service fees for installment or renewal policies and fees for insufficient funds, late payments, cancellations and various financial responsibility filing fees. The fee income we generate varies depending on the type of policy and state regulations. For the year ended December 31, 2018, our P&C segment generated $375.6 million in revenue from policy service fees.

**P&C Gross Premium Written by State**

We are licensed to operate in 50 states and the District of Columbia. For the year ended December 31, 2018 our top ten states represented 76.1% of our gross premium written. The following table sets forth the distribution of our P&C gross premium written by state as a percent of total gross premium written:

| | Year Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | 2016 | | | |
| | *(amounts in thousands, except percentages)* | | | | | | | |
| North Carolina | $729,426 | 15.5 % | $633,948 | 15.2 % | $483,504 | 15.9 % | | |
| California | 720,284 | 15.3 % | 635,020 | 15.2 % | 545,233 | 18.0 % | | |
| New York | 694,736 | 14.7 % | 617,270 | 14.8 % | 493,486 | 16.2 % | | |
| Florida | 499,430 | 10.6 % | 515,723 | 12.4 % | 262,937 | 8.7 % | | |
| Texas | 218,410 | 4.6 % | 201,776 | 4.8 % | 143,711 | 4.7 % | | |
| New Jersey | 174,234 | 3.7 % | 156,035 | 3.7 % | 125,731 | 4.1 % | | |
| Virginia | 148,806 | 3.2 % | 135,479 | 3.2 % | 97,328 | 3.2 % | | |
| Louisiana | 142,483 | 3.0 % | 139,893 | 3.4 % | 125,550 | 4.1 % | | |
| Michigan | 139,642 | 3.0 % | 116,195 | 2.8 % | 104,963 | 3.5 % | | |
| Alabama | 119,462 | 2.5 % | 95,661 | 2.3 % | 54,305 | 1.8 % | | |
| Other States | 1,131,817 | 23.9 % | 927,583 | 22.2 % | 600,140 | 19.8 % | | |
| Total | $4,718,730 | 100.0 % | $4,174,583 | 100.0 % | $3,036,888 | 100.0 % | | |

**Underwriting and Claims Management Philosophy**

We believe that proactive and prompt claims management is essential to reducing losses and lowering loss adjustment expenses ("LAE") and enables us to more effectively and accurately measure reserves. To this end, we utilize our technology and extensive database of loss history in order to appropriately price and structure policies, maintain lower levels of loss, enhance our ability to accurately predict losses, and maintain lower claims costs. We believe that a strong underwriting foundation is best accomplished through careful risk selection and continuous evaluation of underwriting guidelines relative to loss experience. We are committed to a consistent and thorough review of new underwriting opportunities as well as our portfolio and product mix as a whole.

**Underwriting, Pricing and Risk Management, and Actuarial Capabilities**

We establish premium rates for insurance products based upon an analysis of expected losses using historical experience and anticipated future trends. Our product team develops the product and manages our underwriting tolerances. By utilizing a detailed actuarial analysis our actuarial team establishes the necessary rate level for a given product and territory to achieve our targeted return. For risks which fall within our underwriting tolerances, we establish a price by matching a rate to a risk at a detailed level of segmentation. We determine the individual risk using predictive modeling developed by our analytics team with a level of precision that we believe is superior to the traditional loss cost pricing used by many of our competitors. We believe that effective collaboration among the product, analytics and actuarial teams enhances our ability to price risks appropriately and achieve our targeted rates of return.

Our actuarial group is central to the pricing and risk management process. The group carries out a number of functions including developing, tracking, and reporting on accident year loss results, monitoring and addressing national, state and channel-specific profit trends and establishing actuarial rate level needs and indications. Our actuarial group also helps ensure the integrity of reported accident year results.

To assist us in profitably underwriting our P&C products, our predictive analytics team has developed our RAD underwriting pricing tool. The RAD underwriting pricing tool offers significant advantages over our prior pricing tools by employing numerous additional components and pricing strategies such as supplemental risk and improved credit modeling. We believe the RAD underwriting pricing tool facilitates better pricing over the lifetime of a policy by employing lifetime value modeling, elasticity modeling and optimized pricing. We believe that our RAD underwriting pricing tool provides us with competitive advantage for pricing our products relative to other auto insurers of our size.

**Claims**

Claims can be submitted by telephone, email or smartphone app by policyholders, producers or other parties directly to our claims department. Upon notification of a claim, our claims call center creates a loss notice based on policy information in our claims system, EPIC. The claim is then automatically assigned to a claim handler and to a field adjuster for a vehicle inspection, if necessary. An initial reserve is established based on the type and location of the exposure and data from actuarial tables. A notice to the adjuster is automatically generated immediately after a claim has been assigned. The claim handler’s manager receives a status assignment within 24 hours to ensure the claim is being investigated in a timely manner. The claim handler evaluates coverage and loss participants and investigates the loss. If the claim represents a loss exceeding $50,000, the claim handler will establish a case-specific reserve based on the potential exposure. Claims with potential losses exceeding $100,000 are referred to the large loss unit and handled by employees specially trained to handle these claims. Every claims employee is granted authority to reserve and pay up to a specified claim level. If the potential claim amount exceeds the employee’s authority level, the request is automatically forwarded through EPIC to the manager with the appropriate authority level. As part of the investigation, claim handlers contact the parties to the loss and complete their investigations. Claim handlers record all investigation activities in EPIC, which are reviewed periodically by the managers in the department to ensure proper claims handling. Once the claim investigation has been completed, the claim handler works to close the claim as soon as possible. As of December 31, 2018, our Claims department includes approximately 2,580 individuals.

We carefully monitor our claim performance to ensure efficient handling. Management teams perform weekly reviews of open and aged claim reports. Through a combination of peer reviews, supervisor audits and monthly management information system reports, we have established an efficient mechanism designed to maintain and improve our level of claim handling performance.

6

**Competition**

The property and casualty insurance market in the United States is highly competitive. We believe that our primary competition comes not only from national companies or their subsidiaries, such as The Progressive Corporation, The Allstate Corporation, The Travelers Companies, Inc., The Hanover Insurance Group, Inc., Selective Insurance Group, Inc., State Farm Mutual Automobile Insurance Company, Farmers Insurance Group, Assurant, Inc. and GEICO, but also from nonstandard auto focused insurers such as Mercury General Corporation, Kemper Corporation and independent agents that operate in a specific region or single state in which we operate. See Item 1A, “Risk Factors - Risks Relating to Our Insurance Operations - *The insurance industry is highly competitive, and we may not be able to compete effectively against larger companies.*”

We rely heavily on technology and extensive data gathering and analysis to segment markets and price accurately according to risk potential. We have remained competitive by refining our risk measurement and price segmentation skills, closely managing expenses, and achieving operating efficiencies. Superior customer service and fair and accurate claims adjusting are also important factors in our competitive strategy. With our policy administration system and our advanced underwriting pricing tools, we believe we will continue to operate well in the competitive environment.

**P&C Acquisitions**

Since we acquired our P&C insurance business, we have made several acquisitions and entered into a number of renewal rights transactions. These additional operations have increased our presence in our target markets and broadened our distribution capabilities. We believe that merger and acquisition transactions and their effective integration represent a core competency and provide continued growth opportunities. For details of the impact of these acquisitions in our results of operations, see Item 7.

Effective July 1, 2017, we entered into an auto quota share agreement, pursuant to which we cede 15.0% of net liability under our auto policies to an unaffiliated third-party reinsurance provider. Under the auto quota share agreement, we retain the flexibility, under certain conditions, to increase the cession percentage up to a maximum cession of 30.0% and to decrease the cession percentage to a minimum cession of 10.0% during 2018 and 5.0% during 2019. Effective January 1, 2019, we cede 7.0% of net liability under new and renewal auto policies written on or after January 1, 2019.

Effective July 1, 2017, we entered into a homeowners quota share agreement, pursuant to which we ceded 29.6% of net liability under homeowners policies to unaffiliated third-party reinsurance providers. Under the homeowners quota share agreement, 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. See Note 10, “Reinsurance” in the notes to our Consolidated Financial Statements.

**A&H Segment**

Our A&H segment provides supplemental accident and health insurance products. One of the keys to our overall strategy revolves around distribution. We have multiple ways to reach the consumer through established channels, including:

- directly to the consumer through our in-house general agency;

- through independent agents;
- wholesaling through other general agents and Managing General Underwriters (“MGUs”); and
- through employers in the worksite.

We believe that our A&H distribution is unique because it is not driven by “company stores” - outlets that only sell products underwritten by us. In the markets where we choose not to underwrite, such as traditional individual and group fully insured major medical, we still sell these products on behalf of third-party carriers, allowing us to match

consumers' needs, whether it's a product underwritten by us or a third-party carrier. This one-stop shopping element makes our distribution outlets attractive for both consumers and agents and enables us to promote our supplemental/ancillary products in a single sale environment.

Our product focus in our A&H segment is offering economical and quality alternatives to the traditional group and individual insurance markets. A significant portion of the market has challenges in obtaining health insurance that balances depth of coverage with affordability. We believe we are uniquely positioned to offer greater value to our consumers because of our far-reaching distribution and focused product portfolio.

Our products fall into three broad categories: (1) supplemental/ancillary healthcare policies that mitigate exposure to high out-of-pocket costs with some major medical policies; (2) specialty accident policies and short term individual major medical policies specifically not subject to the PPACA for consumers seeking an alternative to more traditional forms of major medical insurance; and (3) self-insurance programs for small employers to assist employers who find self-insurance to be a more cost effective solution to the group healthcare needs.

**A&H Product Overview**

We focus on products that help individuals and employers address the ever increasing affordability challenges in healthcare. Our products include those packaged with other coverages or services to enhance the overall value proposition to the consumer, as well as standalone products. Target products for groups (through employers) and individuals include:

- **Accident/AD&D**. This coverage pays a stated benefit to the insured or his/her beneficiary in the event of bodily injury or death due to accidental means (other than natural causes). These policies can serve as supplemental policies underneath high deductible major medical plans that help reduce out of pocket expenses for consumers that result from unexpected events.
- **Hospital Indemnity**. These plans provide a fixed benefit amount for specific healthcare services (e.g. office visits, hospital stays, diagnostic care, etc.) with no deductibles or copays. They are designed for individuals who are looking for coverage that reduces out of pocket costs not covered by major medical coverage.
- **Short-Term Medical**. These plans can bridge the timing gap between the annual open enrollment periods (when traditional major medical insurance is available), and offers individuals financial protection for certain unexpected medical bills and other health care expenses (e.g. office visits, emergency, care, hospital stays, etc.). These plans have prescribed policy durations; typically durations cannot exceed 12 months and in many states cannot exceed three months.
- **Cancer/Critical Illness**. Critical illness policies provide benefits when specific diseases are first diagnosed. These benefits are paid to the individual directly, who can use them to pay for other out of pocket costs that may arise. This coverage can be sold on a guarantee and simplified issue (health questionnaire) basis either as a standalone product or packaged with other products.
- **Stop Loss**. Increases in health insurance costs in the group fully insured market has caused an increase in the number of employers offering self-insured plans. NHIC offers a wide array of stop loss programs together with self-insured program administration for small and large employers, as permitted by state law.
- **Dental**. These policies provide basic dental coverage and can be sold on a stand-alone basis or packaged with other products. They are frequently matched with discount plans and/or dental networks.

**Ratings**

Financial strength ratings are an important factor in establishing the competitive position of insurance companies and are important to our ability to market and sell our products. Rating organizations continually review the financial positions of insurers, including us. A.M. Best has currently assigned our insurance subsidiaries a rating of "A-"

(Excellent). According to A.M. Best, “A-” ratings are assigned to insurers that have an excellent ability to meet their ongoing financial obligations to policyholders. This rating reflects A.M. Best’s opinion of our ability to pay claims and is not an evaluation directed to investors regarding an investment in our common stock. This rating is subject to periodic review by, and may be revised downward or revoked at the sole discretion of, A.M. Best. There can be no assurance that we will maintain our current ratings. Future changes to our rating may adversely affect our competitive

position. See Item 1A, “Risk Factors - Risks Relating to our Business - *A downgrade in the A.M. Best rating of our insurance subsidiaries would likely reduce the amount of business we are able to write and could materially adversely impact the competitive positions of our insurance subsidiaries.*”

**Loss Reserves**

We record loss reserves for estimated losses under the insurance policies that we write and for LAE 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.

The process of establishing the liability for unpaid losses and loss adjustment expenses is complex and imprecise as it must take into consideration many variables that are subject to the outcome of future events. As a result, informed subjective estimates and judgments as to our ultimate exposure to losses are an important component of our loss reserving process.

Loss reserves include statistical reserves and case estimates for individual claims that have been reported and estimates for claims that have been incurred but not reported at the balance sheet date as well as estimates of the expenses associated with processing and settling all reported and unreported claims, less estimates of anticipated salvage and subrogation recoveries. Estimates are based upon past loss experience modified for current trends as well as economic, legal and social conditions. Loss reserves, except life reserves, are not discounted to present value, which would involve recognizing the time value of money and offsetting estimates of future payments by future expected investment income.

Incurred-but-not-reported (“IBNR”) reserve estimates are generally calculated by first projecting the ultimate cost of all claims that have occurred and then subtracting reported losses and loss expenses. Reported losses include cumulative paid losses and loss expenses plus case reserves. The IBNR reserve includes a provision for claims that have occurred but have not yet been reported, some of which are not yet known to the insured, as well as a provision for future development on reported claims.

We regularly review our loss reserves using a variety of actuarial methods and available information. We update the reserve estimates as historical loss experience develops, additional claims are reported and settled or as new information becomes available. Any changes in estimates are reflected in financial results in the period in which the estimates are changed.

Our actuarial review may include an actual to expected loss analysis or more detailed reserve indications for segments with changes, as well as the actuary’s reasonable reserve range compared to carried reserves. We review available actuarial indications and review carried reserves compared to the reasonable reserve range to determine whether any reserve adjustments are warranted.

Our internal actuarial analysis of the historical data provides the factors we use in our actuarial analysis in estimating our loss and LAE reserves. These factors are implicit measures over time of claims reported, average case incurred amounts, case development, severity and payment patterns. However, these factors cannot be directly used as they do not take into consideration changes in business mix, claims management, regulatory issues, medical trends, and other subjective factors. We generally use a combination of actuarial factors and subjective assumptions in the development of up to seven of the following actuarial methodologies:

- Paid Development Method - uses historical, cumulative paid losses by accident year and develops those actual losses to estimated ultimate losses based upon the assumption that each accident year will develop to estimated ultimate cost

in a manner that is analogous to prior years.

- Paid Generalized Cape Cod Method - combines the Paid Development Method with the expected loss method, where the expected loss ratios are estimated from exposure and claims experience weighted across multiple accident periods. The selected expected loss ratio for a given accident year is derived by giving some weight to all of the accident years in the experience history rather than treating each accident year independently.

- Paid Bornhuetter-Ferguson Method - a combination of the Paid Development Method and the Expected Loss Method, the Paid Bornhuetter-Ferguson Method estimates ultimate losses by adding actual paid losses and projected future unpaid losses. The amounts produced are then added to cumulative paid losses to produce the final estimates of ultimate incurred losses.
- Incurred Development Method - uses historical, cumulative incurred losses by accident year and develops those actual losses to estimated ultimate losses based upon the assumption that each accident year will develop to estimated ultimate cost in a manner that is analogous to prior years.
- Incurred Generalized Cape Cod Method - combines the Incurred Development Method with the expected loss method, where the expected loss ratios are estimated from exposure and claims experience weighted across multiple accident periods. The selected expected loss ratio for a given accident year is derived by giving some weight to all of the accident years in the experience history rather than treating each accident year independently.
- Incurred Bornhuetter-Ferguson Method - a combination of the Incurred Development Method and the Expected Loss Method, the Incurred Bornhuetter-Ferguson Method estimates ultimate losses by adding actual incurred losses and projected future unreported losses. The amounts produced are then added to cumulative incurred losses to produce an estimate of ultimate incurred losses.
- Expected Loss Method - utilizes an expected ultimate loss ratio based on historical experience adjusted for trends multiplied by earned premium to project ultimate losses.

For each method, losses are projected to the ultimate amount to be paid. We then analyze the results and may emphasize or deemphasize some or all of the outcomes to reflect actuarial judgment regarding their reasonableness in relation to supplementary information and operational and industry changes. These outcomes are then aggregated to produce a single selected point estimate that is the basis for the internal actuary's point estimate for loss reserves.

In determining the level of emphasis that may be placed on some or all of the methods, internal actuaries periodically review statistical information as to which methods are most appropriate, whether adjustments are appropriate within the particular methods, and if results produced by each method include inherent bias reflecting operational and industry changes.

This supplementary information may include:

- open and closed claim counts;
- statistics related to open and closed claim count percentages;
- claim closure rates;
- changes in average case reserves and average loss and loss adjustment expenses incurred on open claims;
- reported and ultimate average case incurred changes;
- reported and projected ultimate loss ratios; and
- loss payment patterns.

When reviewing reserves, we analyze historical data and estimate the impact of numerous factors such as (1) individual claim information; (2) industry and the historical loss experience; (3) legislative enactments, judicial decisions, legal developments in the imposition of damages, and changes in political attitudes; and (4) trends in general economic conditions, including the effects of inflation. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of reserves, because the eventual deficiency or redundancy is affected by multiple factors. The key assumptions we use in our determination of appropriate reserve levels include the underlying actuarial methodologies, consideration of pricing and underwriting initiatives, an evaluation of reinsurance costs and retention levels, and consideration of any claims handling impact on paid and incurred loss data trends embedded in the traditional actuarial methods.

With respect to estimating ultimate losses and LAE, the key assumptions remained consistent for the years ended December 31, 2018, 2017 and 2016 and our approach in establishing such assumptions remained consistent for newly underwritten lines. If circumstances bear out our assumptions, losses incurred in 2018 should develop similarly to losses incurred in 2017 and prior years. Thus, if for example, the net loss ratio for auto insurance premiums written in a given accident year is 65.0%, we expect that the net loss ratio for auto insurance premiums written in that same accident year

evolving in Year 2 would also be 65.0%. However, due to the inherent uncertainty in the loss development factors, our actual liabilities may differ significantly from our original estimates.

See Note 9, “Unpaid Losses and Loss Adjustment Expense Reserves” for more information about short-duration insurance contracts and claims development tables in the notes to our Consolidated Financial Statements.

**Technology**

We rely heavily on technology and extensive data gathering and analysis to evaluate and price our products accurately according to risk exposure. In order to provide our policyholders and producers with superior service and realize profitable growth, we have substantially upgraded our information technology capabilities in recent years. In September 2017, we acquired ownership of our personal lines policy administration system (“NPS”) and the related intellectual property from AmTrust Financial Services, Inc. (“AmTrust”), which we previously licensed from them for a licensing fee, for a purchase price of $200 million. The purchase price is payable in three equal payments, 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 NPS to our operating environment and the 18-month anniversary of the agreement in accordance with the terms of the agreement. NPS is based on advanced server-based technology allowing quicker processing and the ability for enhanced scalability. This system reduced cost by eliminating our three costly legacy mainframe based systems and allows for increased straight-through automated processing, removing the need for expensive back office processes as well as providing enhanced self-service functionality. Since inception, we have reduced our information technology operating expenses significantly. Our goal is to continue to make strategic investments in technology in order to develop sophisticated tools that enhance our customer service, product management and data analysis capabilities.

Our RAD underwriting pricing tool accurately prices specific risk exposures to assist us in profitably underwriting our P&C products. Our RAD technology offers significant advantages over our prior underwriting pricing system by employing numerous additional components and pricing strategies such as supplemental risk and improved credit modeling. We believe the RAD underwriting pricing tool will facilitate better pricing over the lifetime of a policy by employing lifetime value modeling, elasticity modeling and optimized pricing.

In our lender-placed insurance business, we use a proprietary insurance-tracking system to monitor the customers’ mortgage portfolios to verify the continuation of insurance coverage on each mortgaged property. We believe we can leverage our technology expertise to operate the business under a more efficient cost structure.

**Regulation**

**General**

We are subject to extensive regulation in the United States and to a lesser extent in Bermuda and Sweden. As of December 31, 2018, we had twenty-one operating insurance subsidiaries domiciled in the United States: 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. We currently conduct a limited amount of business outside the United States, primarily in

Bermuda and Sweden.

**State Insurance Regulation**

Insurance companies are subject to regulation and supervision by the department of insurance in the jurisdiction in which they are domiciled and, to a lesser extent, other jurisdictions in which they are authorized to conduct business.

The primary purpose of such regulatory powers is to protect individual policyholders. State insurance authorities have broad regulatory, supervisory and administrative powers, including, among other things, the power to (a) grant and revoke licenses to transact business, including individual lines of authority, (b) set the standards of solvency to be met and maintained, (c) determine the nature of, and limitations on, investments and dividends, (d) approve policy rules, rates and forms prior to issuance, (e) regulate and conduct specific examinations regarding marketing, unfair trade, claims and fraud prevention and investigation practices, and (f) conduct periodic comprehensive examinations of the financial condition of insurance companies domiciled in their state.

*Financial Oversight*

*Reporting Requirements*

Our insurance subsidiaries are required to file detailed financial statements prepared in accordance with statutory accounting principles and other reports with the departments of insurance in all states in which they are licensed to transact business. These reports include details concerning claims reserves held by the insurer, specific investments held by the insurer, and numerous other disclosures about the insurer's financial condition and operations. These financial statements are subject to periodic examination by the department of insurance in each state in which they are filed.

*Investments*

State insurance laws and insurance departments also regulate investments that insurers are permitted to make. Limitations are placed on the amounts an insurer may invest in a particular issuer, as well as the aggregate amount an insurer may invest in certain types of investments. Certain investments (such as real estate) are prohibited by certain jurisdictions.

Each of our domiciliary states has its own regulations and limitations on the amounts an insurer may invest in a particular issuer and the aggregate amount an insurer may invest in certain types of investments. In general, investments may not exceed a certain percentage of surplus, admitted assets or total investments. For example, the investments of Integon National, domiciled in North Carolina, in stocks shall not exceed twenty-five percent of Integon National's admitted assets and the stock of any one corporation may not exceed three percent of its admitted assets. To ensure compliance in each state, we review our investment portfolio quarterly based on each states regulations and limitations.

*State Insurance Department Examinations*

As part of their regulatory oversight process, state insurance departments conduct periodic detailed financial examinations of insurance companies domiciled in their states, generally once every three to five years. Examinations are generally carried out in cooperation with the insurance departments of other states under guidelines promulgated by the National Association of Insurance Commissioners ("NAIC"). A second type of regulatory oversight examination of insurance companies involves a review by an insurance department of an authorized company's market conduct, which entails a review and examination of a company's compliance with laws governing marketing, underwriting, rating, policy-issuance, claims-handling and other aspects of its insurance business during a specified period of time.

The results of these examinations can give rise to regulatory orders requiring remedial, injunctive or other corrective action on the part of the company that is the subject of the examination or assessing fines or other penalties against that company.

*Risk-Based Capital Regulations*

Our insurance subsidiaries are required to report their risk-based capital based on a formula developed and adopted by the NAIC that attempts to measure statutory capital and surplus needs based on the risks in the insurer's mix of products and investment portfolio. The formula is designed to allow insurance regulators to identify weakly-capitalized companies. Under the formula, a company determines its "risk-based capital" by taking into account certain risks related to the insurer's assets (including risks related to its investment portfolio and ceded reinsurance) and the insurer's

liabilities (including underwriting risks related to the nature and experience of its insurance business). The departments of insurance in our domiciliary states generally require a minimum total adjusted risk-based capital equal to 200% of an insurance company's authorized control level risk-based capital. Each of our insurance subsidiaries had total adjusted risk-based capital substantially in excess of 200% of the authorized control level as of December 31, 2018.

*Insurance Regulatory Information System Ratios*

The NAIC Insurance Regulatory Information System, or IRIS, is part of a collection of analytical tools designed to provide state insurance regulators with an integrated approach to screening and analyzing the financial condition of insurance companies operating in their respective states. IRIS is intended to assist state insurance regulators in targeting resources to those insurers in greatest need of regulatory attention. IRIS consists of two phases: statistical and analytical. In the statistical phase, the NAIC database generates key financial ratio results based on financial information obtained from insurers' annual statutory statements. The analytical phase is a review of the annual statements, financial ratios and other automated solvency tools. The primary goal of the analytical phase is to identify companies that appear to require immediate regulatory attention. A ratio result falling outside the usual range of IRIS ratios is not considered a failing result; rather, unusual values are viewed as part of the regulatory early monitoring system. Furthermore, in some years, it may not be unusual for financially sound companies to have several ratios with results outside the usual ranges. An insurance company may fall out of the usual range for one or more ratios because of specific transactions that are in themselves immaterial or because of certain reinsurance or pooling structures or changes in such structures.

Management does not anticipate regulatory action as a result of the 2018 IRIS ratio results for our U.S. Insurance Subsidiaries. In all instances in prior years, regulators have been satisfied upon any follow-up that no regulatory action was required.

*Statutory Accounting Principles*

Statutory accounting principles, or SAP, are a basis of accounting developed to assist insurance regulators in monitoring and regulating the solvency of insurance companies. SAP is primarily concerned with measuring an insurer's solvency. Statutory accounting focuses on valuing assets and liabilities of insurers at financial reporting dates in accordance with appropriate insurance law and regulatory provisions applicable in each insurer's domiciliary state.

Generally accepted accounting principles, or GAAP, like SAP, is concerned with a company's solvency, but it is also concerned with other financial measurements, principally income and cash flows. Accordingly, GAAP gives more consideration to appropriately matching revenue and expenses and accounting for management's stewardship of assets than does SAP. As a direct result, different assets and liabilities and different amounts of assets and liabilities will be reflected in financial statements prepared in accordance with GAAP as compared to SAP.

*Credit for Reinsurance*

State insurance laws permit U.S. insurance companies, as ceding insurers, to take financial statement credit for reinsurance that is ceded, so long as the assuming reinsurer satisfies the state's credit for reinsurance laws. The Nonadmitted and Reinsurance Reform Act ("NRRA") contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") provides that if the state of domicile of a ceding insurer is an NAIC accredited state, or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and recognizes credit for reinsurance for the insurer's ceded risk, then no other state may deny such credit for reinsurance. Because all states are currently accredited by the NAIC, the Dodd-Frank Act prohibits a state in which a U.S. ceding insurer is licensed but not domiciled from denying credit for reinsurance for the insurer's ceded risk if the cedant's

domestic state regulator recognizes credit for reinsurance. The ceding company in this instance is permitted to reflect in its statutory financial statements a credit in an aggregate amount equal to the ceding company's liability for unearned premium (which are that portion of premiums written which applies to the unexpired portion of the policy period), loss reserves and loss expense reserves to the extent ceded to the reinsurer.

**Holding Company Regulation**

We qualify as a holding company system under state-enacted legislation that regulates insurance holding company systems. Each insurance company in a holding company system is required to register with the insurance regulatory agency of its state of domicile and periodically furnish information concerning its operations and transactions, particularly with other companies within the holding company system that may materially affect its operations, management or financial condition.

*Transactions with Affiliates*

The insurance laws in most of those states provide that all transactions among members of an insurance holding company system must be fair and reasonable. These laws require disclosure of material transactions within the holding company system and, in some cases, prior notice of or approval for certain transactions, including, among other things, (a) the payment of certain dividends, (b) cost sharing agreements, (c) intercompany agency, service or management agreements, (d) acquisition or divestment of control of or merger with domestic insurers, (e) sales, purchases, exchanges, loans or extensions of credit, guarantees or investments if such transactions are equal to or exceed certain thresholds, and (f) reinsurance agreements. All transactions within a holding company system affecting an insurer must have fair and reasonable terms and are subject to other standards and requirements established by law and regulation.

*Dividends*

Our insurance subsidiaries are subject to statutory requirements as to maintenance of policyholders' surplus and payment of dividends. In general, the maximum amount of dividends that the insurance subsidiaries may pay in any 12-month period without regulatory approval is the greater of adjusted statutory net income or 10% of statutory policyholders' surplus as of the preceding calendar year end. Adjusted statutory net income is generally defined for this purpose to be statutory net income, net of realized capital gains, for the calendar year preceding the date of the dividend. Also, most states restrict an insurance company's ability to pay dividends in excess of its statutory unassigned surplus or earned surplus. In addition, state insurance regulators may limit or restrict an insurance company's ability to pay stockholder dividends or as a condition to issuance of a certificate of authority, as a condition to a change of control approval or for other regulatory reasons.

*Enterprise Risk*

The Model Insurance Holding Company System Regulatory Act and Regulation (the "Amended Model Act and Regulation") adopted by the NAIC imposes more extensive informational requirements on an insurance holding company system in order to protect the licensed insurance companies from enterprise risk, including requiring it to prepare an annual enterprise risk report that identifies the material risks within the insurance company holding system that could pose enterprise risk to the licensed insurer. To date, a number of states have adopted some or all of the changes in the Amended Model Act and Regulation, including states where some of our insurance companies are domiciled or commercially domiciled.

The Risk Management and Own Risk and Solvency Assessment ("ORSA") Model Act, adopted by the NAIC, requires insurers to maintain a framework for identifying, assessing, monitoring and reporting on the "material and relevant risks" associated with the insurer's current business plans. Under the ORSA Model Act, an insurer must perform at least annually a self-assessment of its current and future risks and must file a confidential report with the insurer's lead insurance regulator. The ORSA report was filed in 2018 with the Company's lead insurance regulator, as well as with certain other state regulators, and describes our process for assessing our own solvency.

*Change of Control*

State insurance holding company laws require prior approval by the respective state insurance departments of any change of control of an insurer. “Control” is generally defined as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of the company, whether through the ownership of voting securities, by contract or otherwise. Control is generally presumed to exist through the direct or indirect ownership

of 10% or more of the voting securities of a domestic insurance company or any entity that controls a domestic insurance company. Any person wishing to acquire control of us or of any substantial portion of our outstanding shares would first be required to obtain the approval of the domestic regulators (including those asserting “commercial domicile”) of our insurance subsidiaries.

Any future transactions that would constitute a change of control, including a change of control of us and/or any of our domestic insurance subsidiaries, would generally require the party acquiring control to obtain the prior approval of the department of insurance in the state in which the insurance company being acquired is domiciled (and in any other state in which the company may be deemed to be commercially domiciled by reason of concentration of its insurance business within such state) and may also require pre-notification in certain other states. Obtaining these approvals may result in the material delay of, or deter, any such transaction.

These laws may discourage potential acquisition proposals and may delay, deter or prevent a change of control of us, including through transactions, and in particular unsolicited transactions, that some or all of our stockholders might consider to be desirable.

*Market Conduct*

*Regulation of Insurance Rates and Approval of Policy Forms*

The insurance laws of most states in which we conduct business require insurance companies to file insurance rate schedules and insurance policy forms for review and approval. If, as permitted in some states, we begin using new rates before they are approved, we may be required to issue refunds or credits to the policyholders if the new rates are ultimately deemed excessive or unfair and disapproved by the applicable state regulator. In other states, prior approval of rate changes is required and there may be long delays in the approval process or the rates may not be approved. Accordingly, our ability to respond to market developments or increased costs in that state can be adversely affected.

*Restrictions on Withdrawal, Cancellation, and Nonrenewal*

In addition, many states have laws and regulations that limit an insurer’s ability to withdraw from a particular market. For example, states may limit an insurer’s ability to cancel or not renew policies. Furthermore, certain states prohibit an insurer from withdrawing from one or more lines of business written in the state, except pursuant to a plan that is approved by the state insurance department. The state insurance department may disapprove any proposed plan that may lead to market disruption. Laws and regulations that limit cancellation and non-renewal and that subject program withdrawals to prior approval requirements may restrict the ability of our insurance subsidiaries to exit unprofitable markets.

*Required Licensing*

Our insurance subsidiaries operate under licenses issued by the department of insurance in the states in which they sell insurance. If a regulatory authority denies or delays granting a new license, our ability to offer new insurance products in that market may be substantially impaired. In addition, if the department of insurance in any state in which one of our insurance subsidiaries currently operates suspends, non-renews, or revokes an existing license, we would not be able to offer affected products in the state.

In addition, insurance agencies, producers, third-party administrators, claims adjusters and service contract providers and administrators are subject to licensing requirements and regulation by insurance regulators in various states in which they conduct business. Certain of our subsidiaries engage in these functions and are subject to licensing requirements and regulation by insurance regulators in various states.

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*Guaranty Fund Assessments*

Most, if not all, of the states where we are licensed to transact business require that property and casualty insurers doing business within the state participate in a guaranty association, which is organized to pay contractual benefits owed pursuant to insurance policies issued by impaired, insolvent or failed insurers. These associations levy assessments, up to prescribed limits, on all member insurers in a particular state on the basis of the proportionate share of the premiums written by the member insurers in the lines of business in which the impaired, insolvent or failed insurer is engaged. Some states permit member insurers to recover assessments paid through full or partial premium tax offsets.

Property and casualty insurance company insolvencies or failures may result in additional guaranty association assessments to our insurance subsidiaries at some future date. At this time, we are unable to determine the impact, if any, that such assessments may have on their financial positions or results of their operations. As of December 31, 2018, each of our insurance subsidiaries has established accruals for guaranty fund assessments with respect to insurers that are currently subject to insolvency proceedings.

*Assigned Risks*

Many states in which we conduct business require automobile liability insurers to sell bodily injury liability, property damage liability, medical expense, and uninsured motorist coverage to a proportionate number (based on the insurer's share of the state's automobile casualty insurance market) of those drivers applying for placement as "assigned risks." Drivers seek placement as assigned risks because their driving records or other relevant characteristics make them difficult to insure in the voluntary market.

**Federal and State Legislative and Regulatory Changes**

From time to time, various regulatory and legislative changes have been proposed in the insurance industry. Among the proposals that have in the past been or are at present being considered are the possible introduction of federal regulation in addition to, or in lieu of, the current system of state regulation of insurers and proposals in various state legislatures (some of which have been enacted) to conform portions of their insurance laws and regulations to various model acts adopted by the NAIC.

On December 22, 2017, "H.R.1", also known as the Tax Cuts and Jobs Act of 2017 (the "TCJA") was signed into law. The TCJA reduced the federal corporate income tax rate from 35% to 21% effective January 1, 2018, which impacted the Company's effective tax rate and after-tax earnings in the United States. The Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 740, Income Taxes, requires deferred tax assets and liabilities to be adjusted for the effect of a change in tax laws or rates in the year of enactment, which is the year in which the change was signed into law. Accordingly, the Company adjusted its deferred tax assets and liabilities at December 31, 2017, using the new corporate tax rate of 21 percent. The Company was also affected by certain other aspects of the TCJA, including, without limitation, provisions regarding the one-time transition tax on undistributed foreign earnings and profits, limitations on the deductibility of interest expense and executive compensation and deductibility of capital expenditures.

The Dodd-Frank Act established a Federal Insurance Office ("FIO") within the U.S. Department of the Treasury. The Federal Insurance Office is charged with monitoring all aspects of the insurance industry (other than health insurance, certain long-term care insurance and crop insurance), gathering data, and conducting a study on methods to modernize and improve the insurance regulatory system in the United States. In 2013, the FIO issued a report (as required under the Dodd-Frank Act) entitled "How to Modernize and Improve the System of Insurance Regulation in the United States" (the "Report"), which stated that, given the "uneven" progress the states have made with several near-term state reforms,

should the states fail to accomplish the necessary modernization reforms in the near term, “Congress should strongly consider direct federal involvement.” The FIO continues to support the current state-based regulatory regime, but will consider federal regulation should the states fail to take steps to greater uniformity (e.g., federal licensing of insurers). The Report also appears to signal greater activity by the federal government in dealing with non-U.S. regulators and regulatory regimes, using the authority expressly given by the Dodd-Frank Act to Treasury and the United States Trade Representative to negotiate “covered agreements” with foreign authorities.

In addition, the Dodd-Frank Act gives the Federal Reserve supervisory authority over a number of financial services companies, including insurance companies, if they are designated by a two-thirds vote of the Financial Stability Oversight Council as “systemically important.” If an insurance company is designated as systemically important, the Federal Reserve’s supervisory authority could include the ability to impose heightened financial regulation upon that insurance company and could impact requirements regarding its capital, liquidity and leverage as well as its business and investment conduct.

The Dodd-Frank Act also incorporates the NRRA, which, among other things, establishes national uniform standards on how states may regulate and tax surplus lines insurance and sets national standards concerning the regulation of reinsurance. In particular, the NRRA gives regulators in the home state of an insured exclusive authority to regulate and tax surplus lines insurance transactions, and regulators in a ceding insurer’s state of domicile the sole responsibility for regulating the balance sheet credit that the ceding insurer may take for reinsurance recoverables.

Existing and new laws and regulations affecting the health insurance industry, or changes to existing laws and regulations, may transpire. The PPACA was signed into law in 2010, and, throughout 2017 and 2018, there were several judicial and congressional challenges and proposed amendments to the PPACA. The TCJA also includes a provision that repealed certain aspects of the PPACA. If we are unable to adapt our A&H business to current and/or future requirements of the health insurance legislation, our A&H business could be materially adversely affected.

Other possible federal regulatory developments include the introduction of legislation in Congress that would repeal the McCarran-Ferguson Act antitrust exemption for the insurance industry. The antitrust exemption allows insurers to compile and share loss data, develop standard policy forms and manuals and predict future loss costs with greater reliability, among other things. The ability of the industry, under the exemption permitted in the McCarran-Ferguson Act, to collect loss cost data and build a credible database as a means of predicting future loss costs is an important part of cost-based pricing. If the ability to collect this data were removed, the predictability of future loss costs and the reliability of pricing could be undermined.

In recent years, the lender-placed insurance business has been subject to class action litigation and investigations by state insurance regulators and federal regulatory agencies. Litigation and regulatory proceedings have included allegations of excessive premium rates and inappropriate business transactions. Unfavorable outcomes of litigation or regulatory investigations or significant problems in our relationships with regulators could adversely affect our results of operations and financial condition, reputation, and ability to continue to do business. They could also expose us to further investigations or litigation. In addition, certain of our customers in the mortgage industry are the subject of various regulatory investigations and/or litigation regarding mortgage lending practices, which could indirectly affect agreements with these clients and our business.

**Privacy Regulations**

In 1999, Congress enacted the Gramm-Leach-Bliley Act, which, among other things, protects consumers from the unauthorized dissemination of certain personal information. Subsequently, states have implemented additional regulations to address privacy issues. Certain aspects of these laws and regulations apply to all financial institutions, including insurance and finance companies, and require us to maintain appropriate policies and procedures for managing and protecting certain personal information of our policyholders. We may also be subject to future privacy laws and regulations, which could impose additional costs and impact our results of operations or financial condition. In 2000, the NAIC adopted the Privacy of Consumer Financial and Health Information Model Regulation, which assisted states in promulgating regulations to comply with the Gramm-Leach-Bliley Act. In 2002, to further facilitate the implementation of the Gramm-Leach-Bliley Act, the NAIC adopted the Standards for Safeguarding Customer Information Model Regulation. Several states have now adopted similar provisions regarding the safeguarding of policyholder information.

Additionally, the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”), The Health Information Technology for Economic and Clinical Health Act (“HITECH”), and the more recent 2013 Omnibus Rule, dictates the dissemination of an individual’s personal health information by covered entities and their business associates. These laws and their implementing regulations apply to health care providers and health insurers, and thereby requires our

A&H business to maintain policies and procedures with regard to the storage, maintenance and disclosure of our policyholders' personal health information.

**Cybersecurity Regulation**

Insurance regulators have been focusing increased attention on data security during financial exams, and new laws and regulations are pending that would impose new requirements and standards for protecting personally identifiable information of insurance company policyholders. For example, the New York Department of Financial Services enacted a comprehensive cybersecurity regulation that became effective during 2017, requiring insurance companies and other entities to have a cybersecurity program designed to protect consumers' private data; a written policy that is approved by the board or a senior officer; a chief information security officer to help protect data and systems; and controls and plans in place to help ensure the safety of New York's financial services industry. In addition, the NAIC has adopted the Roadmap for Cybersecurity Consumer Protections, a set of directives aimed at protecting consumer data, and is working on a new model data security law that is expected to incorporate the directives and impose additional requirements on insurance companies to the extent ultimately adopted by applicable state legislation. The NAIC has also strengthened and enhanced the cybersecurity guidance included in its handbook for state insurance examiners. We anticipate a continuing focus on new regulatory and legislative proposals at the state and federal levels that further regulate practices regarding privacy and security of personal information.

Our Swedish entities are subject to the recently enacted European Union ("E.U.") General Data Protection Regulation ("GDPR"). GDPR is global in scope to the extent that it applies to all business in the E.U. and any business outside the E.U. that processes E.U. personal data of individuals in the E.U. The regulation is in place to enhance the rights and protections of E.U. citizens' personal data and non-compliance can potentially lead to financial penalties. The introduction of GDPR, and any changes in E.U. member states' national laws and regulations, may increase our compliance obligations and may necessitate the review and implementation of policies and processes relating to our collection and use of data.

**Telephone Sales Regulations**

The United States Congress, the Federal Communications Commission and various states have promulgated and enacted rules and laws that govern telephone solicitations. There are numerous state statutes and regulations governing telephone sales activities that do or may apply to our operations, including the operations of our call center insurance agencies. For example, some states place restrictions on the methods and timing of calls and require that certain mandatory disclosures be made during the course of a telephone sales call. Federal and state "Do Not Call" regulations must be followed for us to engage in telephone sales activities.

**Foreign Regulation**

*Classification*

Our Bermuda subsidiary, National General Re Ltd. ("NG Re") is registered as an insurer by the Bermuda Monetary Authority ("BMA") under the Insurance Act 1978 of Bermuda, as amended (the "Insurance Act - Bermuda"). The BMA is responsible for the day-to-day supervision of insurers and monitors compliance with the solvency and liquidity standards imposed by the Insurance Act - Bermuda. NG Re is registered as a Class 3A insurer. Accordingly, NG Re can carry on general business, broadly including all types of insurance business other than long-term business.

*Annual Financial Statements, Annual Statutory Financial Return and Annual Capital and Solvency Return*

NG Re is required to file annually with the BMA financial statements, a statutory financial return and a capital and solvency return. The statutory financial return for an insurer includes, among other matters, statutory financial statements, a report of the approved auditor on the statutory financial statements, and, a declaration of compliance confirming compliance with various minimum criteria, including certifying the company meets the minimum solvency margin. The capital and solvency return includes NG Re's Bermuda solvency capital return model for a Class 3A insurer, a commercial insurer's solvency self-assessment, a reconciliation of net loss reserves, schedule of solvency, financial condition report, an opinion of the company's loss reserve specialist, a schedule of eligible capital and an economic balance sheet. The capital and solvency return also includes a capital and solvency declaration that the return fairly represents the financial condition of NG Re in all material respects.

*Insurance Code of Conduct*

The Insurance Code of Conduct prescribes the duties and standards with which registered insurers must adhere and comply, to ensure that the registered insurer implements sound corporate governance, risk management and internal controls. Failure to comply with these requirements is a factor considered by the BMA in determining whether an insurer is conducting its business in a sound and prudent manner. Any failure to comply with the requirements of the Insurance Code of Conduct could result in the BMA exercising its statutory powers of intervention.

*Minimum Solvency Margin and Restrictions on Dividends and Distributions*

Under the Insurance Act - Bermuda, the value of the general business assets of a registered Class 3A insurer, such as NG Re, must exceed the amount of its general business liabilities by an amount greater than the prescribed minimum solvency margin.

NG Re could not declare or pay dividends during any financial year if it is in breach of its minimum solvency margin or minimum liquidity ratio or if it would fail to meet such margin or ratio as a result. In addition, BMA approval would be required prior to declaring or paying dividends in any financial year NG Re failed to meet its minimum solvency margin or minimum liquidity ratio on the last day of any financial year.

As a registered Class 3A insurer, NG Re is prohibited from declaring or paying dividends of more than 25% of its previous year's total statutory capital and surplus unless it files with the BMA an affidavit stating it will continue to meet its minimum capital requirements. In addition, NG Re is prohibited, without the approval of the BMA, from reducing by 15% or more its total statutory capital as set out in its previous year's financial statements.

*Minimum Liquidity Ratio*

Under the Insurance Act - Bermuda, an insurer engaged in general business, such as NG Re, is required to maintain the value of its relevant assets at not less than 75% of the amount of its relevant liabilities.

*Solvency II*

The E.U. has adopted a directive, known as Solvency II, covering capital requirements, risk management and regulatory reporting for insurance organizations. Solvency II applies to our Swedish entities, and Solvency II equivalence (an insurance regulatory regime that achieves the same outcomes-based results as Solvency II) applies to our Bermuda entities. Solvency II imposes economic risk-based solvency requirements that comprise three pillars. First, there are quantitative capital requirements, based on a valuation of the entire balance sheet of an insurance organization. Second, Solvency II requires insurance organizations to undertake a qualitative regulatory review, including governance, internal controls, enterprise risk management and the supervisory review process. Third, to

enhance market discipline, insurance organizations must report their financial conditions to regulators.

**Offices**

Our principal executive offices are located at 59 Maiden Lane, 38th Floor, New York New York 10038, and our telephone number at that location is (212) 380-9500. Our website is www.nationalgeneral.com. Our internet website and the information contained therein or connected thereto are not intended to be incorporated by reference into the Annual Report on Form 10-K.

**Employees**

As of December 31, 2018, we have approximately 8,440 employees, including part-time employees, none of whom are covered by collective bargaining arrangements.

**Available Information**

We file our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements on Schedule 14A and all amendments to those reports as required by the U.S. Securities and Exchange Commission (the “SEC”). You may obtain our electronic filings by accessing the SEC’s website at http://www.sec.gov.

You can also obtain on our website’s Investor Relations page (www.nationalgeneral.com), free of charge, a copy of our annual report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file such reports or amendments with, or furnish them to, the SEC.

Also available at the “Corporate Governance” section of the Investor Relations page of our website, free of charge, are copies of our Code of Business Conduct and Ethics, and the charters for our Audit, Compensation, and Nominating and Corporate Governance Committees. Copies of our Code of Business Conduct and Ethics, and Charters are also available in print free of charge, upon request by any shareholder. You can obtain such copies in print by contacting Investor Relations by mail at our corporate office. We intend to disclose on our website any amendment to, or waiver of, any provision of our Code of Business Conduct and Ethics applicable to our directors and executive officers that would otherwise be required to be disclosed under the rules of the SEC or Nasdaq.

**Item 1A. Risk Factors**

*You should carefully consider the following risks and all of the other information set forth in this report, including our consolidated financial statements and the notes thereto. The following discussion of risk factors includes forward-looking statements and our actual results may differ substantially from those discussed in such forward-looking statements. See "Note on Forward-Looking Statements."*

**Risks Relating to Our Business**

***If we are unable to accurately underwrite risks and charge competitive yet profitable rates to our policyholders, our business, financial condition and results of operations may be adversely affected.***

In general, the premiums for our insurance policies are established at the time a policy is issued and, therefore, before all of our underlying costs are known. Like other insurance companies, we rely on estimates and assumptions in setting our premium rates. Establishing adequate premiums is necessary, together with investment income, to generate sufficient revenue to offset losses, loss adjustment expenses and other underwriting costs and to earn a profit. If we do not accurately assess the risks that we assume, we may not charge adequate premiums to cover our losses and expenses, which would negatively affect our results of operations and our profitability. Alternatively, we could set our premiums too high, which could reduce our competitiveness and lead to lower revenues.

Pricing involves the acquisition and analysis of historical loss data, and the projection of future trends, loss costs and expenses, and inflation trends, among other factors, for each of our products in multiple risk tiers and many different markets. In order to accurately price our policies, we:

- collect and properly analyze a substantial volume of data from our insureds;
- develop, test and apply appropriate actuarial projections and rating formulas;
- closely monitor and timely recognize changes in trends; and
- project both frequency and severity of our insureds' losses with reasonable accuracy.

We seek to implement our pricing accurately in accordance with our assumptions. Our ability to undertake these efforts successfully and, as a result, accurately price our policies, is subject to a number of risks and uncertainties, including:

- insufficient or unreliable data;
- incorrect or incomplete analysis of available data;
- uncertainties generally inherent in estimates and assumptions;
- our failure to implement appropriate actuarial projections and rating formulas or other pricing methodologies;
- regulatory constraints on rate increases;
- unexpected escalation in the costs of ongoing medical treatment;
- our failure to accurately estimate investment yields and the duration of our liability for loss and LAE; and
- unanticipated court decisions, legislation or regulatory action.

***If we are unable to establish and maintain accurate loss reserves, our business, financial condition and results of operations may be materially adversely affected.***

Our financial statements include loss reserves, which represent our best estimate of the amounts that our insurance subsidiaries ultimately will pay on claims that have been incurred, and the related costs of adjusting those claims, as of the date of the financial statements. The process of estimating loss reserves involves a high degree of judgment and is subject to a number of variables. These variables can be affected by both internal and external events, such as:

changes in claims handling procedures, adverse changes in loss cost trends, economic conditions (including general inflation), legal trends and legislative changes, and varying judgments and viewpoints in the estimation process, among others. The impact of many of these items on ultimate loss reserves is difficult to estimate.

As a result of these uncertainties, the ultimate paid loss and loss adjustment expenses may deviate, perhaps substantially, from the point-in-time estimates of such losses and expenses, as reflected in the loss reserves included in our financial statements. To the extent that loss and LAE exceed our estimates, we will be required to immediately recognize the unfavorable development and increase loss reserves, with a corresponding reduction in our net income in the period in which the deficiency is identified. Consequently, ultimate losses paid could materially exceed reported loss reserves and have a materially adverse effect on our business, financial condition and results of operations.

***General economic conditions could materially and adversely affect our business, our liquidity and financial condition.***

General economic factors beyond our control that affect our business include unemployment rates, consumer spending, residential and commercial real estate prices, U.S. debt ceiling and budget deficit concerns, tax rates and policies, changes in interest rates and the availability of credit. Such conditions may potentially affect (among other aspects of our business) the demand for and claims made under our products, the ability of customers, counterparties and others to establish or maintain their relationships with us, our ability to access and efficiently use internal and external capital resources and our investment performance. In the event that these conditions result in a prolonged period of economic uncertainty, our results of operations, our financial condition and/or liquidity, our prospects and competitor landscape could be materially and adversely affected.

***Our business is dependent on the efforts of our executive officers and other key employees. If we are unsuccessful in our efforts to attract, train and retain qualified executive officers and key employees, our business may be materially adversely affected.***

Our success has developed from, and will continue to depend on, the efforts of our executive officers because of their industry expertise, knowledge of our markets, and relationships with our independent agents and distribution partners. Should any of our executive officers cease working for us, we may be unable to find acceptable replacements with comparable skills and experience in the specialty P&C and A&H sectors that we target. In addition, our business is also dependent on skilled underwriters and other skilled employees. We cannot assure you that we will be able to attract, train and retain, on a timely basis and on anticipated economic and other terms, experienced and capable senior management, underwriters and support staff. We intend to pay competitive salaries, bonuses and equity-based rewards in order to attract and retain such personnel, but we may not be successful in such endeavors. The loss of key personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business, financial condition or operating results. We do not currently maintain life insurance policies with respect to our executive officers or other employees.

***Revenues and operating profits from our P&C segment depend on our production in several key states and adverse developments in these key states could have a material adverse effect on our business, financial condition and results of operations.***

For the year ended December 31, 2018, our P&C segment derived 76.1% of its gross premium written from the following ten states: North Carolina (15.5%), California (15.3%), New York (14.7%), Florida (10.6%), Texas (4.6%), New Jersey (3.7%), Virginia (3.2%), Louisiana (3.0%), Michigan (3.0%) and Alabama (2.5%). As a result, our financial results are subject to prevailing regulatory, legal, economic, demographic, competitive, and other conditions in these states. Adverse developments relating to any of these conditions could have a material adverse impact on our business, financial condition and results of operations.

***If we cannot sustain our business relationships, including our relationships with independent agents, agencies and other parties, we may be unable to compete effectively and operate profitably.***

We market our products primarily through a network of independent agents and distribution partners. Our relationships with our agents are generally governed by agreements that may be terminated on short notice. Independent agencies generally are not obligated to promote our products and may sell insurance offered by our competitors. As a result, our ability to compete and remain profitable depends, in part, on our maintaining our business relationship with our independent agents and agencies, the marketing efforts of our independent agents and agencies and on our ability

to offer insurance products and maintain financial strength ratings that meet the requirements and preferences of our independent agents and agencies and their policyholders.

In connection with our lender-placed insurance business, we also have relationships with certain mortgage lenders and servicers, and we insure properties securing mortgages serviced by the mortgage loan servicers with whom we do business.

If such lenders terminate important business arrangements with us, or renew contracts on terms less favorable to us, our cash flows, results of operations and financial condition could be materially adversely affected. For example, in our lender-placed insurance business, restrictions imposed by state regulators on us or by federal regulators on our customers could affect our ability to do business with certain mortgage loan servicers or the volume or profitability of such business. Furthermore, the transfer by mortgage servicer clients of loan portfolios to other carriers or the new participation by other carriers in insuring or reinsuring lender-placed insurance risks could materially reduce our revenues and profits from this business.

Any failure on our part to be effective in any of these areas could have a material adverse effect on our business and results of operations.

***Our affinity channel depends on a relatively small number of affinity partner relationships for a significant percentage of the net premium revenue that it generates, and the loss of one of these significant affinity partner relationships could have a material adverse effect on our business, financial condition and results of operations.***

Our affinity channel operates primarily through relationships with affinity partners, which include major retailers and membership organizations. Our top two affinity relationships collectively represent 61% of our affinity channel written premium. Although our relationships with these and most of our other affinity partners are long-standing with long-term contracts, in the event of the termination of any of our significant affinity partner relationships, our net earned premium could be adversely affected.

***If we, together with our affiliates and the other third parties that we contract with, are unable to maintain our technology platform or our technology platform fails to operate properly, or meet the technological demands of our customers with respect to the products and services we offer, our business and financial performance could be significantly harmed.***

We use our own policy administration system that we recently acquired in 2017. We also use technology systems to more accurately evaluate specific risk exposures in order to assist us in profitably underwriting our P&C products.

If we are unable to properly integrate and maintain our policy administration system and maintain our technology systems or if our technology systems otherwise fail to perform in the manner we currently contemplate, our ability to effectively underwrite and issue policies, process claims and perform other business functions could be significantly impaired and our business and financial performance could be significantly harmed. In addition, the success of our business is dependent on our ability to resolve any issues identified with our technology arrangements during operations and make any necessary improvements in a timely manner. Further, we will need to match or exceed the technological capabilities of our competitors over time. We cannot predict with certainty the cost of such integration, maintenance and improvements, but failure to make such improvements could have an adverse effect on our business.

Also, we use e-commerce and other technology to provide, expand and market our products and services. Accordingly, we believe that it will be essential to continue to invest resources in maintaining electronic connectivity with customers and, more generally, in e-commerce and technology. Our business may suffer if we do not maintain these arrangements or keep pace with the technological demands of customers.

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***If we experience security breaches or other disruptions involving our technology, our ability to conduct our business could be adversely affected, we could be liable to third parties and our reputation could suffer, which could have a material adverse effect on our business.***

Our business is dependent upon the uninterrupted functioning of our information technology and telecommunication systems. We rely upon our systems, as well as the systems of our vendors, for all our business operations, including underwriting and issuing policies, processing claims, providing customer service, complying with insurance regulatory requirements and performing actuarial and other analytical functions necessary for underwriting, pricing and product development. Our operations are dependent upon our ability to timely and efficiently maintain and improve our information and telecommunications systems and protect them from physical loss, telecommunications failure or other similar catastrophic events, as well as from security breaches. A shut-down of, or inability to access, one or more of our facilities, a power outage or a failure of one or more of our information technology, telecommunications or other systems could significantly impair our ability to perform such functions on a timely basis. In the event of a disaster such as a natural catastrophe, terrorist attack or industrial accident, or due to a computer virus, our systems could be inaccessible for an extended period of time. While we have implemented business contingency plans and other reasonable and appropriate internal controls to protect our systems from interruption, loss or security breaches, a sustained business interruption or system failure could adversely impact our ability to process our business, provide customer service, pay claims in a timely manner or perform other necessary business functions.

Our operations depend on the reliable and secure processing, storage and transmission of confidential and other information in our computer systems and networks. Computer viruses, hackers, employee misconduct and other external hazards could expose our data systems to security breaches, cyberattacks or other disruptions. In addition, we routinely transmit and receive personal, confidential and proprietary information by electronic means. We have implemented security measures designed to protect against breaches of security and other interference with our systems and networks resulting from attacks by third parties, including hackers, and from employee or adviser error or malfeasance. We also assess and monitor the security measures of our third-party business partners, who in the provision of services to us are provided with or process information pertaining to our business or our customers. Despite these measures, we cannot assure you that our or third party systems and networks will not be subject to breaches or interference. Any such event may result in operational disruptions as well as unauthorized access to or the disclosure or loss of our proprietary information or our customers' information, which in turn may result in legal claims, regulatory scrutiny and liability, reputational damage, the incurrence of costs to eliminate or mitigate further exposure, the loss of customers or affiliated advisors or other damage to our business. In addition, the trend toward broad consumer and general public notification of such incidents could exacerbate the harm to our business, financial condition and results of operations. Even if we successfully protect our technology infrastructure and the confidentiality of sensitive data, we could suffer harm to our business and reputation if attempted security breaches are publicized. We cannot be certain that advances in criminal capabilities, discovery of new vulnerabilities, attempts to exploit vulnerabilities in our systems, data thefts, physical system or network break-ins or inappropriate access, or other developments will not compromise or breach the technology or other security measures protecting the networks and systems used in connection with our business.

The regulatory environment surrounding information security and privacy is increasingly demanding. We are subject to numerous U.S. federal and state laws and regulations in jurisdictions outside the U.S. governing the protection of personal and confidential information of our clients or employees, including in relation to credit card data and financial information. These laws and regulations are increasing in complexity and number and change frequently. If any person, including any of our employees or those with whom we share such information, negligently disregards or intentionally breaches our established controls with respect to our client or employee data, or otherwise mismanages or misappropriates that data, we could be subject to significant monetary damages, regulatory enforcement actions, fines and/or criminal prosecution in one or more jurisdictions.

***We may not be able to successfully acquire or integrate additional businesses or manage the growth of our operations, which could make it difficult for us to compete and could adversely affect our profitability.***

Since our formation, we have grown our business primarily through a number of acquisitions of insurance companies, agencies or books of business. Part of our growth strategy is to continue to grow our business through

acquisitions. This strategy of growing through acquisitions subjects us to numerous risks, including risks associated with:

- our ability to identify profitable geographic markets for entry;
- our ability to identify potential acquisition targets and successfully acquire them on acceptable terms and in a timely manner;
- our ability to integrate acquired businesses smoothly and efficiently;
- our ability to achieve expected synergies, profitability and return on our investment;
- the diversion of management's attention from the day-to-day operations of our business;
- our ability to attract and retain qualified personnel for expanded operations;
- encountering unforeseen operating difficulties or incurring unforeseen costs and liabilities;
- our ability to manage risks associated with entering into geographic and product markets with which we are less familiar;
- our ability to obtain necessary regulatory approvals;
- our ability to expand existing agency relationships; and
- our ability to augment our financial, administrative and other operating systems to accommodate the growth of our business.

Due to any of the above risks, we cannot assure you that (i) we will be able to successfully identify and acquire additional businesses on acceptable terms or at all, (ii) we will be able to successfully integrate any business we acquire, (iii) we will be able to effectively manage our growth or (iv) any new business that we acquire or enter into will be profitable. Our failure in any of these areas could have a material adverse effect on our business, financial condition and results of operations.

***If our businesses, including businesses we have acquired, do not perform well, we may be required to recognize an impairment of our goodwill or other intangible assets, which could have a material adverse effect on our financial condition and results of operations.***

Goodwill represents the excess of the amounts we paid to acquire subsidiaries and other businesses over the fair value of their net assets at the date of acquisition. We are required to perform goodwill impairment tests at least annually and whenever events or circumstances indicate that the carrying value may not be recoverable from estimated future cash flows. If we determine that the goodwill has been impaired, we would be required to write down the goodwill by the amount of the impairment, with a corresponding charge to net income. Such write-downs could have a material adverse effect on our financial condition and results of operations.

Intangible assets represent the amount of fair value assigned to certain assets when we acquire a subsidiary or a book of business. Intangible assets are classified as having either a finite or an indefinite life. We test the recoverability of our intangible assets at least annually. We test the recoverability of finite life intangibles whenever events or changes in circumstances indicate that the carrying value of a finite life intangible may not be recoverable. We recognize an impairment if the carrying value of an intangible asset is not recoverable and exceeds its fair value, in which circumstances we must write down the intangible asset by the amount of the impairment with a corresponding charge to net income. We own two management companies that are attorneys-in-fact for two reciprocal exchanges. If the reciprocal business does not perform well or the reciprocal exchanges are downgraded, we may be required to recognize an impairment of our intangible assets. Such write downs could have a material adverse effect on our financial condition and results of operations.

***Our relationship with AmTrust and its subsidiaries may present, and make us vulnerable to, difficult conflicts of interest, related party transactions, business opportunity issues and legal challenges.***

AmTrust is an insurance holding company controlled by Leah Karfunkel, George Karfunkel and Barry Zyskind. Because Leah Karfunkel beneficially owns 39.5% of our outstanding shares of common stock, AmTrust is a related party.

We are party to arrangements with AmTrust and its affiliates, including, among others, an asset purchase agreement pursuant to which AmTrust sold to us and our affiliates our policy administration system; a consulting and marketing agreement pursuant to which a subsidiary of AmTrust provides certain consulting and marketing services to promote our captive insurance program; an investment in an entity owning life settlement contracts; and joint investments in entities owning office buildings in Ohio, Texas and Illinois. Conflicts of interest could arise with respect to any of our contractual arrangements with AmTrust and its affiliates, as well as any other business opportunities that could be advantageous to AmTrust or its subsidiaries, on the one hand, and disadvantageous to us or our subsidiaries, on the other hand. AmTrust's interests may be different from the interests of our company and the interests of our other stockholders.

***Our relationship with ACP Re and ACP Re Holdings, LLC may present, and make us vulnerable to, difficult conflicts of interest, related party transactions, business opportunity issues and legal challenges.***

ACP Re is a Bermuda reinsurer that is a subsidiary of the Karfunkel Family Trust. We provide management services to ACP Re pursuant to a services agreement we entered into in 2012. We and AmTrust provided ACP Re with financing in an aggregate amount of $250.0 million ($125.0 million each), and in July 2016, ACP Re Holdings, LLC, a Delaware limited liability company owned by the Karfunkel Family Trust ("ACP Re Holdings"), became the borrower in the place of ACP Re. Conflicts of interest could arise with respect to any of the contractual arrangements between us and ACP Re, as well as business opportunities that could be advantageous to ACP Re, on the one hand, and disadvantageous to us or our subsidiaries, on the other hand. There can be no assurance that ACP Re Holdings will have sufficient assets or liquidity to pay its obligations under the terms of the financing. The majority of ACP Re Holdings' assets currently consist of publicly traded equity securities. As a result of the financing, we, through our subsidiary, have significant credit exposure to ACP Re Holdings.

***A downgrade in the A.M. Best rating of our insurance subsidiaries would likely reduce the amount of business we are able to write and could materially adversely impact the competitive positions of our insurance subsidiaries.***

Rating agencies evaluate insurance companies based on their ability to pay claims. A.M. Best has currently assigned our insurance subsidiaries a group rating of "A-" (Excellent). The ratings of A.M. Best are subject to periodic review using, among other things, proprietary capital adequacy models, and are subject to revision or withdrawal at any time. Our competitive position relative to other companies is determined in part by the A.M. Best rating of our insurance subsidiaries. A.M. Best ratings are directed toward the concerns of policyholders and insurance agencies and are not intended for the protection of investors or as a recommendation to buy, hold or sell securities.

There can be no assurances that our insurance subsidiaries will be able to maintain their current ratings. Any downgrade in ratings would likely adversely affect our business through the loss of certain existing and potential policyholders and the loss of relationships with independent agencies that might move to other companies with higher ratings. We are not able to quantify the percentage of our business, in terms of premiums or otherwise, that would be affected by a downgrade in our A.M. Best ratings.

***Performance of our investment portfolio is subject to a variety of investment risks that may adversely affect our financial results.***

Our results are affected, in part, by the performance of our investment portfolio. Our investment portfolio contains interest rate sensitive investments, such as fixed-income securities. As of December 31, 2018, our investment in fixed-income securities was approximately $3,561.0 million, or 84.2% of our total investment portfolio. Increases in market interest rates may have an adverse impact on the value of our investment portfolio by decreasing the value of fixed-income securities. Conversely, declining market interest rates could have an adverse impact on our investment income as we invest positive cash flows from operations and as we reinvest proceeds from maturing and called

investments in new investments that could yield lower rates than our investments have historically generated. Defaults in our investment portfolio may produce operating losses and adversely impact our results of operations.

Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions, and other factors beyond our control. We may not be able to manage

interest rate sensitivity effectively. Despite our efforts to maintain a high quality portfolio and manage the duration of the portfolio to reduce the effect of interest rate changes, a significant change in interest rates could have a material adverse effect on our financial condition and results of operations.

In addition, the performance of our investment portfolio generally is subject to other risks, including the following:

- the risk of decrease in value due to a deterioration in the financial condition, operating performance or business prospects of one or more issuers of our fixed-income securities;
- the risk that our portfolio may be too heavily concentrated in the securities of one or more issuers, sectors or industries;
- the risk that we will not be able to convert investment securities into cash on favorable terms and on a timely basis; and
- general movements in the values of securities markets.

If our investment portfolio were to suffer a substantial decrease in value due to market, sector or issuer-specific conditions, our liquidity, financial condition and results of operations could be materially adversely affected. A decrease in value of an insurance subsidiary's investment portfolio could also put the subsidiary at risk of failing to satisfy regulatory minimum capital requirements and could limit the subsidiary's ability to write new business.

***Our holding company structure and certain regulatory and other constraints, including adverse business performance, could affect our ability to satisfy our obligations.***

We are a holding company and conduct our business operations through our various subsidiaries. Our principal sources of funds are dividends and other payments from our insurance subsidiaries and other operating subsidiaries, income from our investment portfolio and funds that may be raised from time to time in the capital markets. We will be largely dependent on amounts from our insurance subsidiaries to pay principal and interest on any indebtedness that we may incur, to pay holding company operating expenses, to make capital investments in our other subsidiaries and to pay dividends on our common and preferred stock. In addition, our credit agreement contains covenants that limit our ability to pay cash dividends to our stockholders under certain circumstances. See *"-The covenants in our credit agreement limit our financial and operational flexibility, which could have an adverse effect on our financial condition."*

Our insurance subsidiaries are subject to statutory and regulatory restrictions imposed on insurance companies by their states 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 domiciliary state. In general, the maximum amount of dividends that the insurance subsidiaries may pay in any 12-month period without regulatory approval is the greater of adjusted statutory net income or 10% of statutory policyholders' surplus as of the preceding calendar year end. Adjusted statutory net income is generally defined for this purpose to be statutory net income, net of realized capital gains, for the calendar year preceding the date of the dividend. In addition, other states may limit or restrict our insurance subsidiaries' ability to pay stockholder dividends generally or as a condition to issuance of a certificate of authority. The aggregate amount of cash dividends and distributions that could be paid by our insurance subsidiaries without prior approval by the various domiciliary states of our insurance subsidiaries was approximately $287.9 million as of December 31, 2018, taking into account dividends paid in the prior twelve month period.

***Our insurance subsidiaries are subject to minimum capital and surplus requirements. Our failure to meet these requirements could subject us to regulatory action.***

The laws of the states of domicile of our insurance subsidiaries impose risk-based capital standards and other minimum capital and surplus requirements. Failure to meet applicable risk-based capital requirements or minimum statutory capital requirements could subject us to further examination or corrective action imposed by state regulators, including limitations on our writing of additional business, state supervision or liquidation. Any changes in existing risk-based capital requirements or minimum statutory capital requirements may require us to increase our statutory capital levels, which we may be unable to do. See Item 1, “Business - Regulation - State Insurance Regulation - Financial Oversight-Risk-Based Capital Regulations.”

***The insurance industry is subject to extensive regulation, which may affect our ability to execute our business plan and grow our business.***

We are subject to comprehensive regulation and supervision by government agencies in each of the states in which our insurance subsidiaries are domiciled or commercially domiciled, as well as all states in which they are licensed, sell insurance products, issue policies, or handle claims. Some states impose restrictions or require prior regulatory approval of specific corporate actions, which may adversely affect our ability to operate, innovate, obtain necessary rate adjustments in a timely manner or grow our business profitably. These regulations provide safeguards for policyholders and are not intended to protect the interests of stockholders. Our ability to comply with these laws and regulations, and to obtain necessary regulatory action in a timely manner is, and will continue to be, critical to our success. Some of these regulations include:

- *Required Licensing.* We operate under licenses issued by the insurance department in the states in which we sell insurance. If a regulatory authority denies or delays granting a new license, our ability to enter that market quickly or offer new insurance products in that market may be substantially impaired. In addition, if the insurance department in any state in which we currently operate suspends, non-renews, or revokes an existing license, we would not be able to offer affected products in that state.
- *Transactions Between Insurance Companies and Their Affiliates.* Transactions between us or other of our affiliates and our insurance companies generally must be disclosed, and prior approval is required before any material or extraordinary transaction may be consummated. Approval may be refused or the time required to obtain approval may delay some transactions, which may adversely affect our ability to innovate or operate efficiently.
- *Regulation of Insurance Rates and Approval of Policy Forms.* The insurance laws of most states in which we conduct business require insurance companies to file insurance rate schedules and insurance policy forms for review and approval. If, as permitted in some states, we begin using new rates before they are approved, we may be required to issue refunds or credits to the policyholders if the new rates are ultimately deemed excessive or unfair and disapproved by the applicable insurance department. In most of the states in which we operate, prior approval of rate changes is required and there may be long delays in the approval process or the rates may not be approved. Accordingly, our ability to respond to market developments or increased costs in that state could be adversely affected and our ability to operate in a profitable manner may be limited.
- *Restrictions on Cancellation, Non-Renewal or Withdrawal.* Many of the states in which we operate have laws and regulations that limit our ability to exit a market. For example, some states limit a private passenger auto insurer's ability to cancel and refuse to renew policies and some prohibit insurers from withdrawing one or more lines of insurance business from the state unless prior approval is received. In some states, these regulations extend to significant reductions in the amount of insurance written, not just to a complete withdrawal. Laws and regulations that limit our ability to cancel and refuse to renew policies in some states or locations and that subject withdrawal plans to prior approval requirements may restrict our ability to exit unprofitable markets, which may harm our business, financial condition and results of operations.
- *Lender-placed insurance products.* State departments of insurance and regulatory authorities may choose to review the appropriateness of our premium rates for our lender-placed insurance products. If the reviews by state departments of insurance lead to significant decreases in premium rates for our lender-placed insurance products, our results of operations could be materially adversely affected.
- *Other Regulations.* We must also comply with regulations involving, among other matters:
  - the use of non-public consumer information and related privacy issues;
  - the use of credit history in underwriting and rating policies;
  - limitations on the ability to charge policy fees;
  - limitations on types and amounts of investments;
  - restrictions on the payment of dividends by our insurance subsidiaries;
  - the acquisition or disposition of an insurance company or of any company controlling an insurance company;

- involuntary assignments of high-risk policies, participation in reinsurance facilities and underwriting associations,
- assessments and other governmental surcharges for guaranty funds, second-injury funds, catastrophe funds and other mandatory pooling arrangements;
- reporting with respect to financial condition; and

- periodic financial and market conduct examinations performed by state insurance department examiners.

The failure to comply with these laws and regulations may also result in regulatory actions, fines and penalties, and in extreme cases, revocation of our ability to do business in a particular jurisdiction. In the past we have been fined by state insurance departments for failing to comply with certain laws and regulations. In addition, we may face individual and class action lawsuits by insured and other parties for alleged violations of certain of these laws or regulations.

***Our failure to accurately and timely pay claims could adversely affect our business, financial results and liquidity.***

We must accurately and timely evaluate and pay claims that are made under our policies. Many factors affect our ability to pay claims accurately and timely, including the training and experience of our claims representatives, our claims organization's culture and the effectiveness of our management, our ability to develop or select and implement appropriate procedures and systems to support our claims functions and other factors. Our failure to pay claims accurately and timely could lead to material litigation, undermine our reputation in the marketplace and materially adversely affect our financial results and liquidity.

In addition, if we do not train new claims employees effectively or lose a significant number of experienced claims employees, our claims department's ability to handle an increasing workload could be adversely affected. In addition to potentially requiring that growth be slowed in the affected markets, our business could suffer from decreased quality of claims work which, in turn, could lower our operating margins.

***Regulation may become more extensive in the future, which may adversely affect our business, financial condition and results of operations.***

Compliance with applicable laws and regulations is time-consuming and personnel-intensive, and changes in these laws and regulations may materially increase our direct and indirect compliance and other expenses of doing business, thus adversely affecting our business, financial condition and results of operations.

In the future, states may make existing insurance laws and regulation more restrictive or enact new restrictive laws. In such event, we may seek to reduce our business in, or withdraw entirely from, these states. Additionally, from time to time, the United States Congress and certain federal agencies investigate the current condition of the insurance industry to determine whether federal regulation is necessary. Currently, the U.S. federal government does not directly regulate the P&C insurance business. However, The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") established a Federal Insurance Office ("FIO") within the Department of the Treasury. The duties of the FIO include studying and reporting on how to modernize and improve the system of insurance regulation in the United States considering the ability of any federal regulation or a federal regulator to "provide robust consumer protection for policyholders" as well as "the potential consequences of subjecting insurers to a federal resolution authority." We cannot predict whether any proposals promulgated by FIO will be adopted, or what impact, if any, these proposals or, if enacted, these laws may have on our business, financial condition and results of operations. See Item 1, "Business - Regulation."

On December 22, 2017, "H.R.1", also known as the Tax Cuts and Jobs Act of 2017 (the "TCJA") was signed into law. The TCJA reduced the federal corporate income tax rate from 35% to 21% effective January 1, 2018, required companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, created new taxes on certain foreign sourced earnings, and revised the tax treatment of certain items for property and casualty insurers. As of December 31, 2018, we have completed the accounting for the tax effects of enactment of the TCJA. While we used what we believe are reasonable interpretations in applying the TCJA, it is possible that the IRS could take positions that differ from our interpretations which could materially adversely impact our financial condition and

results of operations.

***Reform of the health insurance industry could materially reduce the profitability of our A&H segment.***

The PPACA was signed into law in 2010, and throughout 2017 and 2018, there were several judicial and congressional challenges and proposed amendments to PPACA. The TCJA includes a provision that repealed certain aspects of the PPACA. Congress may consider other legislation to repeal or replace elements of the PPACA.

We expect there may be additional challenges and amendments in the future. Due to the complexity and continued uncertainty surrounding healthcare legislation, the impact from the PPACA or any amendments to the PPACA remains difficult to predict and could significantly affect the health insurance industry. We continue to review our product offerings and make changes to adapt to the current environment and the opportunities presented. However, we could be adversely affected if our plans for operating in the current environment are unsuccessful or if there is less demand than we expect for our A&H products.

If we are unable to adapt our A&H business to current and/or future requirements of the PPACA, or if significant uncertainty continues with respect to implementation of the PPACA or other healthcare reform legislation, our A&H business could be materially adversely affected. Furthermore, should Congress extend the scope of or repeal parts of or all of the PPACA, such a development could have a material adverse effect on our A&H business. For more information on the PPACA and its impact on our A&H segment, see Item 1, “Business - A&H Segment.”

***We may require additional capital in the future and such additional capital may not be available to us, or may only be available to us on unfavorable terms.***

To support our current and future policy writings or potential acquisitions, we may raise substantial additional capital using a combination of debt and equity. Our future capital requirements depend on many factors, including regulatory and rating agency requirements and our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. To the extent that the funds generated by our ongoing operations and initial capitalization are insufficient to fund future operating requirements, we may need to raise additional funds through financings or curtail our growth and reduce our assets. We cannot be sure that we will be able to raise equity or debt financing on terms favorable to us and our stockholders and in the amounts that we require, or at all. If we cannot obtain adequate capital, our business and financial condition could be adversely affected. Issuances of stock may result in dilution of our existing stockholders or a decrease in the per share price of our common stock.

In addition, the terms of a capital raising transaction could require us to agree to stringent financial and operating covenants that could limit our flexibility in operating our business or our ability to pay dividends on our common stock and could make it more difficult for us to obtain capital in the future.

***The covenants in our credit agreement limit our financial and operational flexibility, which could have an adverse effect on our financial condition.***

Our credit agreement contains covenants that limit our ability, among other things, to borrow money, sell assets, merge or consolidate and make particular types of investments or other restricted payments, including the payment of cash dividends if an event of default has occurred and is continuing or if we are out of compliance with our financial covenants. These covenants could restrict our ability to achieve our business objectives, and therefore, could have an adverse effect on our financial condition. In addition, this agreement also requires us to maintain specific financial ratios. If we fail to comply with these covenants or meet these financial ratios, the lenders under our credit agreement could declare a default and demand immediate repayment of all amounts owed to them, cancel their commitments to lend and/or issue letters of credit, any of which could have a material adverse effect on our liquidity, financial condition and business in general.

***Our operations and business activities outside of the United States are subject to a number of risks, which could have an adverse effect on our business, financial condition and results of operations.***

We currently conduct a limited amount of business outside the United States, primarily in Bermuda and Sweden. In these jurisdictions, we are subject to a number of significant risks in conducting such business. These risks include restrictions such as capital controls and other restrictive government actions, which could have an adverse effect on our business and our reputation. Investments outside the United States also subject us to additional domestic and foreign laws and regulations, including the Foreign Corrupt Practices Act and similar laws in other countries that prohibit the making of improper payments to foreign officials. In addition, some countries have laws and regulations that lack clarity and, even with local expertise and effective controls, it can be difficult to determine the exact requirements of the local laws. Failure to comply with local laws in a particular market could have a significant and negative effect not only on our business in that market but also on our reputation generally.

***Changes in accounting standards issued by the FASB or other standard-setting bodies may adversely affect our financial statements.***

Our financial statements are subject to the application of accounting principles generally accepted in the United States of America, which are periodically revised and/or expanded. Accordingly, from time to time we are required to adopt new or revised accounting standards issued by recognized authoritative bodies, including the FASB. The impact of accounting pronouncements that have been issued but not yet implemented is disclosed in our reports filed with the SEC. See Note 2, “Significant Accounting Policies,” in the notes to our Consolidated Financial Statements. An assessment of proposed standards, including standards on insurance contracts and accounting for financial instruments, is not provided as such proposals are subject to change through the exposure process and official positions of the FASB are determined only after extensive due process and deliberations. Therefore, the effects on our financial statements cannot be meaningfully assessed. The required adoption of future accounting standards could have a material adverse effect on our business, financial condition or results of operations, including on our net income.

**Risks Relating to Our Insurance Operations**

***The insurance industry is highly competitive, and we may not be able to compete effectively against larger companies.***

The insurance industry is highly competitive and, except for regulatory considerations, there are relatively few barriers to entry. We compete with both large national insurance providers and smaller regional companies on the basis of price, coverages offered, claims handling, customer service, agent commissions, geographic coverage and financial strength ratings. Some of our competitors have more capital, higher ratings and greater resources than we have, and may offer a broader range of products than we offer.

Many of our competitors invest heavily in advertising and marketing efforts and/or expanding their online service offerings. Many of these competitors have better brand recognition than we have and have a significantly larger market share than we do. As a result, these larger competitors may be better able to offer lower rates to consumers, to withstand larger losses, and to more effectively take advantage of new marketing opportunities. Our ability to compete against these larger competitors depends on our ability to deliver superior service and maintain our relationships with independent agents, distribution partners and affinity groups.

In our lender-placed insurance business, we use a proprietary insurance-tracking system to monitor the clients’ mortgage portfolios to verify the existence of insurance on each mortgaged property and identify those that are uninsured. If, in addition to our current competitors, others in this industry develop a competing system or equivalent

administering capabilities, this could adversely affect our business and results of operations.

***We write a significant amount of business in the nonstandard auto insurance market, which could make us more susceptible to unfavorable market conditions which have a disproportionate effect on that customer base.***

A significant amount of our P&C premium currently is written in the nonstandard auto insurance market. As a result, adverse developments in the economic, competitive or regulatory environment affecting the nonstandard

customer base or the nonstandard auto insurance industry in general may have a greater effect on us as compared to a more diversified auto insurance carrier with a larger percentage of its business in other types of auto insurance products. Adverse developments of this type may have a material adverse effect on our business.

***We generate significant revenue from service fees generated from our P&C and A&H policyholders, which could be adversely affected by additional insurance or consumer protection regulation.***

For the year ended December 31, 2018, we generated $561.6 million in service and fee revenue from our P&C and A&H policyholders, which included, among others, origination fees, installment fees relating to installment payment plans, late payment fees, policy cancellation fees and reinstatement fees. The revenue we generate from these service fees could be reduced by changes in consumer protection or insurance regulation that restrict or prohibit our ability to charge these fees. If our ability to charge fees for these services were to be restricted or prohibited, there can be no assurance that we would be able to obtain rate increases or take other action to offset the lost revenue and the direct and indirect costs associated with providing the services, which could adversely affect our business, financial condition and results of operations.

***The insurance industry is cyclical in nature, which may affect our overall financial performance.***

Historically, the financial performance of the insurance industry has tended to fluctuate in cyclical periods of price competition and excess capacity (known as a soft market) followed by periods of high premium rates and shortages of underwriting capacity (known as a hard market). The profitability of most insurance companies tends to follow this cyclical market pattern. We cannot predict with certainty the timing or duration of changes in the market cycle because the cyclicality is due in large part to the actions of our competitors and general economic factors beyond our control. These cyclical patterns, the actions of our competitors, and general economic factors could cause our revenues and net income to fluctuate, which may adversely affect our business.

***Catastrophic losses or the frequency of smaller insured losses may exceed our expectations as well as the limits of our reinsurance, which could adversely affect our financial condition and results of operations.***

Our P&C insurance business is subject to claims arising from catastrophes, such as hurricanes, tornadoes, windstorms, floods, earthquakes, hailstorms, severe winter weather, and fires, or other events, such as explosions, terrorist attacks, riots, and hazardous material releases. The incidence and severity of such events are inherently unpredictable, and our losses from catastrophes could be substantial. Our 2018 financial results were significantly impacted by hurricanes and wildfires, and due to the inherent uncertainty of such catastrophes in future periods, any future impact remains difficult to predict.

Longer-term weather trends are changing and new types of catastrophe losses may be developing due to climate change, a phenomenon that may be associated with extreme weather events linked to rising temperatures, including effects on global weather patterns, sea, land and air temperature, sea levels, rain and snow. Climate change could increase the frequency and severity of catastrophe losses we experience in both coastal and non-coastal areas.

In addition, it is possible that we may experience an unusual frequency of smaller losses in a particular period. In either case, the consequences could be substantial volatility in our financial condition or results of operations for any fiscal quarter or year, which could have a material adverse effect on our financial condition or results of operations and our ability to write new business. Although we believe that our geographic and product mix creates limited exposure to catastrophic events and we attempt to manage our exposure to these types of catastrophic and cumulative losses, including through the use of reinsurance, catastrophic events are inherently unpredictable and the severity or frequency of these types of losses may exceed our expectations as well as the limits of our reinsurance coverage.

***We rely on the use of credit scoring in pricing and underwriting our auto insurance policies and any legal or regulatory requirements which restrict our ability to access credit score information could decrease the accuracy of our pricing and underwriting process and thus lower our profitability.***

We use credit scoring as a factor in pricing and underwriting decisions where allowed by state law. Consumer groups and regulators have questioned whether the use of credit scoring unfairly discriminates against some groups of people and are calling for laws and regulations to prohibit or restrict the use of credit scoring in underwriting and pricing. Laws or regulations that significantly curtail or regulate the use of credit scoring, if enacted in a large number of states in which we operate, could impact the integrity of our pricing and underwriting process, which could, in turn, adversely affect our business, financial condition and results of operations and make it harder for us to be profitable over time.

***If market conditions cause our reinsurance to be more costly or unavailable, we may be required to bear increased risks or reduce the level of our underwriting commitments.***

As part of our overall risk and capacity management strategy, we purchase excess of loss catastrophic and casualty reinsurance for protection against catastrophic events and other large losses. We also rely on quota share insurance agreements to cede a portion of the risk on the policies that we write. Market conditions beyond our control, in terms of price and available capacity, may affect the amount of reinsurance we acquire and our profitability.

We may be unable to maintain our current reinsurance arrangements or to obtain other reinsurance in adequate amounts and at favorable rates. Increases in the cost of reinsurance would adversely affect our profitability. In addition, if we are unable to renew our expiring arrangements or to obtain new reinsurance on favorable terms, either our net exposure to risk would increase, which would increase our costs, or, if we are unwilling to bear an increase in net risk exposures, we would have to reduce the amount of risk we underwrite, which would reduce our revenues.

***We may not be able to recover amounts due from our reinsurers, which would adversely affect our financial condition.***

Reinsurance does not discharge our obligations under the insurance policies we write; it merely provides us with a contractual right to seek reimbursement on certain claims. We remain liable to our policyholders even if we are unable to make recoveries that we are entitled to receive under our reinsurance contracts. As a result, we are subject to credit risk with respect to our reinsurers. Losses are recovered from our reinsurers after underlying policy claims are paid. The creditworthiness of our reinsurers may change before we recover amounts to which we are entitled. Therefore, if a reinsurer is unable to meet its obligations to us, we would be responsible for claims and claim settlement expenses for which we would have otherwise received payment from the reinsurer. If we were unable to collect these amounts from our reinsurers, our costs would increase and our financial condition would be adversely affected. As of December 31, 2018, we had an aggregate amount of approximately $1,611.7 million of recoverables from reinsurers.

Our largest reinsurance recoverables are from the NCRF and the MCCA. The NCRF is a non-profit organization established to provide automobile liability reinsurance to those insurance companies that write automobile insurance in North Carolina. The MCCA is a Michigan reinsurance mechanism that covers no-fault first party medical losses of retentions in excess of $0.6 million in 2018. At December 31, 2018, the amount of reinsurance recoverable on unpaid losses from the NCRF and the MCCA was approximately $134.9 million and $590.2 million, respectively. If any of our principal reinsurers were unable to meet its obligations to us, our financial condition and results of operations would be materially adversely affected.

***The effects of emerging claim and coverage issues on our business are uncertain and negative developments in this area could have an adverse effect on our business.***

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until after we have issued insurance policies that are affected by the changes. As a result, the full extent of our liability under an insurance policy may not be known until many years after the policy

is issued. For example, medical costs associated with permanent and partial disabilities may increase more rapidly or be higher than we currently expect. Changes of this nature may expose us to higher claims than we anticipated when we wrote the underlying policy. Unexpected increases in our claim costs many years after policies are issued may also result in our inability to recover from certain of our reinsurers the full amount that they would otherwise owe us for such claims costs because certain of the reinsurance agreements covering our business include commutation clauses that permit the reinsurers to terminate their obligations by making a final payment to us based on an estimate of their remaining liabilities. In addition, the potential passage of new legislation designed to expand the right to sue, to remove limitations on recovery, to deem by statute the existence of a covered occurrence, to extend the statutes of limitations or otherwise repeal or weaken tort reforms could have an adverse impact on our business. The effects of these and other unforeseen emerging claim and coverage issues are extremely hard to predict and could be harmful to our business and have a material adverse effect on our results of operations.

***The effects of litigation on our business are uncertain and could have an adverse effect on our business.***

We may from time to time be subject to a variety of legal actions relating to our current and past business operations including, but not limited to, disputes over coverage or claims adjudication, including claims alleging that we have acted in bad faith in the administration of claims by our policyholders, disputes with our agents or producers over compensation and termination of contracts and related claims, disputes relating to certain business acquired or disposed of by us and disputes with former employees. We also cannot determine with any certainty what new theories of recovery may evolve or what their impact may be on our business.

Class action claims present additional exposure to substantial economic, non-economic or punitive damage awards. The loss of even one of these claims, if it results in a significant damage award or a judicial ruling that was otherwise detrimental, could create a precedent in the industry that could have an adverse effect on our business.

***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.

**Risks Related to an Investment in our Common Stock**

***Our revenues and results of operations may fluctuate as a result of factors beyond our control, which may cause volatility in the price of our shares of common stock.***

Our common stock is listed on the Nasdaq Global Market (“Nasdaq”) under the symbol “NGHC.” Our performance, as well as the risks discussed herein, government or regulatory action, tax laws, interest rates and general market conditions could have a significant impact on the future market price of our common stock. The market price for shares of our common stock may be subject to low volume and may be highly volatile and you may not be able to resell your shares of our common stock at or above the price you paid to purchase the shares or at all. Some of the factors that could negatively affect our share price or result in fluctuations in the price of our common stock include:

- our operating results in any future quarter not meeting or being anticipated not to meet the expectations of market analysts or investors;

- reductions in our earnings estimates by us or market analysts;
- publication of negative research or other unfavorable publicity or speculation in the press or investment community about our company, related companies or the insurance industry in general;
- rising level of claims costs, changes in the frequency or severity of claims or new types of claims and new or changing judicial interpretations relating to the scope of insurance company liability;

- the financial stability of our third-party reinsurers, changes in the level of reinsurance capacity, termination of reinsurance arrangements and changes in our capital capacity;
- increases in interest rates causing investors to demand a higher yield or return on investment than an investment in our common stock may be projected to provide;
- changes in market valuations of other insurance companies;
- adverse market reaction to any increased indebtedness we incur in the future;
- fluctuations in interest rates or inflationary pressures and other changes in the investment environment that affect returns on invested assets;
- additions or departures of key personnel;
- reaction to the sale or purchase of company stock by our principal stockholders or our executive officers;
- changes in the economic or regulatory environment in the markets in which we operate;
- changes in law; and
- general market, economic and political conditions.

***Our principal stockholder has the ability to significantly impact our business, which may be disadvantageous to other stockholders.***

Leah Karfunkel beneficially owns or controls approximately 39.5% of our outstanding shares of common stock. As a result, Mrs. Karfunkel has the ability to significantly impact all matters requiring approval by our stockholders, including the election and removal of directors, amendments to our certificate of incorporation (other than changes to the rights of the common stock) and bylaws, any proposed merger, consolidation or sale of all or substantially all of our assets and other corporate transactions. Mrs. Karfunkel may have interests that are different from those of other stockholders.

In addition, members of the Karfunkel family, through entities that they control, have entered into transactions with us and may from time to time in the future enter into other transactions with us. As a result, they may have interests that are different from, or are in addition to, their interests as a stockholder in our company. Such transactions may adversely affect our results or operations or financial condition.

Our officers, directors and principal stockholder could delay or prevent an acquisition or merger of our company even if the transaction would benefit other stockholders. Moreover, this concentration of share ownership makes it difficult for other stockholders to replace directors without the consent of Leah Karfunkel. In addition, this significant concentration of share ownership may adversely affect the price at which prospective buyers are willing to pay for our common stock because investors often perceive disadvantages in owning stock in companies with principal stockholders.

***In order to comply with the requirements of being a public company we continually enhance certain of our corporate processes, which require significant company resources and management attention.***

As a public company with listed equity securities, we need to comply with the laws, regulations and requirements, corporate governance provisions of The Sarbanes-Oxley Act of 2002, periodic reporting requirements of the Exchange Act and other regulations of the SEC and the requirements of the Nasdaq Global Market. In order to comply with these laws, rules and regulations, we have to continually monitor and enhance certain of our corporate processes, which require us to incur significant legal, accounting and other expenses. These efforts also require a significant amount of time from our board of directors and management, possibly diverting their attention from the implementation of our business plan and growth strategy.

We have made, and will continue to make, changes to our corporate governance standards, disclosure controls, financial reporting and accounting systems to meet our obligations as a public company. We cannot assure you that

the changes we have made and will continue to make to satisfy our obligations as a public company will be successful, and any failure on our part to do so could subject us to delisting of our common stock, fines, sanctions and other regulatory action and potential litigation.

***Failure to maintain an effective system of internal control over financial reporting may have an adverse effect on our stock price.***

Section 404 of the Sarbanes-Oxley Act of 2002 and the related rules and regulations of the SEC require an annual management assessment of the effectiveness of our internal control over financial reporting. If we fail to maintain the adequacy of our internal control over financial reporting, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 and the related rules and regulations of the SEC. If we cannot in the future favorably assess the effectiveness of our internal control over financial reporting, investor confidence in the reliability of our financial reports may be adversely affected, which could have a material adverse effect on our common stock prices.

***Future sales and issuances of shares of our capital stock may depress our share price.***

We may in the future issue our previously authorized and unissued securities. We have an authorized capitalization of 150 million shares of common stock and 10 million shares of preferred stock with such designations, preferences and rights as are contained in our charter or bylaws and as determined by our board of directors. Issuances of stock may result in dilution of our existing stockholders or a decrease in the per share price of our common stock. It is not possible to state the actual effect of the issuance of any shares of our preferred stock on the rights of holders of our common stock until our board of directors determines the specific rights attached to that class or series of preferred stock.

We cannot predict what effect, if any, future sales of our common stock, or the availability of shares for future sale, will have on the price prospective buyers are willing to pay for our common stock. Sales of a substantial number of shares of our common stock by us or our principal stockholders, or the perception that such sales could occur, may adversely affect the price prospective buyers are willing to pay for our common stock and may make it more difficult for you to sell your shares at a time and price that you determine appropriate.

***Applicable insurance laws may make it difficult to effect a change of control of our company.***

State insurance holding company laws require prior approval by the respective state insurance departments of any change of control of an insurer. “Control” is generally defined as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of the company, whether through the ownership of voting securities, by contract or otherwise. Control is generally presumed to exist through the direct or indirect ownership of 10% or more of the voting securities of a domestic insurance company or any entity that controls a domestic insurance company. Any person wishing to acquire control of us or of any substantial portion of our outstanding shares would first be required to obtain the approval of the domestic regulators (including those asserting “commercial domicile”) of our insurance subsidiaries. These laws may discourage potential acquisition proposals and may delay, deter or prevent a change of control of us, including through transactions, and in particular unsolicited transactions, that some or all of our stockholders might consider to be desirable.

***Future issuance of debt or preferred stock, which would rank senior to our common stock upon our liquidation, and future offerings of equity securities, which would dilute our existing stockholders, may adversely affect the market value of our common stock.***

In the future, we may attempt to increase our capital resources by issuing debt or making additional offerings of equity securities, including bank debt, commercial paper, medium-term notes, senior or subordinated notes and classes of shares of preferred stock. Upon liquidation, holders of our debt securities and preferred stock and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of shares of our common

stock. Additional equity offerings may dilute the holdings of our existing stockholders or reduce the market value of our common stock, or both. Future issuances of preferred stock could have a preference on liquidating distributions or a preference on dividend payments that would limit amounts available for distribution to holders of shares of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings.

Thus, holders of shares of our common stock bear the risk of our future offerings reducing the market value of our common stock and diluting their stockholdings in us.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

We use an aggregate of approximately 1,944,100 square feet in approximately 65 office locations and approximately 460 store fronts. We have an ownership interest in the entities that own the buildings in which we lease space at two of these locations, which represent an aggregate of approximately 276,770 square feet.

**Item 3. 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. See Note 14, “Commitments and Contingencies” in the notes to our Consolidated Financial Statements.

**Item 4. Mine Safety Disclosures**

None.

**PART II**

**Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities**

*Shareholders*

Our common shares began trading on the Nasdaq Global Market under the symbol "NGHC" on February 20, 2014. We have one class of authorized common stock for 150,000,000 shares at a par value of $0.01 per share. As of February 20, 2019 there were approximately 279 registered record holders of our common shares. This figure does not include beneficial owners who hold shares in nominee name.

*Dividend Policy*

Our board of directors currently intends to continue to authorize the payment of a quarterly cash dividend to our stockholders of record. Any declaration and payment of dividends by our board of directors will depend on many factors, including general economic and business conditions, our strategic plans, our financial results and condition, legal and regulatory requirements and other factors that our board of directors deems relevant.

National General Holdings Corp. is a holding company and has no direct operations. Our ability to pay dividends in the future depends on the ability of our operating subsidiaries, including our insurance subsidiaries, to transfer funds to us in the form of a dividend. The laws of the jurisdictions in which our insurance subsidiaries are organized regulate and restrict, under certain circumstances, their ability to pay dividends to us. The aggregate amount of cash dividends and distributions that could be paid to us by our insurance subsidiaries without prior approval by the various domiciliary states of our insurance subsidiaries was approximately $287.9 million as of December 31, 2018, taking into account dividends paid in the prior twelve month period. Under the terms of our credit agreement, we are not prohibited from paying cash dividends so long as no event of default has occurred and is continuing and we are not out of compliance with our financial covenants. We may, however, enter into credit agreements or other debt arrangements in the future that will restrict our ability to declare or pay cash dividends on our common stock.

*Common Stock Performance Graph*

Set forth below is a line graph comparing the cumulative total shareholder return on our common stock for the period beginning February 20, 2014 and ending on December 31, 2018 with the cumulative total return on the Nasdaq Global Market Index and a peer group comprised of the Nasdaq Insurance Index. The graph shows the change in value of an initial $100 investment on February 20, 2014. The stock price performance of the following graph is not necessarily indicative of future stock price performance.

Comparative Cumulative Total Returns Since February 20, 2014 for National General Holdings Corp., Nasdaq Composite Index and Nasdaq Insurance Index

This information is not deemed to be “soliciting material” or to be “filed” with the SEC or subject to the liabilities of Section 18 of the Exchange Act, nor shall it be deemed incorporated by reference in any of our filings under the Securities Act or the Exchange Act.

## Item 6. Selected Financial Data

The following tables set forth our selected historical consolidated financial and operating information for the periods ended and as of the dates indicated. The income statement data for the years ended December 31, 2018, 2017 and 2016 and the balance sheet data as of December 31, 2018 and 2017 are derived from our audited financial statements included elsewhere in this annual report. These historical results are not necessarily indicative of results to be expected from any future period.

You should read the following selected consolidated financial information together with the other information contained in this annual report, including "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and related notes included elsewhere in this annual report.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | **2018** | **2017** | **2016** | **2015** | **2014** |
| **Selected Income Statement Data[1]** | *(amounts in thousands, except percentages and per share data)* | | | | |
| Gross premium written | $5,416,839 | $4,755,985 | $3,500,898 | $2,590,044 | $2,135,107 |
| Ceded premiums[2] | (1,589,126) | (1,178,390) | (428,202) | (403,502) | (265,083) |
| Net premium written | $3,827,713 | $3,577,595 | $3,072,696 | $2,186,542 | $1,870,024 |
| Change in unearned premium | (95,511) | 76,581 | (77,525) | (56,436) | (236,804) |
| Net earned premium | $3,732,202 | $3,654,176 | $2,995,171 | $2,130,106 | $1,633,220 |
| Ceding commission income | 224,697 | 116,456 | 45,600 | 43,790 | 12,430 |
| Service and fee income | 561,583 | 502,927 | 380,817 | 273,548 | 168,571 |
| Net investment income[3] | 119,034 | 101,950 | 115,187 | 78,783 | 53,606 |
| Net gain (loss) on investments | (29,545) | 46,763 | 7,904 | (11,095) | (4,552) |
| Other income (expense) | — | (198) | 24,308 | — | — |
| Total revenues | $4,607,971 | $4,422,074 | $3,568,987 | $2,515,132 | $1,863,275 |
| Loss and loss adjustment expense | 2,662,226 | 2,626,082 | 2,092,280 | 1,485,320 | 1,125,136 |
| Acquisition costs and other underwriting expenses[4] | 735,266 | 672,429 | 497,007 | 406,662 | 315,089 |
| General and administrative expenses[5] | 938,046 | 912,996 | 709,148 | 426,976 | 283,334 |
| Interest expense | 51,425 | 47,086 | 40,180 | 28,885 | 17,736 |
| Total expenses | $4,386,963 | $4,258,593 | $3,338,615 | $2,347,843 | $1,741,295 |
| Income before provision for income taxes | $221,008 | $163,481 | $230,372 | $167,289 | $121,980 |
| Provision for income taxes | 53,484 | 61,273 | 33,998 | 16,176 | 21,551 |
| Net income | $167,524 | $102,208 | $196,374 | $151,113 | $100,429 |
| Less: Net (income) loss attributable to non-controlling interest | 39,830 | 3,637 | (20,668) | (14,025) | (2,504) |
| Net income attributable to National General Holdings Corp. | $207,354 | $105,845 | $175,706 | $137,088 | $97,925 |
| Dividends on preferred stock | (32,492) | (31,500) | (24,333) | (14,025) | (2,291) |
| Net income attributable to National General Holdings Corp. common stockholders | $174,862 | $74,345 | $151,373 | $123,063 | $95,634 |
| **Per common share data:** | | | | | |
| Basic earnings per share | $1.62 | $0.70 | $1.43 | $1.25 | $1.05 |
| Weighted average shares outstanding - basic | 107,660 | 106,588 | 105,952 | 98,242 | 91,499 |
| Diluted earnings per share | $1.59 | $0.68 | $1.40 | $1.22 | $1.02 |
| Weighted average shares outstanding - diluted | 110,822 | 108,752 | 108,278 | 100,724 | 93,515 |
| Dividends declared per common share | $0.16 | $0.16 | $0.14 | $0.09 | $0.05 |
| **Insurance Ratios** | | | | | |
| Net loss ratio[6] | 71.3 % | 71.9 % | 69.9 % | 69.7 % | 68.9 % |
| Net operating expense ratio (non-GAAP)[7][8] | 23.5 % | 26.4 % | 26.0 % | 24.2 % | 25.6 % |
| Net combined ratio (non-GAAP)[7][8][9] | 94.8 % | 98.3 % | 95.9 % | 93.9 % | 94.5 % |
| **Insurance Ratios Before Amortization and Impairment (non-GAAP)** | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net operating expense ratio before amortization and impairment (non-GAAP)[10] | 22.7 | % 24.7 | % 23.6 | % 22.4 | % 23.7 | % |
| Net combined ratio before amortization and impairment (non-GAAP)[10][11] | 94.0 | % 96.6 | % 93.5 | % 92.1 | % 92.6 | % |

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| **Selected Balance Sheet Data** | *(amounts in thousands)* | | | | |
| Investments | $4,226,806 | $3,649,788 | $3,631,064 | $2,785,510 | $1,991,105 |
| Cash, cash equivalents and restricted cash | $233,583 | $357,484 | $285,900 | $282,277 | $132,615 |
| Premiums and other receivables, net | $1,399,812 | $1,324,321 | $1,091,774 | $694,577 | $588,125 |
| Reinsurance recoverable | $1,611,738 | $1,294,165 | $948,236 | $897,232 | $971,116 |
| Intangible assets, net and Goodwill | $560,120 | $578,223 | $626,084 | $461,312 | $319,601 |
| Total assets | $9,439,280 | $8,439,743 | $7,238,028 | $5,556,192 | $4,324,716 |
| Unpaid loss and loss adjustment expense reserves | $2,957,159 | $2,663,557 | $2,273,866 | $1,762,575 | $1,568,796 |
| Unearned premiums and other revenue | $2,280,728 | $2,032,605 | $1,701,286 | $1,257,598 | $872,963 |
| Debt | $675,449 | $713,710 | $752,001 | $491,537 | $299,082 |
| Total liabilities | $7,238,409 | $6,486,318 | $5,320,670 | $4,029,034 | $3,255,584 |
| Common stock and additional paid-in capital | $1,058,912 | $918,818 | $914,851 | $901,170 | $691,670 |
| Preferred stock | $450,000 | $420,000 | $420,000 | $220,000 | $55,000 |
| Non-controlling interest | $(19,967) | $24,856 | $31,918 | $22,840 | $13,756 |
| Total stockholders' equity | $2,200,871 | $1,953,425 | $1,917,358 | $1,527,158 | $1,069,132 |

(1) Results of operations were affected by our various acquisitions and reinsurance transactions from 2014 to 2018.

(2) Premiums ceded to related parties were not material for the years ended December 31, 2018, 2017 and 2016, and amounted to $1,578 and $44,936 for the years ended December 31, 2015 and 2014, respectively.

(3) Earnings (losses) of equity method investments, including those with related parties, is recorded within net investment income.

(4) Acquisition costs and other underwriting expenses include policy acquisition expenses, commissions paid directly to producers, premium taxes and assessments, salary and benefits and other insurance general and administrative expenses which represent other costs that are directly attributable to insurance activities.

(5) 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.

(6) Net loss ratio is calculated by dividing the loss and loss adjustment expense by net earned premiums.

(7) 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, service and fee income and significant corporate litigation expenses. 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, service and fee income and significant corporate litigation expenses in the calculation of net operating expense, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation-Results of Operations-Consolidated Results of Operations."

(8) Net operating expense ratio (non-GAAP) is calculated by dividing the net operating expense by net earned premium. Net operating expense consists of the sum of acquisition costs and other underwriting expenses and

general and administrative expenses less ceding commission income, service and fee income and significant corporate litigation expenses.

(9) Net combined ratio (non-GAAP) is calculated by adding net loss ratio and net operating expense ratio (non-GAAP) together.

(10) Net operating expense ratio before amortization and impairment (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 before non-cash amortization of intangible assets and non-cash impairment of goodwill to net earned premium.

(11) The net combined ratio before amortization and impairment (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 before amortization and impairment (non-GAAP). If the net combined ratio before amortization and impairment (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. Management believes that this measure of underwriting profitability provides a more useful comparison to the combined ratio of other insurance companies involved in less acquisitions.

**Item 7. 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 consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. This Form 10-K 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. See "Note on Forward-Looking Statements."*

**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 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 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 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 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. Our operating results for the

year ended December 31, 2018 have been negatively impacted by losses resulting from severe weather, including Hurricanes Florence and Michael, and losses from California wildfires.

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 year ended December 31, 2018, our operating leverage (the ratio of net earned premium to average total stockholders' equity) was 1.8x, 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 $119.0 million, $102.0 million and $115.2 million for the years ended December 31, 2018, 2017 and 2016, respectively. We held 5.2% and 8.9%, of total invested assets in cash, cash equivalents and restricted cash as of December 31, 2018 and 2017, respectively.

Our most significant balance sheet liability is our unpaid loss and loss adjustment expense ("LAE") reserves. As of December 31, 2018 and 2017, our reserves, net of reinsurance recoverable on unpaid losses, were $1.7 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 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 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 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, at the time when the policy is sold. 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. We report all gains (losses) on equity securities 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 financial statement balances that are denominated or stated in another currency into the 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 attributable to those agents, wholesalers or brokers that produce premiums written on our behalf and promotional fees 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 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, service and fee income and significant corporate litigation expenses.

*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 are 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 combined ratio before amortization and impairment (non-GAAP)*. The net combined ratio before amortization and impairment (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 before amortization and impairment (non-GAAP). If the net combined ratio before amortization and impairment (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. Management believes that this measure of underwriting profitability provides a more useful comparison to the combined ratio of other insurance companies involved in less acquisitions. Our definition of net operating expense ratio before amortization and impairment is as follows:

*Net operating expense ratio before amortization and impairment (non-GAAP)*. The net operating expense ratio before amortization and impairment (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 before non-cash amortization of intangible assets and non-cash impairment of goodwill to net earned premium.

Net operating expense ratio, net operating expense ratio before amortization and impairment, net combined ratio and net combined ratio before amortization and impairment 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. We use net operating expense ratio (non-GAAP), net operating expense ratio before amortization and impairment (non-GAAP), net combined ratio (non-GAAP) and net combined ratio before amortization and impairment (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 us. 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, service and fee income and significant corporate litigation expenses in the calculation of net operating expense, see “Results of Operations - Consolidated Results of Operations” below.

**Critical Accounting Policies and Estimates**

Our significant accounting policies are discussed in Note 2, “Significant Accounting Policies” in the notes to our Consolidated Financial Statements.

*Use of estimates and assumptions*. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Our principal estimates include unpaid losses and LAE reserves; deferred acquisition costs; reinsurance recoverables, including the provision for uncollectible amounts; recording of impairment losses for other-than-temporary declines in fair value; determining the fair value of investments; determining the fair value of share-based awards for stock compensation; the valuation of intangibles and the determination of goodwill and goodwill impairment; and income taxes. In developing the estimates and assumptions, management uses all available evidence. Because of uncertainties associated with estimating the amounts, timing and likelihood of possible outcomes, actual results could differ from estimates.

*Premiums and Other Receivables.* We recognize earned premium on a pro rata basis over the terms of the policies, generally periods of six or twelve months. Unearned premium represents the portion of premiums written applicable to the unexpired terms of the policies. Net premiums receivable represent premium written and not yet collected, net of an allowance for uncollectible premium. We regularly evaluate premium and other receivables and adjust for uncollectible amounts as appropriate. Receivables specifically identified as uncollectible are charged to expense in the period the determination is made.

*Service and fee income.* We currently 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 costs associated with generating fee income are not separately tracked. We estimate an allowance for doubtful accounts based on a percentage of fee income.

We also collect service fees in the form of commissions and general agent fees by selling policies issued by third-party insurance companies. We do not bear insurance underwriting risk with respect to these policies. Commission income and general agent fees are recognized, net of an allowance for estimated policy cancellations, at the time when the policy is sold. The allowance for estimated third-party cancellations is periodically evaluated and adjusted as necessary.

*Reserves for loss and loss adjustment expenses.* We record reserves for estimated losses under insurance policies that we write and for LAE related to the investigation and settlement of policy claims. Our reserves for loss and LAE represent the estimated cost of all reported and unreported loss and LAE incurred and unpaid at any given point in time based on known facts and circumstances.

Loss reserves include statistical reserves and case estimates for individual claims that have been reported and estimates for claims that have been incurred but not reported at the balance sheet date as well as estimates of the expenses associated with processing and settling all reported and unreported claims, less estimates of anticipated salvage and subrogation recoveries. Estimates are based upon past loss experience modified for current trends as well as economic, legal and social conditions. Loss reserves, except life reserves, are not discounted to present value, which would involve recognizing the time value of money and offsetting estimates of future payments by future expected investment income.

In establishing these estimates, we make various assumptions regarding a number of factors, including frequency and severity of claims, the length of time needed to achieve ultimate settlement of claims, inflation of medical costs, insurance policy coverage interpretations, jury determinations and legislative changes. Due to the inherent uncertainty associated with these estimates, and the cost of incurred but unreported claims, our actual liabilities may be different from our original estimates. On a quarterly basis, we review our reserves for loss and loss adjustment expenses to determine whether further adjustments are required. Any resulting adjustments are included in the period in which adjustments are determined. Additional information regarding the judgments and uncertainties surrounding our estimated reserves for loss and loss adjustment expenses can be found in Item 1, “Business-Loss Reserves.”

*Reinsurance.* We cede insurance risk under various reinsurance agreements. We seek to reduce the loss that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk with other insurance enterprises. We remain liable with respect to any insurance ceded if the assuming companies are unable to meet their obligations under these reinsurance agreements.

Reinsurance premiums, losses and LAE ceded to other companies are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Earned premiums and losses and LAE incurred ceded to other companies have been recorded as a reduction of premium revenue and losses and LAE. Commissions allowed by reinsurers on business ceded have been recorded as ceding commission revenue to the extent the ceding commission exceeds acquisition costs. Reinsurance recoverables are reported based on the portion of reserves and paid losses and LAE that are ceded to other companies. Assessing whether or not a reinsurance contract meets the condition for risk transfer requires judgment. The determination of risk transfer is critical to reporting premiums and losses, and is based, in part, on the use of actuarial and pricing models and assumptions. If we determine that a reinsurance contract does not transfer sufficient risk, we account for the contract under deposit accounting.

*Deferred acquisition costs.* Deferred acquisition costs include commissions, premium taxes, payments to affinity partners, promotional fees, and other direct sales costs that vary and are directly related to the successful acquisition of insurance policies. These costs are deferred and amortized to the extent recoverable over the policy period in which the related premiums are earned. Anticipated investment income is considered in the calculation of premium deficiency losses for short-duration contracts. Management believes that these costs are recoverable.

*Assessments related to insurance premiums.* We are subject to a variety of insurance-related assessments, such as assessments by state guaranty funds used by state insurance regulators to cover losses of policyholders of insolvent

insurance companies and for the operating expenses of such agencies. A typical obligating event would be the issuance of an insurance policy or the occurrence of a claim. These assessments are accrued in the period in which they have been incurred. We use estimated assessment rates in determining the appropriate assessment expense and accrual. We use estimates derived from state regulators and/or National Association of Insurance Commissioners ("NAIC") Tax and Assessments Guidelines.

*Unearned premium reserves.* Unearned premium reserves represent the portion of premiums written applicable to the unexpired terms of the policies.

*Investments.* We account for our investments in debt securities in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 320, "Investments - Debt Securities," and certain equity investments with ASC 321, "Investments - Equity Securities." In accordance with ASC 320, our debt securities are classified as available for sale and are measured at fair value with unrealized gains and losses reported as a separate component of comprehensive income. Equity investments (except those accounted for under the equity method, and those that result in consolidation of the investee and certain other investments) are measured at fair value with all gains and losses reported in net income in accordance with ASC 321. We may sell our available-for-sale and equity securities in response to changes in interest rates, risk/reward characteristics, liquidity needs or other factors. Available-for-sale and equity securities are reported at their estimated fair values based on quoted market prices or recognized pricing services.

Purchases and sales of investments are recorded on a trade date basis. Realized gains and losses are determined based on the specific identification method. Net investment income is recognized when earned and includes interest and dividend income together with amortization of market premiums and discounts using the effective yield method and is net of investment management fees and other expenses. For mortgage-backed securities and any other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised as necessary. Any adjustments required due to the change in effective yields and maturities are recognized on a prospective basis through yield adjustments.

We use a set of quantitative and qualitative criteria to evaluate the necessity of recording impairment losses for other-than-temporary declines in fair value. These criteria include:

- the current fair value compared to amortized cost;
- the length of time that the security's fair value has been below its amortized cost;
- specific credit issues related to the issuer such as changes in credit rating or non-payment of scheduled interest payments;
- whether management intends to sell the security and, if not, whether it is not more likely than not that we will be required to sell the security before recovery of its amortized cost basis;
- the financial condition and near-term prospects of the issuer of the security, including any specific events that may affect its operations or earnings;
- the occurrence of a discrete credit event resulting in the issuer defaulting on a material outstanding obligation or the issuer seeking protection under bankruptcy laws; and
- other items, including management, media exposure, sponsors, marketing and advertising agreements, debt restructurings, regulatory changes, acquisitions and dispositions, pending litigation, distribution agreements and general industry trends.

Impairment of investment securities results in a charge to operations when a market decline below cost is deemed to be other-than-temporary. We immediately write down investments that we consider to be impaired based on the foregoing criteria collectively.

In the event of the decline in fair value of a debt security, a holder of that security that does not intend to sell the debt security and for whom it is not more likely than not that such holder will be required to sell the debt security before recovery of its amortized cost basis is required to separate the decline in fair value into (a) the amount representing the credit loss and (b) the amount related to other factors. The amount of total decline in fair value related to the credit loss shall be recognized in earnings as an other-than-temporary impairment ("OTTI") with the amount related to other

factors recognized in accumulated other comprehensive income or loss, net of tax. OTTI credit losses result in a permanent reduction of the cost basis of the underlying investment. The determination of OTTI is a subjective process, and different judgments and assumptions could affect the timing of the loss realization.

*Goodwill and intangible assets*. We account for goodwill and intangible assets in accordance with ASC 350, “Intangibles - Goodwill and Other.” A purchase price paid that is in excess of net assets (“goodwill”) arising from a business combination is recorded as an asset and is not amortized. Intangible assets with a finite life are amortized over the estimated useful life of the asset. Intangible assets with an indefinite useful life are not amortized. Goodwill and intangible assets are tested for impairment on an annual basis or more frequently if changes in circumstances indicate that the carrying amount may not be recoverable. If the goodwill or intangible asset is impaired, it is written down to its realizable value with a corresponding expense reflected in the Consolidated Statements of Income.

*Business combinations.* We account for business combinations under the acquisition method of accounting, which requires us to record assets acquired, liabilities assumed and any non-controlling interest in the acquiree at their respective fair values as of the acquisition date. We account for the insurance and reinsurance contracts under the acquisition method as new contracts, which requires us to record assets and liabilities at fair value. We adjust the fair value of loss and LAE reserves by recording the acquired loss reserves based on our existing accounting policies and then discounting them based on expected reserve payout patterns using a current risk-free rate of interest. This risk-free interest rate is then adjusted based on different cash flow scenarios that use different payout and ultimate reserve assumptions deemed to be reasonably possible based upon the inherent uncertainties present in determining the amount and timing of payment of such reserves. The difference between the acquired loss and LAE reserves and our best estimate of the fair value of such reserves at the acquisition date is recorded as either an intangible asset or another liability, as applicable and is amortized proportionately to the reduction in the related loss reserves (e.g., over the estimated payout period of the acquired loss and LAE reserves). We assign fair values to intangible assets acquired based on valuation techniques including the income and market approaches. We record contingent consideration at fair value based on the terms of the purchase agreement with subsequent changes in fair value recorded through earnings. The purchase price is the fair value of the total consideration conveyed to the seller and we record the excess of the purchase price over the fair value of the acquired net assets, where applicable, as goodwill. We expense costs associated with the acquisition of a business in the period incurred.

*Non-controlling Interest.* Non-redeemable non-controlling interest is the portion of equity (net assets) not attributable, directly or indirectly, to a parent. We have no ownership interest in the Reciprocal Exchanges. Therefore, the difference between the value of their assets and liabilities represent the value of the non-controlling interest.

*Fair value of financial instruments.* Our estimates of fair value for financial assets and financial liabilities are based on the framework established in ASC 820, “Fair Value Measurements and Disclosures.” The framework is based on the inputs used in valuation and gives the highest priority to quoted prices in active markets and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the ASC 820 hierarchy is based on whether the significant inputs into the valuation are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect our significant market assumptions. Additionally, valuation of debt securities investments is more subjective when markets are less liquid due to lack of market-based inputs, which may increase the potential that the estimated fair value of an investment is not reflective of the price at which an actual transaction could occur. Fair values of other financial instruments which are short-term in nature approximate their carrying values.

ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value

hierarchy that prioritizes the information used to develop those assumptions. Additionally, ASC 820 requires an entity to consider all aspects of nonperformance risk, including the entity's own credit standing, when measuring the fair value of a liability.

ASC 820 establishes a three-level hierarchy to be used when measuring and disclosing fair value. An instrument's categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation. Following is a description of the three hierarchy levels:

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 availability of observable inputs can vary from financial instrument to financial instrument and is affected by a wide variety of factors, including, for example, the type of financial instrument, whether the financial instrument is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires significantly more judgment. Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorized in Level 3. We use prices and inputs that are current as of the measurement date. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified between levels.

For investments that have quoted market prices in active markets, we use the quoted market prices as fair value and include these prices in the amounts disclosed in the Level 1 hierarchy. We receive the quoted market prices from nationally recognized third-party pricing services ("pricing service"). When quoted market prices are unavailable, we utilize the pricing service to determine an estimate of fair value. This pricing method is used, primarily, for debt securities. The fair value estimates provided by the pricing services are included in the Level 2 hierarchy. The pricing service utilizes evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information and for structured securities, cash flow and, when available, loan performance data. The pricing service's evaluated pricing applications apply available information as applicable through processes such as benchmark curves, benchmarking of like securities, sector groupings and matrix pricing, to prepare evaluations. In addition, the pricing service uses model processes, such as the Option Adjusted Spread model, to assess interest rate impact and develop prepayment scenarios. The market inputs that the pricing service normally seeks for evaluations of securities, listed in approximate order of priority, include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data including market research publications.

We utilize the fair values received from the pricing service to estimate fair value measurements for all our debt securities and equity securities. The following describes the valuation techniques we used to determine the fair value of financial instruments held as of December 31, 2018 and 2017:

•*U.S. Treasury and Federal Agencies* Comprised primarily of bonds issued by the U.S. Treasury. The fair values of U.S. government securities are based on quoted market prices in active markets, and are included in the Level 1 fair value hierarchy. We believe the market for U.S. government securities is an actively traded market given the high

level of daily trading volume.

•*States and Political Subdivision Bonds* Comprised of bonds and auction rate securities issued by U.S. states and municipal entities or agencies. The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, these are classified within Level 2 of the fair value hierarchy. We also hold 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 and are classified as Level 3 in the fair value hierarchy.

•*Foreign Government* Comprised of bonds issued by foreign governments. The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, these are classified within Level 2 of the fair value hierarchy. We also hold certain foreign government bonds that are valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable and are classified as Level 3 in the fair value hierarchy.

•*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, we obtain 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, these are classified within Level 2 of the fair value hierarchy. We also hold 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 and are classified as Level 3 in the fair value hierarchy.

•*Mortgage, Asset-backed and Structured Securities* Comprised of commercial and residential mortgage-backed, asset-backed 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, these are classified within Level 2 of the fair value hierarchy. We also hold 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, these are classified within Level 3 of the fair value hierarchy.

•*Equity Securities* The pricing service utilizes market quotations for equity securities that have quoted market prices in active markets and their respective quoted prices are provided as fair value. We classified the values of these equity securities as Level 1. 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. We classified the value of these equity securities as Level 2. From time to time, we also hold certain equity securities that are issued by privately-held entities or equity investments that do not have an active market. We estimate the fair value of these securities primarily based on inputs such as third-party broker quote, 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 and are classified as Level 3 in the fair value hierarchy.

•*Other Investments, at fair value* - Comprised of our rights to receive the Excess Servicing Spread ("ESS") related to servicing rights. We use a discounted cash flow approach 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 reported in earnings. We classified the fair value estimates of ESS as Level 3 in the fair value hierarchy.

•*Premiums and Other Receivables* - The carrying values reported in the accompanying balance sheets for these financial instruments approximate their fair values due to the short-term nature of these assets.

•*Debt* - The amount reported in the accompanying balance sheets for these financial instruments represents the carrying value of our debt. We utilize a pricing service to estimate its fair value, other than our publicly traded debt.

*Stock Compensation Expense.* We recognize shared-based employee compensation expense including stock options and restricted stock units (“RSUs”), to be measured based on the grant date fair value of the awards, with the resulting expense recognized on a straight-line basis over the period during which the employee is required to perform service in exchange for the award. The majority of our awards are earned over a service period of three or four years.

*Earnings per Share.* Basic earnings per share are computed by dividing income available to common stockholders by the number of weighted average common shares outstanding. Dilutive earnings per share are computed by dividing income available to common stockholders, adjusted for the effects of the presumed issuance of potential common shares, by the number of weighted average common shares outstanding, plus potentially issuable shares, such as options, unvested share-based payment awards and convertible securities.

*Income Taxes*. We join our subsidiaries in the filing of a consolidated federal income tax return and are party to federal income tax allocation agreements. Under the tax allocation agreements, we pay to or receive from our subsidiaries the amount, if any, by which the group's federal income tax liability was affected by virtue of inclusion of the subsidiary in the consolidated federal return. The Reciprocal Exchanges are not party to federal income tax allocation agreements but file separate tax returns annually.

Deferred income taxes reflect the impact of temporary differences between the amount of our assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations. The deferred tax asset and liability primarily consists of book versus tax differences for earned premiums, loss and LAE reserve discounting, deferred acquisition costs, earned but unbilled premiums, and unrealized holding gains and losses on debt securities. We record changes in deferred income tax assets and liabilities that are associated with components of other comprehensive income, primarily unrealized investment gains and losses, to other comprehensive income. We include changes in deferred income tax assets and liabilities as a component of income tax expense.

In assessing the recoverability of deferred tax assets, management considers whether it is more likely than not that we will generate future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, tax planning strategies and projected future taxable income in making this assessment. If necessary, we establish a valuation allowance to reduce the deferred tax assets to the amounts that are more likely than not to be realized.

We recognize tax benefits only on tax positions that are more likely than not to be sustained upon examination by taxing authorities. Our policy is to prospectively classify accrued interest and penalties related to any unrecognized tax benefits in our income tax provision. We file our consolidated tax returns as prescribed by the tax laws of the jurisdictions in which we operate.

On December 22, 2017, "H.R.1", also known as the Tax Cuts and Jobs Act of 2017 (the "TCJA") was signed into law. The TCJA reduced the federal corporate income tax rate from 35% to 21% effective January 1, 2018, which impacts our future effective tax rate and after-tax earnings in the United States. As a result of the reduction in the corporate income tax rate, we were required to revalue our deferred tax assets and deferred tax liabilities to account for the future impact of lower corporate tax rates on these deferred tax amounts. Under the SEC guidance, Staff Accounting Bulletin No. 118, we recognized additional provision for income taxes in the amount of $20.6 million (net of a $5.2 million benefit in the Reciprocal Exchanges) related to this revaluation in 2017. We also recognized an additional benefit of $1.3 million (net of a $0.4 million benefit in the Reciprocal Exchanges) related to this revaluation in 2018. We are affected by certain other aspects of the TCJA, including, without limitation, provisions regarding the one-time transition tax on undistributed foreign earnings and profits, limitations on the deductibility of interest expense and executive compensation and deductibility of capital expenditures.

## Results of Operations

### *Consolidated Results of Operations*

| | Year Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | | | | 2017 | | | |
| | NGHC | Reciprocal Exchanges | Eliminations | Total | NGHC | Reciprocal Exchanges | Eliminations | Total |
| | *(amounts in thousands)* | | | | | | | |
| Gross premium written | $4,969,517 | $448,923 | $(1,601) | $5,416,839 | $4,375,414 | $383,773 | $(3,202) | $4,755,985 |
| Ceded premiums | (1,325,369) | (265,358) | 1,601 | (1,589,126) | (973,468) | (208,124) | 3,202 | (1,178,390) |
| Net premium written | $3,644,148 | $183,565 | $— | $3,827,713 | $3,401,946 | $175,649 | $— | $3,577,595 |
| Change in unearned premium | (98,707) | 3,196 | — | (95,511) | 82,359 | (5,778) | — | 76,581 |
| Net earned premium | $3,545,441 | $186,761 | $— | $3,732,202 | $3,484,305 | $169,871 | $— | $3,654,176 |
| Ceding commission income | 167,948 | 56,749 | — | 224,697 | 56,276 | 60,180 | — | 116,456 |
| Service and fee income | 625,463 | 5,751 | (69,631) | 561,583 | 552,580 | 5,794 | (55,447) | 502,927 |
| Total underwriting revenues | $4,338,852 | $249,261 | $(69,631) | $4,518,482 | $4,093,161 | $235,845 | $(55,447) | $4,273,559 |
| Underwriting expenses: | | | | | | | | |
| Loss and loss adjustment expense | 2,499,508 | 162,718 | — | 2,662,226 | 2,506,242 | 119,840 | — | 2,626,082 |
| Acquisition costs and other underwriting expenses | 693,283 | 41,983 | — | 735,266 | 622,269 | 50,160 | — | 672,429 |
| General and administrative expenses | 923,921 | 83,756 | (69,631) | 938,046 | 887,472 | 80,971 | (55,447) | 912,996 |
| Total underwriting expenses | $4,116,712 | $288,457 | $(69,631) | $4,335,538 | $4,015,983 | $250,971 | $(55,447) | $4,211,507 |
| Underwriting income (loss) | $222,140 | $(39,196) | $— | $182,944 | $77,178 | $(15,126) | $— | $62,052 |
| Net investment income | 119,852 | 8,875 | (9,693) | 119,034 | 102,229 | 9,325 | (9,604) | 101,950 |
| Net gain (loss) on investments | (26,179) | (3,366) | — | (29,545) | 40,640 | 6,123 | — | 46,763 |
| Other income (expense) | — | — | — | — | (198) | — | — | (198) |
| Interest expense | (51,425) | (9,693) | 9,693 | (51,425) | (47,086) | (9,604) | 9,604 | (47,086) |
| Income (loss) before provision (benefit) for income taxes | $264,388 | $(43,380) | $— | $221,008 | $172,763 | $(9,282) | $— | $163,481 |
| Provision (benefit) for income taxes | 57,034 | (3,550) | — | 53,484 | 66,918 | (5,645) | — | 61,273 |
| Net income (loss) | $207,354 | $(39,830) | $— | $167,524 | $105,845 | $(3,637) | $— | $102,208 |
| Net (income) loss attributable to non-controlling interest | — | 39,830 | — | 39,830 | — | 3,637 | — | 3,637 |
| Net income attributable to NGHC | $207,354 | $— | $— | $207,354 | $105,845 | $— | $— | $105,845 |
| Dividends on preferred stock | (32,492) | — | — | (32,492) | (31,500) | — | — | (31,500) |
| Net income attributable to NGHC common stockholders | $174,862 | $— | $— | $174,862 | $74,345 | $— | $— | $74,345 |

| | Year Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | | | | 2017 | | | |
| | NGHC | Reciprocal Exchanges | Eliminations | Total | NGHC | Reciprocal Exchanges | Eliminations | Total |
| *Underwriting ratios:* | *(amounts in thousands, except percentages)* | | | | | | | |
| Net loss ratio | 70.5 % | 87.1 % | — % | 71.3 % | 71.9 % | 70.5 % | — % | 71.9 % |
| Net operating expense ratio (non-GAAP) | 23.0 % | 33.9 % | — % | 23.5 % | 25.9 % | 38.4 % | — % | 26.4 % |
| Net combined ratio (non-GAAP) | 93.5 % | 121.0 % | — % | 94.8 % | 97.8 % | 108.9 % | — % | 98.3 % |
| *Underwriting ratios before amortization and impairment (non-GAAP):* | | | | | | | | |
| Net loss ratio | 70.5 % | 87.1 % | — % | 71.3 % | 71.9 % | 70.5 % | — % | 71.9 % |
| Net operating expense ratio before amortization and impairment (non-GAAP) | 22.1 % | 33.8 % | — % | 22.7 % | 24.2 % | 34.3 % | — % | 24.7 % |
| Net combined ratio before amortization and impairment (non-GAAP) | 92.6 % | 120.9 % | — % | 94.0 % | 96.1 % | 104.8 % | — % | 96.6 % |
| *Reconciliation of net operating expense ratio (non-GAAP):* | | | | | | | | |
| Total expenses | $4,168,137 | $298,150 | $(79,324) | $4,386,963 | $4,063,069 | $260,575 | $(65,051) | $4,258,593 |
| Less: Loss and loss adjustment expense | 2,499,508 | 162,718 | — | 2,662,226 | 2,506,242 | 119,840 | — | 2,626,082 |
| Less: Interest expense | 51,425 | 9,693 | (9,693) | 51,425 | 47,086 | 9,604 | (9,604) | 47,086 |
| Less: Ceding commission income | 167,948 | 56,749 | — | 224,697 | 56,276 | 60,180 | — | 116,456 |
| Less: Service and fee income | 625,463 | 5,751 | (69,631) | 561,583 | 552,580 | 5,794 | (55,447) | 502,927 |
| Less: Other general and administrative expenses | 10,000 | — | — | 10,000 | — | — | — | — |
| Net operating expense | $813,793 | $63,239 | $— | $877,032 | $900,885 | $65,157 | $— | $966,042 |
| Net earned premium | $3,545,441 | $186,761 | $— | $3,732,202 | $3,484,305 | $169,871 | $— | $3,654,176 |
| Net operating expense ratio (non-GAAP) | 23.0 % | 33.9 % | — % | 23.5 % | 25.9 % | 38.4 % | — % | 26.4 % |
| Net operating expense | $813,793 | $63,239 | $— | $877,032 | $900,885 | $65,157 | $— | $966,042 |
| Less: Non-cash impairment of goodwill | — | — | — | — | 4,884 | — | — | 4,884 |
| Less: Non-cash amortization of intangible assets | 31,323 | 44 | — | 31,367 | 51,729 | 6,882 | — | 58,611 |
| Net operating expense before amortization and impairment | $782,470 | $63,195 | $— | $845,665 | $844,272 | $58,275 | $— | $902,547 |
| Net earned premium | $3,545,441 | $186,761 | $— | $3,732,202 | $3,484,305 | $169,871 | $— | $3,654,176 |
| Net operating expense ratio before amortization and impairment (non-GAAP) | 22.1 % | 33.8 % | — % | 22.7 % | 24.2 % | 34.3 % | — % | 24.7 % |

| | Year Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | | | | 2016 | | | |
| | NGHC | Reciprocal Exchanges | Eliminations | Total | NGHC | Reciprocal Exchanges | Eliminations | Total |
| | *(amounts in thousands)* | | | | | | | |
| Gross premium written | $4,375,414 | $383,773 | $(3,202) | $4,755,985 | $3,261,670 | $241,540 | $(2,312) | $3,500,898 |
| Ceded premiums | (973,468) | (208,124) | 3,202 | (1,178,390) | (309,522) | (120,992) | 2,312 | (428,202) |
| Net premium written | $3,401,946 | $175,649 | $— | $3,577,595 | $2,952,148 | $120,548 | $— | $3,072,696 |
| Change in unearned premium | 82,359 | (5,778) | — | 76,581 | (67,372) | (10,153) | — | (77,525) |
| Net earned premium | $3,484,305 | $169,871 | $— | $3,654,176 | $2,884,776 | $110,395 | $— | $2,995,171 |
| Ceding commission income | 56,276 | 60,180 | — | 116,456 | 2,078 | 43,522 | — | 45,600 |
| Service and fee income | 552,580 | 5,794 | (55,447) | 502,927 | 410,771 | 3,862 | (33,816) | 380,817 |
| Total underwriting revenues | $4,093,161 | $235,845 | $(55,447) | $4,273,559 | $3,297,625 | $157,779 | $(33,816) | $3,421,588 |
| Underwriting expenses: | | | | | | | | |
| Loss and loss adjustment expense | 2,506,242 | 119,840 | — | 2,626,082 | 2,023,064 | 69,216 | — | 2,092,280 |
| Acquisition costs and other underwriting expenses | 622,269 | 50,160 | — | 672,429 | 481,865 | 15,148 | (6) | 497,007 |
| General and administrative expenses | 887,472 | 80,971 | (55,447) | 912,996 | 677,582 | 65,376 | (33,810) | 709,148 |
| Total underwriting expenses | $4,015,983 | $250,971 | $(55,447) | $4,211,507 | $3,182,511 | $149,740 | $(33,816) | $3,298,435 |
| Underwriting income (loss) | $77,178 | $(15,126) | $— | $62,052 | $115,114 | $8,039 | $— | $123,153 |
| Net investment income | 102,229 | 9,325 | (9,604) | 101,950 | 112,977 | 8,716 | (6,506) | 115,187 |
| Net gain on investments | 40,640 | 6,123 | — | 46,763 | 7,389 | 515 | — | 7,904 |
| Other income (expense) | (198) | — | — | (198) | 24,308 | — | — | 24,308 |
| Interest expense | (47,086) | (9,604) | 9,604 | (47,086) | (40,180) | (6,506) | 6,506 | (40,180) |
| Income (loss) before provision (benefit) for income taxes | $172,763 | $(9,282) | $— | $163,481 | $219,608 | $10,764 | $— | $230,372 |
| Less: Provision (benefit) for income taxes | 66,918 | (5,645) | — | 61,273 | 43,789 | (9,791) | — | 33,998 |
| Net income (loss) | $105,845 | $(3,637) | $— | $102,208 | $175,819 | $20,555 | $— | $196,374 |
| Less: Net (income) loss attributable to non-controlling interest | — | 3,637 | — | 3,637 | (113) | (20,555) | — | (20,668) |
| Net income attributable to NGHC | $105,845 | $— | $— | $105,845 | $175,706 | $— | $— | $175,706 |
| Dividends on preferred stock | (31,500) | — | — | (31,500) | (24,333) | — | — | (24,333) |
| Net income attributable to NGHC common stockholders | $74,345 | $— | $— | $74,345 | $151,373 | $— | $— | $151,373 |

| | Year Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | | | | 2016 | | | |
| | NGHC | Reciprocal Exchanges | Eliminations | Total | NGHC | Reciprocal Exchanges | Eliminations | Total |
| *Underwriting ratios:* | *(amounts in thousands, except percentages)* | | | | | | | |
| Net loss ratio | 71.9 % | 70.5 % | — % | 71.9 % | 70.1 % | 62.7 % | — % | 69.9 % |
| Net operating expense ratio (non-GAAP) | 25.9 % | 38.4 % | — % | 26.4 % | 25.9 % | 30.0 % | — % | 26.0 % |
| Net combined ratio (non-GAAP) | 97.8 % | 108.9 % | — % | 98.3 % | 96.0 % | 92.7 % | — % | 95.9 % |
| *Underwriting ratios before amortization and impairment (non-GAAP):* | | | | | | | | |
| Net loss ratio | 71.9 % | 70.5 % | — % | 71.9 % | 70.1 % | 62.7 % | — % | 69.9 % |
| Net operating expense ratio before amortization and impairment (non-GAAP) | 24.2 % | 34.3 % | — % | 24.7 % | 24.1 % | 11.2 % | — % | 23.6 % |
| Net combined ratio before amortization and impairment (non-GAAP) | 96.1 % | 104.8 % | — % | 96.6 % | 94.2 % | 73.9 % | — % | 93.5 % |
| *Reconciliation of net operating expense ratio (non-GAAP):* | | | | | | | | |
| Total expenses | $4,063,069 | $260,575 | $(65,051) | $4,258,593 | $3,222,691 | $156,246 | $(40,322) | $3,338,615 |
| Less: Loss and loss adjustment expense | 2,506,242 | 119,840 | — | 2,626,082 | 2,023,064 | 69,216 | — | 2,092,280 |
| Less: Interest expense | 47,086 | 9,604 | (9,604) | 47,086 | 40,180 | 6,506 | (6,506) | 40,180 |
| Less: Ceding commission income | 56,276 | 60,180 | — | 116,456 | 2,078 | 43,522 | — | 45,600 |
| Less: Service and fee income | 552,580 | 5,794 | (55,447) | 502,927 | 410,771 | 3,862 | (33,816) | 380,817 |
| Net operating expense | $900,885 | $65,157 | $— | $966,042 | $746,598 | $33,140 | $— | $779,738 |
| Net earned premium | $3,484,305 | $169,871 | $— | $3,654,176 | $2,884,776 | $110,395 | $— | $2,995,171 |
| Net operating expense ratio (non-GAAP) | 25.9 % | 38.4 % | — % | 26.4 % | 25.9 % | 30.0 % | — % | 26.0 % |
| Net operating expense | $900,885 | $65,157 | $— | $966,042 | $746,598 | $33,140 | $— | $779,738 |
| Less: Non-cash impairment of goodwill | 4,884 | — | — | 4,884 | 3,552 | — | — | 3,552 |
| Less: Non-cash amortization of intangible assets | 51,729 | 6,882 | — | 58,611 | 48,130 | 20,795 | — | 68,925 |
| Net operating expense before amortization and impairment | $844,272 | $58,275 | $— | $902,547 | $694,916 | $12,345 | $— | $707,261 |
| Net earned premium | $3,484,305 | $169,871 | $— | $3,654,176 | $2,884,776 | $110,395 | $— | $2,995,171 |
| Net operating expense ratio before amortization and impairment (non-GAAP) | 24.2 % | 34.3 % | — % | 24.7 % | 24.1 % | 11.2 % | — % | 23.6 % |

Effective July 1, 2017, we entered into auto and homeowners quota share agreements with third party reinsurers (collectively, the "Quota Shares"). Pursuant to the auto quota share agreement, we cede 15.0% of net liability under our auto policies. Effective January 1, 2019, we cede 7.0% of net liability under new and renewal auto policies written on or after January 1, 2019. Pursuant to our homeowners quota share agreement, we ceded 29.6% of net liability under homeowners policies through April 30, 2018 and 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:

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| | *(amounts in thousands)* | |
| Ceded premium current period - Quota Shares | $731,540 | $299,875 |
| Ceded premium - unearned premium transfer as of July 1, 2017 | — | 265,894 |
| Ceded premium current period - Additional Cession | 73,860 | — |
| Ceded premium - unearned premium transfer as of May 1, 2018 | 49,970 | — |
| Total | $855,370 | $565,769 |

For more information on our reinsurance agreements, refer to Note 10, "Reinsurance" in the notes to our Consolidated Financial Statements.

During 2016, we entered into a number of acquisitions and other transactions, including the following: (i) in November 2016, we closed on the acquisition of Elara Holdings, Inc., the parent company of Direct General Corporation, a Tennessee-based property and casualty insurance company ("Direct General"), (ii) in October 2016, we closed on the acquisition of Standard Property and Casualty Insurance Company, an Illinois-based property and casualty insurance company ("SPCIC"), and (iii) in June 2016, we closed on the acquisition of Century-National Insurance Company, a California-based property and casualty insurance company ("Century-National"). In addition, in the first quarter of 2016, the Reciprocal Exchanges were deconsolidated at January 1, 2016, and subsequently reconsolidated at March 31, 2016.

As a result of these transactions and reinsurance agreements, comparisons in our results of operation between 2018 and 2017, and between 2017 and 2016, will be less meaningful. Other than the life portion of Direct General, all of these transactions impacted our P&C segment only.

***Consolidated Results of Operations for the Year Ended December 31, 2018 Compared to the Year Ended December 31, 2017***

*Gross premium written*. Gross premium written increased by $660.9 million, or 13.9%, from $4,756.0 million for the year ended December 31, 2017 to $5,416.8 million for the year ended December 31, 2018, due to an increase of $544.1 million from the P&C segment as a result of organic growth ($479.0 million) and growth in the Reciprocal Exchanges ($65.2 million); and an increase of $116.7 million from the A&H segment primarily as a result of domestic organic growth ($86.0 million).

*Net premium written*. Net premium written increased by $250.1 million, or 7.0%, from $3,577.6 million for the year ended December 31, 2017 to $3,827.7 million for the year ended December 31, 2018. Net premium written for the P&C segment increased by $158.9 million for the year ended December 31, 2018 compared to the same period in 2017, primarily as a result of organic growth ($440.6 million), partially offset by premium ceded to the Quota Shares ($289.6 million). Net premium written for the A&H segment increased by $91.2 million for the year ended December

31, 2018 compared to the same period in 2017, primarily as a result of domestic organic growth ($89.7 million).

*Net earned premium*. Net earned premium increased by $78.0 million, or 2.1%, from $3,654.2 million for the year ended December 31, 2017 to $3,732.2 million for the year ended December 31, 2018. The change by segment was: P&C decreased by $5.1 million and A&H increased by $83.1 million. The decrease in the P&C segment was

mainly attributable to increased ceded earned premium to the Quota Shares ($463.2 million), partially offset by organic growth ($441.2 million). The increase in the A&H segment was primarily due to domestic organic growth ($88.7 million).

*Ceding commission income.* Ceding commission income increased by $108.2 million, or 92.9%, from $116.5 million for the year ended December 31, 2017 to $224.7 million for the year ended December 31, 2018, primarily driven by an increase in P&C ceded earned premium.

*Service and fee income.* Service and fee income increased by $58.7 million, or 11.7%, from $502.9 million for the year ended December 31, 2017 to $561.6 million for the year ended December 31, 2018.

The components of service and fee income are as follows:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2018 | 2017 | Change | % Change |
| | *(amounts in thousands)* | | | |
| Commission revenue | $163,321 | $145,693 | $17,628 | 12.1 % |
| Finance and processing fees | 125,593 | 124,305 | 1,288 | 1.0 % |
| Installment fees | 92,785 | 83,883 | 8,902 | 10.6 % |
| Group health administrative fees | 79,411 | 62,217 | 17,194 | 27.6 % |
| Late payment fees | 33,851 | 27,305 | 6,546 | 24.0 % |
| Other service and fee income | 66,622 | 59,524 | 7,098 | 11.9 % |
| Total | $561,583 | $502,927 | $58,656 | 11.7 % |

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE increased by $36.1 million, from $2,626.1 million for the year ended December 31, 2017 to $2,662.2 million for the year ended December 31, 2018, reflecting losses ceded to the Quota Shares ($278.8 million) partially offset by organic growth ($272.0 million) and growth in the Reciprocal Exchanges ($42.9 million). The changes by segment were: P&C - increased by $33.3 million and A&H - increased by $2.9 million. P&C weather-related events, excluding the Reciprocal Exchanges, were $128.7 million in 2018 compared to $130.3 million in 2017, a decrease of $1.6 million year over year.

Loss and LAE for the year ended December 31, 2018 included $34.0 million of favorable development on prior accident year loss and LAE reserves. The development was composed of $3.1 million of favorable development in the P&C segment (including $1.7 million of unfavorable development for the Reciprocal Exchanges), and $31.0 million of favorable development in the A&H segment primarily driven by favorable development in the domestic A&H stop loss and short-term medical products. Loss and LAE for the year ended December 31, 2017 included $7.3 million of unfavorable development on prior accident year loss and LAE reserves. The development was composed of $16.2 million of unfavorable development in the P&C segment (including $0.9 million of unfavorable development for the Reciprocal Exchanges) primarily driven by higher than expected unfavorable development in auto liability coverages, and $8.8 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 71.9% for the year ended December 31, 2017 to 71.3% for the year ended December 31, 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 $62.8 million, from $672.4 million for the year ended December 31, 2017 to $735.3 million for the year ended December 31, 2018, due to an increase of $33.0 million in the P&C segment and an increase of $29.8 million in the

A&H segment in the domestic business. The increase was primarily due to premium growth.

*General and administrative expenses.* General and administrative expenses increased by $25.1 million, from $913.0 million for the year ended December 31, 2017 to $938.0 million for the year ended December 31, 2018, with

a decrease of $15.3 million in the P&C segment, partially offset by an increase of $30.3 million in the A&H segment. The decrease in the P&C segment was primarily due to lower intangible assets amortization, while the increase in the A&H segment was due to domestic organic growth. General and administrative expenses include $10.0 million corporate expense related to the estimated resolution expense for a class action lawsuit.

*Net operating expense; net operating expense ratio (non-GAAP).* Net operating expense decreased by $89.0 million, from $966.0 million for the year ended December 31, 2017 to $877.0 million for the year ended December 31, 2018, due to a decrease of $111.8 million from the P&C segment, partially offset by an increase of $22.8 million from the A&H segment. The decrease in the P&C segment was primarily driven by higher ceding commission revenue from the Quota Shares, additional service and fee income and lower intangible assets amortization.

The consolidated net operating expense ratio decreased from 26.4% for the year ended December 31, 2017 to 23.5% for the year ended December 31, 2018. Excluding the Reciprocal Exchanges, the net operating expense ratio was 23.0% and 25.9% for the years ended December 31, 2018 and 2017, respectively. The Reciprocal Exchanges' net operating expense ratio was 33.9% and 38.4% for the years ended December 31, 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 $17.1 million, or 16.8%, from $102.0 million for the year ended December 31, 2017 to $119.0 million for the year ended December 31, 2018. The increase was primarily due to increased income from our equity method investments and increased invested assets.

*Net gain (loss) on investments.* Net gain (loss) on investments decreased by $76.3 million from a gain of $46.8 million for the year ended December 31, 2017 to a $29.5 million loss for the year ended December 31, 2018. The decrease was mainly attributable to sales at gain from repositioning our debt securities portfolio in 2017.

*Interest expense.* Interest expense for the years ended December 31, 2018 and 2017 was $51.4 million and $47.1 million, respectively.

*Provision for income taxes.* Income tax expense decreased by $7.8 million from $61.3 million for the year ended December 31, 2017, reflecting an effective tax rate of 37.5%, to $53.5 million for the year ended December 31, 2018, reflecting an effective tax rate of 24.2%. The decrease in consolidated income tax expense and the effective tax rate was primarily driven by the TCJA.

***Consolidated Results of Operations for the Year Ended December 31, 2017 Compared to the Year Ended December 31, 2016***

*Gross premium written*. Gross premium written increased by $1,255.1 million, or 35.9%, from $3,500.9 million for the year ended December 31, 2016 to $4,756.0 million for the year ended December 31, 2017, due to an increase of $1,137.7 million from the P&C segment as a result of the acquisitions of Direct General ($374.2 million), Century-National ($81.6 million) and SPCIC ($34.1 million), from organic growth ($537.2 million) and the consolidation of the Reciprocal Exchanges ($142.2 million), partially offset by a decline in lender-placed premiums ($31.7 million); and an increase of $117.4 million from the A&H segment as a result of the acquisition of Direct General ($10.4 million) and organic growth ($107.0 million).

*Net premium written*. Net premium written increased by $504.9 million, or 16.4%, from $3,072.7 million for the year ended December 31, 2016 to $3,577.6 million for the year ended December 31, 2017. Net premium written for the P&C segment increased by $388.3 million for the year ended December 31, 2017 compared to the same period in 2016, as a result of the acquisitions of Direct General ($367.2 million), Century-National ($69.5 million) and SPCIC ($34.0 million), from organic growth ($464.2 million) and the consolidation of the Reciprocal Exchanges

($55.1 million), partially offset by the Quota Shares ($565.8 million) and a decline in lender-placed premiums ($36.0 million). Net premium written for the A&H segment increased by $116.6 million for the year ended December 31, 2017 compared to the same period in 2016, as a result of the acquisition of Direct General ($10.4 million) and organic growth ($106.2 million).

*Net earned premium.* Net earned premium increased by $659.0 million, or 22.0%, from $2,995.2 million for the year ended December 31, 2016 to $3,654.2 million for the year ended December 31, 2017. The increase by segment was: P&C $540.1 million and A&H $118.9 million. The increase in the P&C segment was attributable to the acquisitions of Direct General ($352.8 million), Century-National ($84.0 million) and SPCIC ($35.2 million), from organic growth ($392.4 million) and the consolidation of the Reciprocal Exchanges ($59.5 million), partially offset by the Quota Shares ($291.1 million) and a decline in lender-placed premiums ($92.7 million). The increase in the A&H segment was primarily due to the acquisition of Direct General ($10.7 million) and organic growth ($108.2 million).

*Ceding commission income.* Ceding commission income increased by $70.9 million, from $45.6 million for the year ended December 31, 2016 to $116.5 million for the year ended December 31, 2017, mainly driven by an increase in the P&C segment primarily from the Quota Shares ($51.2 million) and the consolidation of the Reciprocal Exchanges ($16.7 million).

*Service and fee income.* Service and fee income increased by $122.1 million, or 32.1%, from $380.8 million for the year ended December 31, 2016 to $502.9 million for the year ended December 31, 2017. The increase was attributable to an increase in our P&C segment ($106.4 million), primarily resulting from the acquisition of Direct General ($85.7 million) and from organic growth ($13.8 million); and an increase in the A&H segment ($15.7 million) primarily due to growth in our domestic business.

The components of service and fee income are as follows:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2017 | 2016 | Change | % Change |
| | *(amounts in thousands)* | | | |
| Commission revenue | $145,693 | $110,343 | $35,350 | 32.0 % |
| Finance and processing fees | 124,305 | 88,624 | 35,681 | 40.3 % |
| Installment fees | 83,883 | 43,460 | 40,423 | 93.0 % |
| Group health administrative fees | 62,217 | 69,689 | (7,472 ) | (10.7)% |
| Late payment fees | 27,305 | 16,737 | 10,568 | 63.1 % |
| Other service and fee income | 59,524 | 51,964 | 7,560 | 14.5 % |
| Total | $502,927 | $380,817 | $122,110 | 32.1 % |

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE increased by $533.8 million, or 25.5%, from $2,092.3 million for the year ended December 31, 2016 to $2,626.1 million for the year ended December 31, 2017, primarily reflecting the acquisitions of Direct General ($234.7 million), SPCIC ($29.4 million) and Century-National ($26.4 million), organic growth ($341.6 million), catastrophe losses in 2017 compared to 2016 ($72.1 million) and the consolidation of the Reciprocal Exchanges ($50.6 million), partially offset by the Quota Shares ($221.1 million). The changes by segment were: P&C - increased by $516.5 million and A&H - increased by $17.3 million.

Loss and LAE for the year ended December 31, 2017 included $7.3 million of unfavorable development on prior accident year loss and LAE reserves. The development was composed of $16.2 million of unfavorable development in the P&C segment (including $0.9 million of unfavorable development for the Reciprocal Exchanges) primarily driven by higher than expected unfavorable development in auto liability coverages, and $8.8 million of favorable development in the A&H segment primarily driven by favorable development in our domestic products. Loss and LAE for the year ended December 31, 2016 included $13.5 million of unfavorable development on prior accident year loss and LAE reserves. The development was composed of $4.2 million of unfavorable development in the P&C segment primarily driven by higher than expected development in private passenger auto bodily injury coverage, and $9.3 million of unfavorable development in the A&H segment primarily driven by unfavorable development in the

domestic stop loss, short-term medical products and European A&H policies.

Our consolidated net loss ratio increased from 69.9% for the year ended December 31, 2016 to 71.9% for the year ended December 31, 2017, with a higher P&C segment net loss ratio and a lower A&H segment net loss ratio in 2017 compared to 2016. 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 $175.4 million, or 35.3%, from $497.0 million for the year ended December 31, 2016 to $672.4 million for the year ended December 31, 2017, due to an increase of $123.3 million in the P&C segment, primarily as a result of the acquisitions of Direct General ($33.8 million) and Century-National ($33.5 million), from organic growth ($62.3 million) and the consolidation of the Reciprocal Exchanges ($35.0 million), partially offset by the Quota Shares ($47.4 million); and an increase of $52.1 million in the A&H segment, primarily from organic growth ($49.3 million).

*General and administrative expenses.* General and administrative expenses increased by $203.8 million, or 28.7%, from $709.1 million for the year ended December 31, 2016 to $913.0 million for the year ended December 31, 2017, due to an increase of $160.7 million in the P&C segment, primarily as a result of the acquisition of Direct General ($152.4 million); and an increase of $43.2 million in the A&H segment, primarily from organic growth ($27.5 million).

*Net operating expense; net operating expense ratio (non-GAAP).* Net operating expense increased by $186.3 million, or 23.9%, from $779.7 million for the year ended December 31, 2016 to $966.0 million for the year ended December 31, 2017, due to an increase of $106.4 million from the P&C segment and an increase of $80.0 million from the A&H segment.

The consolidated net operating expense ratio increased from 26.0% for the year ended December 31, 2016 to 26.4% for the year ended December 31, 2017. Excluding the Reciprocal Exchanges, the net operating expense ratio was 25.9% and 25.9% for the years ended December 31, 2017 and 2016, respectively. The Reciprocal Exchanges' net operating expense ratio was 38.4% and 30.0% for the years ended December 31, 2017 and 2016, respectively. Net operating expense ratio is discussed in more detail in the segment discussions that follow.

*Net investment income.* Net investment income decreased by $13.2 million, or 11.5%, from $115.2 million for the year ended December 31, 2016 to $102.0 million for the year ended December 31, 2017. The decrease was primarily attributable to losses recorded in 2017 in our equity method investments.

*Net gain on investments.* Net gain on investments increased by $38.9 million from a gain of $7.9 million for the year ended December 31, 2016 to a $46.8 million gain for the year ended December 31, 2017. The increase was mainly attributable to gains in our debt securities portfolio in 2017 and insignificant impairment losses in 2017 compared to 2016.

*Interest expense.* Interest expense for the years ended December 31, 2017 and 2016 was $47.1 million and $40.2 million, respectively. The increase of $6.9 million is primarily due to interest payable under our credit facility and debt assumed from our 2016 acquisitions.

*Provision for income taxes.* Income tax expense increased by $27.3 million, or 80.2%, from $34.0 million for the year ended December 31, 2016, reflecting an effective tax rate of 14.8%, to $61.3 million for the year ended December 31, 2017, reflecting an effective tax rate of 37.5%. The increase in consolidated income tax expense and the effective tax rate was primarily driven by the revaluation of our deferred tax assets resulting from the enactment of the TCJA.

### *P&C Segment - Results of Operations*

| | Year Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | | | | 2017 | | | |
| | NGHC | Reciprocal Exchanges | Eliminations | Total | NGHC | Reciprocal Exchanges | Eliminations | Total |
| | *(amounts in thousands, except percentages)* | | | | | | | |
| Gross premium written | $4,271,408 | $448,923 | $(1,601) | $4,718,730 | $3,794,012 | $383,773 | $(3,202) | $4,174,583 |
| Ceded premiums | (1,253,799) | (265,358) | 1,601 | (1,517,556) | (927,362) | (208,124) | 3,202 | (1,132,284) |
| Net premium written | $3,017,609 | $183,565 | $— | $3,201,174 | $2,866,650 | $175,649 | $— | $3,042,299 |
| Change in unearned premium | (88,581) | 3,196 | — | (85,385) | 84,372 | (5,778) | — | 78,594 |
| Net earned premium | $2,929,028 | $186,761 | $— | $3,115,789 | $2,951,022 | $169,871 | $— | $3,120,893 |
| Ceding commission income | 160,945 | 56,749 | — | 217,694 | 55,263 | 60,180 | — | 115,443 |
| Service and fee income | 439,483 | 5,751 | (69,631) | 375,603 | 397,966 | 5,794 | (55,447) | 348,313 |
| Total underwriting revenues | $3,529,456 | $249,261 | $(69,631) | $3,709,086 | $3,404,251 | $235,845 | $(55,447) | $3,584,649 |
| Underwriting expenses: | | | | | | | | |
| Loss and loss adjustment expense | 2,178,163 | 162,718 | — | 2,340,881 | 2,187,779 | 119,840 | — | 2,307,619 |
| Acquisition costs and other underwriting expenses | 508,557 | 41,983 | — | 550,540 | 467,390 | 50,160 | — | 517,550 |
| General and administrative expenses | 712,113 | 83,756 | (69,631) | 726,238 | 715,975 | 80,971 | (55,447) | 741,499 |
| Total underwriting expenses | $3,398,833 | $288,457 | $(69,631) | $3,617,659 | $3,371,144 | $250,971 | $(55,447) | $3,566,668 |
| Underwriting income (loss) | $130,623 | $(39,196) | $— | $91,427 | $33,107 | $(15,126) | $— | $17,981 |
| *Underwriting ratios:* | | | | | | | | |
| Net loss ratio | 74.4 % | 87.1 % | — % | 75.1 % | 74.1 % | 70.5 % | — % | 73.9 % |
| Net operating expense ratio (non-GAAP) | 21.2 % | 33.9 % | — % | 21.9 % | 24.7 % | 38.4 % | — % | 25.5 % |
| Net combined ratio (non-GAAP) | 95.6 % | 121.0 % | — % | 97.0 % | 98.8 % | 108.9 % | — % | 99.4 % |
| *Underwriting ratios before amortization and impairment (non-GAAP):* | | | | | | | | |
| Net loss ratio | 74.4 % | 87.1 % | — % | 75.1 % | 74.1 % | 70.5 % | — % | 73.9 % |
| Net operating expense ratio before amortization and impairment (non-GAAP) | 20.4 % | 33.8 % | — % | 21.2 % | 23.1 % | 34.3 % | — % | 23.7 % |
| Net combined ratio before amortization and impairment (non-GAAP) | 94.8 % | 120.9 % | — % | 96.3 % | 97.2 % | 104.8 % | — % | 97.6 % |
| *Reconciliation of net operating expense ratio (non-GAAP):* | | | | | | | | |
| Total expenses | $3,398,833 | $288,457 | $(69,631) | $3,617,659 | $3,371,144 | $250,971 | $(55,447) | $3,566,668 |
| Less: Loss and loss adjustment expense | 2,178,163 | 162,718 | — | 2,340,881 | 2,187,779 | 119,840 | — | 2,307,619 |
| Less: Ceding commission income | 160,945 | 56,749 | — | 217,694 | 55,263 | 60,180 | — | 115,443 |
| Less: Service and fee income | 439,483 | 5,751 | (69,631) | 375,603 | 397,966 | 5,794 | (55,447) | 348,313 |
| Net operating expense | $620,242 | $63,239 | $— | $683,481 | $730,136 | $65,157 | $— | $795,293 |
| Net earned premium | $2,929,028 | $186,761 | $— | $3,115,789 | $2,951,022 | $169,871 | $— | $3,120,893 |
| Net operating expense ratio (non-GAAP) | 21.2 % | 33.9 % | — % | 21.9 % | 24.7 % | 38.4 % | — % | 25.5 % |
| Net operating expense | $620,242 | $63,239 | $— | $683,481 | $730,136 | $65,157 | $— | $795,293 |
| Less: Non-cash impairment of goodwill | — | — | — | — | 4,884 | — | — | 4,884 |
| Less: Non-cash amortization of intangible assets | 23,960 | 44 | — | 24,004 | 42,858 | 6,882 | — | 49,740 |
| Net operating expense before amortization and impairment | $596,282 | $63,195 | $— | $659,477 | $682,394 | $58,275 | $— | $740,669 |
| Net earned premium | $2,929,028 | $186,761 | $— | $3,115,789 | $2,951,022 | $169,871 | $— | $3,120,893 |
| Net operating expense ratio before amortization and impairment (non-GAAP) | 20.4 % | 33.8 % | — % | 21.2 % | 23.1 % | 34.3 % | — % | 23.7 % |

| | Year Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | | | | 2016 | | | |
| | NGHC | Reciprocal Exchanges | Eliminations | Total | NGHC | Reciprocal Exchanges | Eliminations | Total |
| | *(amounts in thousands, except percentages)* | | | | | | | |
| Gross premium written | $3,794,012 | $383,773 | $(3,202) | $4,174,583 | $2,797,660 | $241,540 | $(2,312) | $3,036,888 |
| Ceded premiums | (927,362) | (208,124) | 3,202 | (1,132,284) | (264,180) | (120,992) | 2,312 | (382,860) |
| Net premium written | $2,866,650 | $175,649 | $— | $3,042,299 | $2,533,480 | $120,548 | $— | $2,654,028 |
| Change in unearned premium | 84,372 | (5,778) | — | 78,594 | (63,131) | (10,153) | — | (73,284) |
| Net earned premium | $2,951,022 | $169,871 | $— | $3,120,893 | $2,470,349 | $110,395 | $— | $2,580,744 |
| Ceding commission income | 55,263 | 60,180 | — | 115,443 | 747 | 43,522 | — | 44,269 |
| Service and fee income | 397,966 | 5,794 | (55,447) | 348,313 | 271,835 | 3,862 | (33,816) | 241,881 |
| Total underwriting revenues | $3,404,251 | $235,845 | $(55,447) | $3,584,649 | $2,742,931 | $157,779 | $(33,816) | $2,866,894 |
| Underwriting expenses: | | | | | | | | |
| Loss and loss adjustment expense | 2,187,779 | 119,840 | — | 2,307,619 | 1,721,854 | 69,216 | — | 1,791,070 |
| Acquisition costs and other underwriting expenses | 467,390 | 50,160 | — | 517,550 | 379,135 | 15,148 | (6) | 394,277 |
| General and administrative expenses | 715,975 | 80,971 | (55,447) | 741,499 | 549,249 | 65,376 | (33,810) | 580,815 |
| Total underwriting expenses | $3,371,144 | $250,971 | $(55,447) | $3,566,668 | $2,650,238 | $149,740 | $(33,816) | $2,766,162 |
| Underwriting income (loss) | $33,107 | $(15,126) | $— | $17,981 | $92,693 | $8,039 | $— | $100,732 |
| *Underwriting ratios:* | | | | | | | | |
| Net loss ratio | 74.1 % | 70.5 % | — % | 73.9 % | 69.7 % | 62.7 % | — % | 69.4 % |
| Net operating expense ratio (non-GAAP) | 24.7 % | 38.4 % | — % | 25.5 % | 26.5 % | 30.0 % | — % | 26.7 % |
| Net combined ratio (non-GAAP) | 98.8 % | 108.9 % | — % | 99.4 % | 96.2 % | 92.7 % | — % | 96.1 % |
| *Underwriting ratios before amortization and impairment (non-GAAP):* | | | | | | | | |
| Net loss ratio | 74.1 % | 70.5 % | — % | 73.9 % | 69.7 % | 62.7 % | — % | 69.4 % |
| Net operating expense ratio before amortization and impairment (non-GAAP) | 23.1 % | 34.3 % | — % | 23.7 % | 24.9 % | 11.2 % | — % | 24.3 % |
| Net combined ratio before amortization and impairment (non-GAAP) | 97.2 % | 104.8 % | — % | 97.6 % | 94.6 % | 73.9 % | — % | 93.7 % |
| *Reconciliation of net operating expense ratio (non-GAAP):* | | | | | | | | |
| Total expenses | $3,371,144 | $250,971 | $(55,447) | $3,566,668 | $2,650,238 | $149,740 | $(33,816) | $2,766,162 |
| Less: Loss and loss adjustment expense | 2,187,779 | 119,840 | — | 2,307,619 | 1,721,854 | 69,216 | — | 1,791,070 |
| Less: Ceding commission income | 55,263 | 60,180 | — | 115,443 | 747 | 43,522 | — | 44,269 |
| Less: Service and fee income | 397,966 | 5,794 | (55,447) | 348,313 | 271,835 | 3,862 | (33,816) | 241,881 |
| Net operating expense | $730,136 | $65,157 | $— | $795,293 | $655,802 | $33,140 | $— | $688,942 |
| Net earned premium | $2,951,022 | $169,871 | $— | $3,120,893 | $2,470,349 | $110,395 | $— | $2,580,744 |
| Net operating expense ratio (non-GAAP) | 24.7 % | 38.4 % | — % | 25.5 % | 26.5 % | 30.0 % | — % | 26.7 % |
| Net operating expense | $730,136 | $65,157 | $— | $795,293 | $655,802 | $33,140 | $— | $688,942 |
| Less: Non-cash impairment of goodwill | 4,884 | — | — | 4,884 | 3,552 | — | — | 3,552 |
| Less: Non-cash amortization of intangible assets | 42,858 | 6,882 | — | 49,740 | 37,537 | 20,795 | — | 58,332 |
| Net operating expense before amortization and impairment | $682,394 | $58,275 | $— | $740,669 | $614,713 | $12,345 | $— | $627,058 |
| Net earned premium | $2,951,022 | $169,871 | $— | $3,120,893 | $2,470,349 | $110,395 | $— | $2,580,744 |
| Net operating expense ratio before amortization and impairment (non-GAAP) | 23.1 % | 34.3 % | — % | 23.7 % | 24.9 % | 11.2 % | — % | 24.3 % |

***P&C Segment Results of Operations for the Year Ended December 31, 2018 Compared to the Year Ended December 31, 2017***

*Gross premium written*. Gross premium written increased by $544.1 million, or 13.0%, from $4,174.6 million for the year ended December 31, 2017 to $4,718.7 million for the year ended December 31, 2018, as a result of organic growth ($479.0 million) and growth in the Reciprocal Exchanges ($65.2 million).

*Net premium written*. Net premium written increased by $158.9 million, or 5.2%, from $3,042.3 million for the year ended December 31, 2017 to $3,201.2 million for the year ended December 31, 2018, primarily as a result of organic growth ($440.6 million), partially offset by premium ceded to the Quota Shares ($289.6 million).

*Net earned premium*. Net earned premium decreased by $5.1 million, from $3,120.9 million for the year ended December 31, 2017 to $3,115.8 million for the year ended December 31, 2018, mainly attributable to increased ceded premiums to the Quota Shares ($463.2 million), partially offset by organic growth ($441.2 million).

*Ceding commission income.* Ceding commission income increased by $102.3 million, or 88.6%, from $115.4 million for the year ended December 31, 2017 to $217.7 million for the year ended December 31, 2018, primarily driven by an increase in ceded earned premium to the Quota Shares.

*Service and fee income.* Service and fee income increased by $27.3 million, from $348.3 million for the year ended December 31, 2017 to $375.6 million for the year ended December 31, 2018.

The components of service and fee income are as follows:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2018 | 2017 | Change | % Change |
| | *(amounts in thousands)* | | | |
| Finance and processing fees | $121,058 | $117,122 | $3,936 | 3.4 % |
| Commission revenue | 93,235 | 78,678 | 14,557 | 18.5 % |
| Installment fees | 92,785 | 83,883 | 8,902 | 10.6 % |
| Late payment fees | 33,765 | 27,184 | 6,581 | 24.2 % |
| Other service and fee income | 34,760 | 41,446 | (6,686 ) | (16.1)% |
| Total | $375,603 | $348,313 | $27,290 | 7.8 % |

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE increased by $33.3 million, from $2,307.6 million for the year ended December 31, 2017 to $2,340.9 million for the year ended December 31, 2018, reflecting losses ceded to the Quota Shares ($278.8 million), partially offset by organic growth ($269.2 million) and growth in the Reciprocal Exchanges ($42.9 million). Weather-related events, excluding the Reciprocal Exchanges, were $128.7 million in 2018 compared to $130.3 million in 2017, a decrease of $1.6 million year over year.

Our P&C segment net loss ratio, which includes the Reciprocal Exchanges, increased from 73.9% for the year ended December 31, 2017 to 75.1% for the year ended December 31, 2018. Excluding the Reciprocal Exchanges, the net loss ratio was 74.4% and 74.1% for the years ended December 31, 2018 and 2017, respectively. The Reciprocal Exchanges' net loss ratio was 87.1% and 70.5% for the years ended December 31, 2018 and 2017, respectively.

*Acquisition costs and other underwriting expenses.* Acquisition costs and other underwriting expenses increased by $33.0 million, from $517.6 million for the year ended December 31, 2017 to $550.5 million for the year ended December 31, 2018. The increase was primarily due to premium growth.

*General and administrative expenses.* General and administrative expenses decreased by $15.3 million, or 2.1%, from $741.5 million for the year ended December 31, 2017 to $726.2 million for the year ended December 31, 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 $111.8 million, or 14.1%, from $795.3 million for the year ended December 31, 2017 to $683.5 million for the year ended December 31, 2018. Our P&C segment net operating expense ratio decreased from 25.5% for the year ended December 31, 2017 to 21.9% for the year ended December 31, 2018. Decreases in net operating expense and net operating expense ratio were primarily as a result of higher ceding commission revenue from the Quota Shares, additional service and fee income and lower intangible assets amortization.

*Underwriting income; net combined ratio (non-GAAP).* Underwriting income increased from $18.0 million for the year ended December 31, 2017 to $91.4 million for the year ended December 31, 2018. Our P&C segment net combined ratio decreased from 99.4% for the year ended December 31, 2017 to 97.0% for the year ended December 31, 2018. The increase in underwriting income and the decrease in net combined ratio were primarily as a result of increased ceding commission revenue from the Quota Shares, additional service and fee income and lower intangible assets amortization.

***P&C Segment Results of Operations for the Year Ended December 31, 2017 Compared to the Year Ended December 31, 2016***

*Gross premium written*. Gross premium written increased by $1,137.7 million, or 37.5%, from $3,036.9 million for the year ended December 31, 2016 to $4,174.6 million for the year ended December 31, 2017, as a result of the acquisitions of Direct General ($374.2 million), Century-National ($81.6 million) and SPCIC ($34.1 million), from organic growth ($537.2 million) and the consolidation of the Reciprocal Exchanges ($142.2 million), partially offset by a decline in lender-placed premiums ($31.7 million).

*Net premium written*. Net premium written increased by $388.3 million, or 14.6%, from $2,654.0 million for the year ended December 31, 2016 to $3,042.3 million for the year ended December 31, 2017, as a result of the acquisitions of Direct General ($367.2 million), Century-National ($69.5 million) and SPCIC ($34.0 million), from organic growth ($464.2 million) and the consolidation of the Reciprocal Exchanges ($55.1 million), partially offset by the Quota Shares ($565.8 million) and a decline in lender-placed premiums ($36.0 million).

*Net earned premium*. Net earned premium increased by $540.1 million, or 20.9%, from $2,580.7 million for the year ended December 31, 2016 to $3,120.9 million for the year ended December 31, 2017, attributable to the acquisitions of Direct General ($352.8 million), Century-National ($84.0 million) and SPCIC ($35.2 million), from organic growth ($392.4 million) and the consolidation of the Reciprocal Exchanges ($59.5 million), partially offset by the Quota Shares ($291.1 million) and a decline in lender-placed premiums ($92.7 million).

*Ceding commission income.* Ceding commission income increased by $71.2 million, from $44.3 million for the year ended December 31, 2016 to $115.4 million for the year ended December 31, 2017, primarily from the Quota Shares ($51.2 million) and the consolidation of the Reciprocal Exchanges ($16.7 million).

*Service and fee income.* Service and fee income increased by $106.4 million, or 44.0%, from $241.9 million for the year ended December 31, 2016 to $348.3 million for the year ended December 31, 2017, primarily resulting from the acquisition of Direct General ($85.7 million) and from organic growth ($13.8 million).

The components of service and fee income are as follows:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2017 | 2016 | Change | % Change |
| | *(amounts in thousands)* | | | |
| Finance and processing fees | $117,122 | $80,292 | $36,830 | 45.9 % |
| Installment fees | 83,883 | 43,460 | 40,423 | 93.0 % |
| Commission revenue | 78,678 | 58,498 | 20,180 | 34.5 % |
| Late payment fees | 27,184 | 16,609 | 10,575 | 63.7 % |
| Other service and fee income | 41,446 | 43,022 | (1,576 ) | (3.7 )% |
| Total | $348,313 | $241,881 | $106,432 | 44.0 % |

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE increased by $516.5 million, or 28.8%, from $1,791.1 million for the year ended December 31, 2016 to $2,307.6 million for the year ended December 31, 2017, reflecting the acquisitions of Direct General ($234.7 million), SPCIC ($29.4 million) and Century-National ($26.4 million), increased premiums from organic growth ($341.6 million), catastrophe losses in 2017 compared to 2016 ($72.1 million) and the consolidation of the Reciprocal Exchanges ($50.6 million), partially offset by the Quota Shares ($221.1 million).

Our P&C segment net loss ratio, which includes the Reciprocal Exchanges, increased from 69.4% for the year ended December 31, 2016 to 73.9% for the year ended December 31, 2017, primarily due to higher catastrophe losses in 2017 compared to 2016, a decline in lender-placed premiums and higher catastrophe losses in the Reciprocal Exchanges in 2017 compared to 2016, partially offset by the Quota Shares.

Excluding the Reciprocal Exchanges, the net loss ratio was 74.1% and 69.7% for the years ended December 31, 2017 and 2016, respectively. Higher catastrophe losses for the year ended December 31, 2017 compared to the same period in 2016 represented an increase of 2.0 basis points in the net loss ratio. The Reciprocal Exchanges' net loss ratio was 70.5% and 62.7% for the years ended December 31, 2017 and 2016, respectively, with the 2017 increase primarily due to catastrophe losses.

*Acquisition costs and other underwriting expenses.* Acquisition costs and other underwriting expenses increased by $123.3 million, or 31.3%, from $394.3 million for the year ended December 31, 2016 to $517.6 million for the year ended December 31, 2017, primarily as a result of the acquisitions of Direct General ($33.8 million) and Century-National ($33.5 million), from organic growth ($62.3 million) and the consolidation of the Reciprocal Exchanges ($35.0 million), partially offset by the Quota Shares ($47.4 million).

*General and administrative expenses.* General and administrative expenses increased by $160.7 million, or 27.7%, from $580.8 million for the year ended December 31, 2016 to $741.5 million for the year ended December 31, 2017, primarily as a result of the acquisition of Direct General ($152.4 million).

*Net operating expense; net operating expense ratio (non-GAAP).* Net operating expense increased by $106.4 million, or 15.4%, from $688.9 million for the year ended December 31, 2016 to $795.3 million for the year ended December 31, 2017, primarily as a result of our 2016 acquisitions, organic growth, commission income from the Quota Shares and the consolidation of the Reciprocal Exchanges, partially offset by a reduction in transition related expenses in the lender-placed business. Our P&C segment net operating expense ratio decreased from 26.7% for the year ended December 31, 2016 to 25.5% for the year ended December 31, 2017, primarily as a result of higher net earned premium in 2017 compared to 2016.

*Underwriting income; net combined ratio (non-GAAP).* Underwriting income decreased from $100.7 million for the year ended December 31, 2016 to $18.0 million for the year ended December 31, 2017. Our P&C segment net combined ratio increased from 96.1% for the year ended December 31, 2016 to 99.4% for the year ended December 31, 2017, with a higher net loss ratio in 2017 compared to 2016 as a result of higher catastrophe losses in 2017.

### *A&H Segment - Results of Operations*

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | *(amounts in thousands, except percentages)* | | |
| Gross premium written | $698,109 | $581,402 | $464,010 |
| Ceded premiums | (71,570) | (46,106) | (45,342) |
| Net premium written | $626,539 | $535,296 | $418,668 |
| Change in unearned premium | (10,126) | (2,013) | (4,241) |
| Net earned premium | $616,413 | $533,283 | $414,427 |
| Ceding commission income | 7,003 | 1,013 | 1,331 |
| Service and fee income | 185,980 | 154,614 | 138,936 |
| Total underwriting revenues | $809,396 | $688,910 | $554,694 |
| Underwriting expenses: | | | |
| Loss and loss adjustment expense | 321,345 | 318,463 | 301,210 |
| Acquisition costs and other underwriting expenses | 184,726 | 154,879 | 102,730 |
| General and administrative expenses | 201,808 | 171,497 | 128,333 |
| Total underwriting expenses | $707,879 | $644,839 | $532,273 |
| Underwriting income | $101,517 | $44,071 | $22,421 |
| | | | |
| *Underwriting ratios:* | | | |
| Net loss ratio | 52.1 % | 59.7 % | 72.7 % |
| Net operating expense ratio (non-GAAP) | 31.4 % | 32.0 % | 21.9 % |
| Net combined ratio (non-GAAP) | 83.5 % | 91.7 % | 94.6 % |
| *Underwriting ratios before amortization and impairment (non-GAAP):* | | | |
| Net loss ratio | 52.1 % | 59.7 % | 72.7 % |
| Net operating expense ratio before amortization and impairment (non-GAAP) | 30.2 % | 30.4 % | 19.4 % |
| Net combined ratio before amortization and impairment (non-GAAP) | 82.3 % | 90.1 % | 92.1 % |
| | | | |
| *Reconciliation of net operating expense ratio (non-GAAP):* | | | |
| Total expenses | $707,879 | $644,839 | $532,273 |
| Less: Loss and loss adjustment expense | 321,345 | 318,463 | 301,210 |
| Less: Ceding commission income | 7,003 | 1,013 | 1,331 |
| Less: Service and fee income | 185,980 | 154,614 | 138,936 |
| Net operating expense | $193,551 | $170,749 | $90,796 |
| Net earned premium | $616,413 | $533,283 | $414,427 |
| Net operating expense ratio (non-GAAP) | 31.4 % | 32.0 % | 21.9 % |
| | | | |
| Net operating expense | $193,551 | $170,749 | $90,796 |
| Less: Non-cash impairment of goodwill | — | — | — |
| Less: Non-cash amortization of intangible assets | 7,363 | 8,871 | 10,593 |
| Net operating expense before amortization and impairment | $186,188 | $161,878 | $80,203 |
| Net earned premium | $616,413 | $533,283 | $414,427 |
| Net operating expense ratio before amortization and impairment (non-GAAP) | 30.2 % | 30.4 % | 19.4 % |

***A&H Segment Results of Operations for the Year Ended December 31, 2018 Compared to the Year Ended December 31, 2017***

*Gross premium written*. Gross premium written increased by $116.7 million, or 20.1%, from $581.4 million for the year ended December 31, 2017 to $698.1 million for the year ended December 31, 2018, primarily as a result of domestic organic growth.

*Net premium written*. Net premium written increased by $91.2 million, or 17.0%, from $535.3 million for the year ended December 31, 2017 to $626.5 million for the year ended December 31, 2018, primarily as a result of domestic organic growth, partially offset by a new quota share entered into on certain European business.

*Net earned premium*. Net earned premium increased by $83.1 million, or 15.6%, from $533.3 million for the year ended December 31, 2017 to $616.4 million for the year ended December 31, 2018, primarily as a result of domestic organic growth.

*Service and fee income.* Service and fee income increased by $31.4 million, or 20.3%, from $154.6 million for the year ended December 31, 2017 to $186.0 million for the year ended December 31, 2018, primarily due to growth in our domestic business.

The components of service and fee income are as follows:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2018 | 2017 | Change | % Change |
| | *(amounts in thousands)* | | | |
| Group health administrative fees | $79,411 | $62,217 | $17,194 | 27.6 % |
| Commission revenue | 70,086 | 67,015 | 3,071 | 4.6 % |
| Finance and processing fees | 4,535 | 7,183 | (2,648 ) | (36.9)% |
| Other service and fee income | 31,948 | 18,199 | 13,749 | 75.5 % |
| Total | $185,980 | $154,614 | $31,366 | 20.3 % |

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE increased by $2.9 million, from $318.5 million for the year ended December 31, 2017 to $321.3 million for the year ended December 31, 2018. Our A&H net loss ratio decreased from 59.7% for the year ended December 31, 2017 to 52.1% for the year ended December 31, 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 $29.8 million, or 19.3%, from $154.9 million for the year ended December 31, 2017 to $184.7 million for the year ended December 31, 2018, primarily from domestic organic growth. The increase was primarily from commissions.

*General and administrative expenses.* General and administrative expenses increased by $30.3 million, or 17.7%, from $171.5 million for the year ended December 31, 2017 to $201.8 million for the year ended December 31, 2018. The increase was due to domestic organic growth.

*Net operating expense; net operating expense ratio (non-GAAP)*. Net operating expense increased by $22.8 million, or 13.4%, from $170.7 million for the year ended December 31, 2017 to $193.6 million for the year ended December 31, 2018. Our A&H net operating expense ratio decreased from 32.0% for the year ended December 31, 2017 to 31.4% for the year ended December 31, 2018.

*Underwriting income; net combined ratio (non-GAAP).* Underwriting income increased from $44.1 million for the year ended December 31, 2017 to $101.5 million for the year ended December 31, 2018. The increase was primarily due to domestic organic growth. Our A&H net combined ratio decreased from 91.7% for the year ended December 31, 2017 to 83.5% for the year ended December 31, 2018. The net combined ratio decrease was primarily as a result of a lower net loss ratio.

***A&H Segment Results of Operations for the Year Ended December 31, 2017 Compared to the Year Ended December 31, 2016***

*Gross premium written*. Gross premium written increased by $117.4 million, or 25.3%, from $464.0 million for the year ended December 31, 2016 to $581.4 million for the year ended December 31, 2017, as a result of the acquisition of Direct General ($10.4 million) and organic growth, both domestic ($90.4 million) and international ($16.6 million).

*Net premium written*. Net premium written increased by $116.6 million, or 27.9%, from $418.7 million for the year ended December 31, 2016 to $535.3 million for the year ended December 31, 2017, as a result of the acquisition of Direct General ($10.4 million) and organic growth, both domestic ($89.7 million) and international ($16.6 million).

*Net earned premium*. Net earned premium increased by $118.9 million, or 28.7%, from $414.4 million for the year ended December 31, 2016 to $533.3 million for the year ended December 31, 2017, primarily as a result of the acquisition of Direct General ($10.7 million) and organic growth, both domestic ($89.1 million) and international ($19.1 million).

*Service and fee income.* Service and fee income increased by $15.7 million, or 11.3%, from $138.9 million for the year ended December 31, 2016 to $154.6 million for the year ended December 31, 2017, primarily due to growth in our domestic business.

The components of service and fee income are as follows:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2017 | 2016 | Change | % Change |
| | *(amounts in thousands)* | | | |
| Commission revenue | $67,015 | $51,845 | $15,170 | 29.3 % |
| Group health administrative fees | 62,217 | 69,689 | (7,472 ) | (10.7 )% |
| Finance and processing fees | 7,183 | 8,332 | (1,149 ) | (13.8 )% |
| Other service and fee income | 18,199 | 9,070 | 9,129 | 100.7 % |
| Total | $154,614 | $138,936 | $15,678 | 11.3 % |

*Loss and loss adjustment expense; net loss ratio.* Loss and LAE increased by $17.3 million, from $301.2 million for the year ended December 31, 2016 to $318.5 million for the year ended December 31, 2017. Our A&H net loss ratio decreased from 72.7% for the year ended December 31, 2016 to 59.7% for the year ended December 31, 2017. The loss ratio decrease was a result of higher premiums with lower loss experience due to a change in product mix primarily in our domestic business.

*Acquisition costs and other underwriting expenses.* Acquisition costs and other underwriting expenses increased by $52.1 million, or 50.8%, from $102.7 million for the year ended December 31, 2016 to $154.9 million for the year ended December 31, 2017, primarily from organic growth ($49.3 million).

*General and administrative expenses.* General and administrative expenses increased by $43.2 million, or 33.6%, from $128.3 million for the year ended December 31, 2016 to $171.5 million for the year ended December 31, 2017, primarily from organic growth ($27.5 million).

*Net operating expense; net operating expense ratio (non-GAAP)*. Net operating expense increased by $80.0 million, or 88.1%, from $90.8 million for the year ended December 31, 2016 to $170.7 million for the year ended December 31,

2017. Our A&H net operating expense ratio increased from 21.9% for the year ended December 31, 2016 to 32.0% for the year ended December 31, 2017. The increases in net operating expense and net operating expense ratio were primarily due to higher expenses primarily in our domestic business.

*Underwriting income; net combined ratio (non-GAAP).* Underwriting income increased from $22.4 million for the year ended December 31, 2016 to $44.1 million for the year ended December 31, 2017. Our A&H net combined ratio decreased from 94.6% for the year ended December 31, 2016 to 91.7% for the year ended December 31, 2017. The net combined ratio decrease was primarily a result of a lower net loss 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 3.3% for the years ended December 31, 2018 and 2017, respectively, and the average duration of the portfolio was 4.2 and 4.0 years as of December 31, 2018 and 2017, respectively.

For more information related to our investments, see Note 3, “Investments” in the notes to our 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 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 December 31, 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 $287.9 million and $387.6 million as of December 31, 2018 and 2017, respectively, taking into account dividends paid in the prior twelve month periods. During the years ended December 31, 2018, 2017 and 2016, there were $156.7 million, $339.4 million and $29.5 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 $2.5 billion, $2.5 billion and $1.9 billion in the years ended December 31, 2018, 2017 and 2016, 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 increased from $3.9 billion at December 31, 2016 to $4.0 billion at December 31, 2017, and increased to $4.5 billion at December 31, 2018. 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 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:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | *(amounts in thousands)* | | |
| Net cash provided by operating activities | $598,133 | $317,301 | $318,146 |
| Net cash used in investing activities | (790,774) | (171,472) | (462,041) |
| Net cash provided by (used in) financing activities | 73,463 | (81,903) | 152,704 |
| Effect of exchange rate changes on cash and cash equivalents | (4,723) | 7,658 | (5,186) |
| Net (decrease) increase in cash, cash equivalents, and restricted cash | $(123,901) | $71,584 | $3,623 |

***Comparison of Years Ended December 31, 2018 and 2017***

Net cash provided by operating activities increased by $280.8 million, primarily due to higher net income in 2018.

Net cash used in investing activities increased by $619.3 million, primarily due to higher purchases of investments net of proceeds from sales in 2018.

Net cash provided by (used in) financing activities increased by $155.4 million, primarily due to proceeds received from issuances of common and preferred stock in 2018.

***Comparison of Years Ended December 31, 2017 and 2016***

Net cash used in investing activities decreased by $290.6 million, primarily reflecting a decrease of $250.6 million in cash used for acquisitions in 2017.

Net cash (used in) provided by financing activities decreased by $234.6 million, primarily due to a decrease of $198.5 million in proceeds received from issuances of common and preferred stock, an increase of $14.2 million in dividends paid and an increase of $64.7 million in cash used in repayments of debt, net of proceeds, partially offset by a decrease of $47.5 million in the securities sold under agreements to repurchase, net.

## Consolidating Balance Sheet Information

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | NGHC | Reciprocal Exchanges | Eliminations | Total |
| **ASSETS** | *(amounts in thousands)* | | | |
| **Investments:** | | | | |
| Debt securities, available-for-sale, at fair value | $3,263,949 | $297,083 | $— | $3,561,032 |
| Equity securities, at fair value | 10,949 | — | — | 10,949 |
| Short-term investments | 331,221 | 17,328 | — | 348,549 |
| Other investments | 407,580 | — | (101,304) | 306,276 |
| **Total investments** | 4,013,699 | 314,411 | (101,304) | 4,226,806 |
| Cash and cash equivalents | 193,858 | — | — | 193,858 |
| Restricted cash and cash equivalents | 39,525 | 200 | — | 39,725 |
| Accrued investment income | 50,981 | 1,596 | (25,400) | 27,177 |
| Premiums and other receivables, net | 1,338,485 | 61,327 | — | 1,399,812 |
| Deferred acquisition costs | 231,401 | 20,007 | — | 251,408 |
| Reinsurance recoverable | 1,494,670 | 117,068 | — | 1,611,738 |
| Prepaid reinsurance premiums | 529,241 | 136,433 | — | 665,674 |
| Premises and equipment, net | 306,309 | 1,695 | — | 308,004 |
| Intangible assets, net | 376,532 | 3,405 | — | 379,937 |
| Goodwill | 180,183 | — | — | 180,183 |
| Prepaid and other assets | 150,377 | 4,581 | — | 154,958 |
| **Total assets** | $8,905,261 | $660,723 | $(126,704) | $9,439,280 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | | | |
| **Liabilities:** | | | | |
| Unpaid loss and loss adjustment expense reserves | $2,778,689 | $178,470 | $— | $2,957,159 |
| Unearned premiums and other revenue | 2,014,965 | 265,763 | — | 2,280,728 |
| Reinsurance payable | 615,872 | 40,393 | — | 656,265 |
| Accounts payable and accrued expenses | 390,338 | 33,120 | (25,400) | 398,058 |
| Debt | 675,449 | 101,304 | (101,304) | 675,449 |
| Other liabilities | 209,110 | 61,640 | — | 270,750 |
| **Total liabilities** | $6,684,423 | $680,690 | $(126,704) | $7,238,409 |
| **Stockholders' equity:** | | | | |
| Common stock | $1,129 | $— | $— | $1,129 |
| Preferred stock | 450,000 | — | — | 450,000 |
| Additional paid-in capital | 1,057,783 | — | — | 1,057,783 |
| Accumulated other comprehensive income | (52,130) | — | — | (52,130) |
| Retained earnings | 764,056 | — | — | 764,056 |
| **Total National General Holdings Corp. Stockholders' Equity** | 2,220,838 | — | — | 2,220,838 |
| Non-controlling interest | — | (19,967) | — | (19,967) |
| **Total stockholders' equity** | $2,220,838 | $(19,967) | $— | $2,200,871 |
| **Total liabilities and stockholders' equity** | $8,905,261 | $660,723 | $(126,704) | $9,439,280 |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | NGHC | Reciprocal Exchanges | Eliminations | Total |
| **ASSETS** | *(amounts in thousands)* | | | |
| **Investments:** | | | | |
| 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 |
| **Total investments** | 3,411,730 | 327,213 | (89,155) | 3,649,788 |
| 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 |
| **Total assets** | $7,927,455 | $ 618,099 | $ (105,811) | $8,439,743 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | | | |
| **Liabilities:** | | | | |
| 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 | 390,507 | 24,682 | (15,855) | 399,334 |
| Debt | 713,710 | 89,155 | (89,155) | 713,710 |
| Other liabilities | 237,483 | 41,582 | — | 279,065 |
| **Total liabilities** | $5,998,886 | $ 593,243 | $ (105,811) | $6,486,318 |
| **Stockholders' equity:** | | | | |
| 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 |
| **Total National General Holdings Corp. Stockholders' Equity** | 1,928,569 | — | — | 1,928,569 |
| Non-controlling interest | — | 24,856 | — | 24,856 |
| **Total stockholders' equity** | $1,928,569 | $ 24,856 | $ — | $1,953,425 |
| **Total liabilities and stockholders' equity** | $7,927,455 | $ 618,099 | $ (105,811) | $8,439,743 |

**Other Material Changes in Financial Position**

| | December 31, | | | |
|---|---|---|---|---|
| | 2018 | 2017 | Change | % Change |
| | *(amounts in thousands)* | | | |
| Selected Assets: | | | | |
| Reinsurance recoverable | $1,611,738 | $1,294,165 | $317,573 | 24.5 % |
| Selected Liabilities: | | | | |
| Unearned premiums and other revenue | $2,280,728 | $2,032,605 | $248,123 | 12.2 % |

***Changes in Financial Position During the Year Ended December 31, 2018 Compared to December 31, 2017***

Reinsurance recoverable increased by $317.6 million, driven by growth in our P&C segment ($300.7 million) and A&H segment ($16.9 million). Unearned premiums and other revenue increased by $248.1 million, driven by growth in our P&C segment ($265.4 million), partially offset by a decline in our A&H segment ($17.3 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 large loss events.

For more information on our reinsurance agreements, see Note 10 “Reinsurance” in the notes to our Consolidated Financial Statements.

**Debt**

**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 years ended December 31, 2018, 2017 and 2016 was $23.6 million, $23.7 million and $23.6 million, respectively. For more information on the 6.75% Notes, including ranking and restrictive covenants, see Note 12, "Debt" in the notes to our Consolidated Financial Statements.

**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 years ended December 31, 2018, 2017 and 2016 was $7.6 million, $7.5 million and $7.6 million, respectively. For more information on the 7.625% notes, including ranking and restrictive covenants, see Note 12, "Debt" in the notes to our 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 years ended December 31, 2018, 2017 and 2016, was $4.3 million, $3.8 million and $0.5 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 currently a $245.0 million base revolving credit facility with a letter of credit sublimit of $112.5 million and a remaining expansion feature of up to $30.0 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 December 31, 2018).

As of December 31, 2018, there was $160.0 million outstanding under the Credit Agreement. The weighted average interest rate on the amount outstanding as of December 31, 2018 was 4.58%. 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 years ended December 31, 2018, 2017 and 2016 was $7.5 million, $4.2 million and $0.9 million, respectively.

On February 25, 2019 we repaid the Credit Agreement and entered into a new credit agreement (the "2019 Credit Agreement"), among JPMorgan Chase Bank, N.A., as Administrative Agent, KeyBank National Association and Fifth Third Bank, as Syndication Agents, and the various lending institutions party thereto. The 2019 Credit Agreement is currently a $340.0 million base revolving credit facility with a letter of credit sublimit of $150.0 million and a expansion feature of up to $50.0 million. Any borrowing under the 2019 Credit Agreement will bear interest at LIBOR plus 1.75% and a commitment fee of 0.225% depending on our leverage ratio. The 2019 Credit Agreement has a maturity date of February 24, 2023. As of February 25, 2019, there was $160.0 million outstanding under the 2019 Credit Agreement.

For more information on the Credit Agreement and the 2019 Credit Agreement including ranking and restrictive covenants, see Note 12, "Debt" in the notes to our Consolidated Financial Statements.

**Common Stock**

On November 19, 2018, we issued 5,750,000 shares of common stock in a public offering. The common stock offering was priced at $24 per share, resulting in net proceeds of approximately $132.2 million, after deducting underwriting discount and issuance expenses. Underwriting discount and issuance expenses of approximately $5.8 million were charged to additional paid-in capital.

**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 depositary shares. Dividends on the Series A, B and C preferred stock 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 preferred stock 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 year ended December 31, 2018 |
|---|---|---|---|---|---|---|---|
| | | | | | *(amounts in thousands)* | | |
| A | 7.50 % | 2,200,000 | — | $ 25 | $ 55,000 | $ 53,164 | $ 4,125 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| B | 7.50 | % | 165,000 | 6,600,000 | $ 1,000 | $ 165,000 | $ 159,802 | $ 12,375 |
| C | 7.50 | % | 200,000 | 8,000,000 | $ 1,000 | $ 200,000 | $ 193,518 | $ 15,000 |
| D | Fixed/ Floating[1] | | 120 | — | $ 250,000 | $ 30,000 | $ 29,890 | $ — |

[1] 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, see Note 15, “Stockholders’ Equity” in the notes to our Consolidated Financial Statements.

**Contractual Obligations and Commitments**

The following table sets forth certain of our contractual obligations as of December 31, 2018:

| | Payment Due by Period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 Year | 1 – 3 Years | 3 – 5 Years | More than 5 Years |
| | *(amounts in thousands)* | | | | |
| Loss and LAE reserves[1] | $2,957,159 | $1,498,183 | $797,201 | $243,831 | $417,944 |
| Debt and interest[2][3] | 1,200,077 | 41,881 | 85,910 | 240,003 | 832,283 |
| Operating leases | 151,217 | 32,056 | 47,576 | 30,808 | 40,777 |
| Purchase obligations[4] | 66,667 | 66,667 | — | — | — |
| Capital lease obligations | 30,346 | 11,146 | 16,941 | 1,599 | 660 |
| Employment agreement obligations | 9,449 | 4,928 | 3,176 | 1,345 | — |
| Contributions to partnerships | 5,797 | 1,420 | 1,713 | 591 | 2,073 |
| Total | $4,420,712 | $1,656,281 | $952,517 | $518,177 | $1,293,737 |

(1) The loss and LAE payments due by period in the table above are based upon the loss and LAE estimates as of December 31, 2018, and actuarial estimates of expected payout patterns and are not contractual liabilities with finite maturities. Our contractual liability is to provide benefits under the policy. As a result, our calculation of loss and LAE payments due by period is subject to the same uncertainties associated with determining the level of loss and LAE generally and to the additional uncertainties arising from the difficulty of predicting when claims (including claims that have not yet been reported to us) will be paid. For a discussion of our loss and LAE estimate process, see Item 1, “Business - Loss Reserves.” Actual payments of loss and LAE by period will vary, perhaps materially, from the table above to the extent that current estimates of loss and LAE vary from actual ultimate claims amounts and as a result of variations between expected and actual payout patterns. See Item 1A, “Risk Factors - Risks Relating to Our Business - *If we are unable to establish and maintain accurate loss reserves, our business, financial condition and results of operations may be materially adversely affected”* for a discussion of the uncertainties associated with estimating loss and LAE.

(2) Pro forma for the repayment of our Credit Agreement and 2019 Credit Agreement entered on February 25, 2019.

(3) Pro forma interest related to our debt by period as of December 31, 2018 was as follows: $41.9 million - less than 1 year, $85.9 million - 1 - 3 years, $80.0 million - 3 - 5 years and $310.1 million - more than 5 years.

(4) Relates to the purchase of our policy management system.

**Inflation**

We establish insurance premiums before we know the amount of losses and LAE or the extent to which inflation may affect such amounts. We attempt to anticipate the potential impact of inflation in establishing our reserves, especially as it relates to medical and hospital rates where historical inflation rates have exceeded the general level of inflation. Inflation in excess of the levels we have assumed could cause loss and LAE to be higher than we anticipated, which would require us to increase reserves and reduce earnings. Fluctuations in rates of inflation also influence interest rates, which in turn impact the market value of our investment portfolio and yields on new investments. Operating expenses, including salaries and benefits, are also usually affected by inflation.

**Item 7A. 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 7, “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 with a fair value of $3.6 billion as of December 31, 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 December 31, 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 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 December 31, 2018.

| Hypothetical Change in Interest Rates | Fair Value | Estimated Change in Fair Value | Hypothetical Percentage Increase (Decrease) in Stockholders' Equity |
|---|---|---|---|
| | *(amounts in thousands)* | | |
| 200 basis point increase | $3,257,169 | $(303,863) | (10.9)% |
| 100 basis point increase | 3,409,083 | (151,949) | (5.5) |
| No change | 3,561,032 | — | — |
| 100 basis point decrease | 3,706,785 | 145,753 | 5.2 |
| 200 basis point decrease | 3,850,793 | 289,761 | 10.4 |

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. As of December 31, 2018, we had $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 December 31, 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 8. Financial Statements and Supplementary Data**

The financial statements and financial statement schedules required to be filed pursuant to this Item 8 are listed in the accompanying Index to Consolidated Financial Statements and Schedules at page F-1 and are filed as part of this report.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

**Item 9A. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our chief executive officer (CEO) and chief financial officer (CFO), has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act)), as of the end of the period covered by this Annual Report on Form 10-K. Based on such evaluation, our CEO and CFO have concluded that as of December 31, 2018, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (SEC), and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

**Management's Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Management conducted an assessment of the effectiveness of our internal control over financial reporting based on the criteria set forth in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework). Based on the assessment, management has concluded that its internal control over financial reporting was effective as of December 31, 2018 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with U.S. GAAP. Our independent registered public accounting firm, Ernst & Young LLP, has issued an audit report with respect to our internal control over financial reporting.

**Changes in Internal Control**

There were no changes in our internal control over financial reporting identified in Management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the fourth quarter of 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Limitations on Effectiveness of Controls and Procedures and Internal Control over Financial Reporting**

In designing and evaluating the disclosure controls and procedures and internal control over financial reporting, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures and internal control over financial reporting must reflect the fact that there are resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Stockholders and the Board of Directors of
National General Holdings Corp:

**Opinion on Internal Control over Financial Reporting**
We have audited National General Holdings Corp.'s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, National General Holdings Corp. (the "Company") maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of National General Holdings Corp. as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the two years in the period ended December 31, 2018, and the related notes and the financial statement schedules listed in the accompanying index, of the Company and our report dated February 25, 2019 expressed an unqualified opinion thereon.

**Basis for Opinion**
The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

**Definition and Limitations of Internal Control Over Financial Reporting**
A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP
New York, New York
February 25, 2019

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information required by Item 10 of Form 10-K is incorporated by reference to the information contained in our Proxy Statement for our Annual Meeting of Stockholders to be held May 6, 2019 (the "Proxy Statement") under the captions "Proposal 1: Election of Directors," "Executive Officers," "Certain Relationships and Related Transactions — Family Relationships," "Corporate Governance — Code of Business Conduct and Ethics," "Corporate Governance — Audit Committee" and "Security Ownership of Management — Section 16(a) Beneficial Ownership Reporting Compliance." The Proxy Statement, or an amendment to this Annual Report on Form 10-K containing the information, will be filed with the SEC before April 30, 2019.

**Item 11. Executive Compensation**

The information required by Item 11 of Form 10-K is incorporated by reference to the information contained in our Proxy Statement under the captions "Executive Compensation," "Compensation of Directors," "Compensation Discussion and Analysis," "Corporate Governance — Oversight of Risk Management," "Corporate Governance — Compensation Committee Interlocks and Insider Participation," "CEO Compensation Pay Ratio" and "Compensation Committee Report." The Proxy Statement, or an amendment to this Annual Report on Form 10-K containing the information, will be filed with the SEC before April 30, 2019.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

A portion of the information required by Item 12 of Form 10-K is incorporated by reference to the information contained in our Proxy Statement under the captions "Security Ownership of Certain Beneficial Owners" and "Security Ownership of Management." The Proxy Statement, or an amendment to this Annual Report on Form 10-K containing the information, will be filed with the SEC before April 30, 2019.

*Equity Compensation Plan Information*

The table below shows information regarding awards outstanding and shares of common stock available for issuance as of December 31, 2018 under our 2010 Equity Incentive Plan and 2013 Equity Incentive Plan.

| Plan Category | Number of Securities to Be Issued Upon Exercise of Outstanding Options, Warrants and Rights[1] | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights[2] | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans |
|---|---|---|---|
| Equity Compensation Plans Approved by Security Holders | 4,123,147 | $ 9.53 | 521,311 |
| Equity Compensation Plans Not Approved by Security Holders | — | — | — |
| Total | 4,123,147 | $ 9.53 | 521,311 |

[1] Includes restricted stock unit awards that, upon vesting, provide the holder with the right to receive common shares on a one-to-one basis. For further discussion of these awards, see Note 18, "Share-Based Compensation" in the notes to

our Consolidated Financial Statements.

(2) Only applies to outstanding options, as restricted stock units do not have exercise prices.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by Item 13 of Form 10-K is incorporated by reference to the information contained in our Proxy Statement under the captions “Certain Relationships and Related Transactions” and “Corporate Governance — Independence of Directors.” The Proxy Statement, or an amendment to this Annual Report on Form 10-K containing the information, will be filed with the SEC before April 30, 2019.

**Item 14. Principal Accounting Fees and Services**

The information required by Item 14 of Form 10-K is incorporated by reference to the information contained in our Proxy Statement under the caption “Proposal 2: Ratification of Independent Registered Public Accounting Firm.” The Proxy Statement, or an amendment to this Annual Report on Form 10-K containing the information, will be filed with the SEC before April 30, 2019.

## PART IV

### Item 15. Exhibits and Financial Statement Schedules

(a) Documents filed as part of this report: The financial statements and financial schedules listed in the accompanying Index to Consolidated Financial Statements and Schedules are filed as part of this report. All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and, therefore, have been omitted.

(b) Schedules: See Item 15(a).

(c) Exhibits listing

| Exhibit No. | Exhibit Description |
|---|---|
| 3.1 | Second Amended and Restated Certificate of Incorporation of National General Holdings Corp. (the "Company") (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 3.2 | Amended and Restated Bylaws of the Company (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 3.3 | Certificate of Designations for 7.50% Non-Cumulative Preferred Stock, Series A (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q filed on August 11, 2014) |
| 3.4 | Certificate of Designations of 7.50% Non-Cumulative Preferred Stock, Series B (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on March 27, 2015) |
| 3.5 | Certificate of Designations of 7.50% Non-Cumulative Preferred Stock, Series C (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on July 7, 2016) |
| 3.6 | 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) |
| 4.1 | Form of Common Stock Certificate of the Company (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 4.2 | Registration Rights Agreement, dated as of October 16, 2009, by and among the Company, The Michael Karfunkel 2005 Grantor Retained Annuity Trust, Michael Karfunkel and AmTrust International Insurance, Ltd., as assignee of AmTrust Financial Services, Inc. (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 4.3 | Form of Stock Certificate evidencing 7.50% Non-Cumulative Preferred Stock, Series A (incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q filed on August 11, 2014) |
| 4.4 | Form of stock certificate evidencing 7.50% Non-Cumulative Preferred Stock, Series B (incorporated by reference to Exhibit 4.3 to the Company's Current Report on Form 8-K filed on March 27, 2015) |
| 4.5 | Form of stock certificate evidencing 7.50% Non-Cumulative Preferred Stock, Series C (incorporated by reference to Exhibit 4.3 to the Company's Current Report on Form 8-K filed on July 7, 2016) |
| 4.6 | Form of 6.750% Notes due 2024 (included as Exhibit A to Exhibit 4.9) (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on May 28, 2014) |
| 4.7 | Form of 7.625% Subordinated Notes due 2055 (included as Exhibit A to Exhibit 4.10) (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on August 18, 2015) |
| 4.8 | Indenture, dated as of May 23, 2014, by and between the Company, as Issuer, and The Bank of New York Mellon, as Trustee (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on May 28, 2014) |
| 4.9 | First Supplemental Indenture, dated as of May 23, 2014, by and between the Company, as Issuer, and The Bank of New York Mellon, as Trustee (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on May 28, 2014) |
| 4.10 | Second Supplemental Indenture, dated as of August 18, 2015, by and between the Company and The Bank of New York Mellon, as trustee (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on August 18, 2015) |
| 4.11 | Deposit Agreement, dated March 27, 2015, among National General Holdings Corp., American Stock Transfer & Company, LLC and the holders from time to time of the depositary receipts described therein (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on March 27, 2015) |

| Exhibit No. | Exhibit Description |
|---|---|
| 4.12 | Deposit Agreement, dated July 7, 2016, among National General Holdings Corp., American Stock Transfer & Trust Company, LLC and the holders from time to time of the depositary receipts described therein (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on July 7, 2016) |
| 4.13 | Form of depositary receipt (included as Exhibit A to Exhibit 4.11) (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on March 27, 2015) |
| 4.14 | Form of depositary receipt (included as Exhibit A to Exhibit 4.12) (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on July 7, 2016) |
| 10.1* | American Capital Acquisition Corporation 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.7 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 10.2* | Form of Statutory Time-Based Stock Option Agreement for the American Capital Acquisition Corporation 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.8 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 10.3* | Amendment to Form of Statutory Time-Based Stock Option Agreement for the American Capital Acquisition Corporation 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.9 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 10.4* | 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.10 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 10.5* | Form of Non-Qualified Stock Option Award Agreement for the NGHC 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.11 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 10.6* | Form of Incentive Stock Option Award Agreement for the NGHC 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.12 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 10.7* | Form of Restricted Stock Unit Agreement for the NGHC 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q filed on August 11, 2014) |
| 10.8* | Form of Indemnification Agreement for Directors and Certain Officers (incorporated by reference to Exhibit 10.14 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 10.9* | Employment Agreement, dated as of January 1, 2013, by and between National General Management Corp. and Michael Weiner (incorporated by reference to Exhibit 10.16 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 10.10 | Personal and Commercial Automobile Quota Share Reinsurance Agreement between Integon National Insurance Company and Technology Insurance Company, Inc., Maiden Insurance Company Ltd., and ACP Re, Ltd., effective March 1, 2010 (incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 10.11 | Addendum No. 1 to Personal and Commercial Automobile Quota Share Reinsurance Agreement between Integon National Insurance Company and Technology Insurance Company, Inc., Maiden Insurance Company Ltd., and ACP Re, Ltd., effective October 1, 2012 (incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form S-1 (No. 333-190454) filed on August 7, 2013) |
| 10.12 | Credit Agreement, dated January 25, 2016, among the Company, 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 parties thereto (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on January 26, 2016) |
| 10.13 | Amendment No. 1, dated October 14, 2016, to the Credit Agreement, among the Company, 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 parties thereto (incorporated by reference to Exhibit 10.1 to the Company's current Report on Form 8-K filed on October 14, 2016) |
| 10.14 | Amended and Restated Credit Agreement, dated September 20, 2016, among AmTrust Financial Services, Inc.as Administrative Agent, ACP Re Holdings, LLC, the Michael Karfunkel Family 2005 Trust, and AmTrust International Insurance, Ltd. and National General Re Ltd., as Lenders (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on September 21, 2016) |

| Exhibit No. | Exhibit Description |
|---|---|
| 10.15 | Credit Agreement, dated February 25, 2019, among the Company, JPMorgan Chase Bank, N.A., as Administrative Agent, KeyBank National Association and Fifth Third Bank as Co-Syndication Agents, and Associated Bank, National Association and The Bank of Nova Scotia, as Co-Documentation Agents, and the various lending institutions party thereto (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 25, 2019) |
| 10.16 | Asset Purchase and License Agreement, dated September 13, 2017, between AmTrust North America, Inc. and National General Holdings Corp. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 18, 2017) |
| 21.1 | List of subsidiaries of the Company (filed herewith) |
| 23.1 | Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm, relating to the Financial Statements of the Company (filed herewith) |
| 23.2 | Consent of BDO USA LLP, Independent Registered Public Accounting Firm, relating to the Financial Statements of the Company (filed herewith) |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.SC. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith) |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.SC. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith) |
| 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) |
| 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) |

*Management contract or compensatory plan or arrangement.

## Item 16. Form 10-K Summary

None.

**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.

| **Date** | **NATIONAL GENERAL HOLDINGS CORP.** |
|---|---|
| February 25, 2019 | By: /s/ Michael Weiner<br>Name: Michael Weiner<br>Title: Chief Financial Officer |

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

| **Signature** | **Title** | **Date** |
|---|---|---|
| /s/ Barry Karfunkel<br>Barry Karfunkel | Chief Executive Officer, Co-Chairman and Director<br>(Principal Executive Officer) | February 25, 2019 |
| /s/ Michael Weiner<br>Michael Weiner | Chief Financial Officer<br>(Principal Financial Officer) | February 25, 2019 |
| /s/ Lawrence J. Moloney<br>Lawrence J. Moloney | Chief Accounting Officer<br>(Principal Accounting Officer) | February 25, 2019 |
| /s/ Robert Karfunkel<br>Robert Karfunkel | President, Co-Chairman and Director | February 25, 2019 |
| /s/ Barry Zyskind<br>Barry Zyskind | Director | February 25, 2019 |
| /s/ Donald DeCarlo<br>Donald DeCarlo | Director | February 25, 2019 |
| /s/ Patrick Fallon<br>Patrick Fallon | Director | February 25, 2019 |
| /s/ Barbara Paris<br>Barbara Paris | Director | February 25, 2019 |
| /s/ John Marshaleck<br>John Marshaleck | Director | February 25, 2019 |
| /s/ John Nichols<br>John Nichols | Director | February 25, 2019 |

**NATIONAL GENERAL HOLDINGS CORP.**
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES**


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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Stockholders and the Board of Directors of
National General Holdings Corp:

**Opinion on the Financial Statements**
We have audited the accompanying consolidated balance sheets of National General Holdings Corp. (the "Company") as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the two years in the period ended December 31, 2018, and the related notes and the financial statement schedules listed in the accompanying index (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 25, 2019 expressed an unqualified opinion thereon.

**Basis for Opinion**
These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 2017.

New York, New York
February 25, 2019

**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders
National General Holdings Corp
New York, New York

We have audited the accompanying consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows of National General Holdings Corp. (the "Company") for the year ended December 31, 2016, and the related financial statement schedules listed in the accompanying index. These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosure in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedules. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of its operations and its cash flows for the year ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion the financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/s/ BDO USA, LLP
New York, New York
March 23, 2017 (except for the revisions of previously issued financial statements described in Note 3 to the 2017 financial statements which are not presented herein which is as of February 26, 2018)

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

| | December 31, | |
|---|---|---|
| | **2018** | **2017** |
| **ASSETS** | | |
| **Investments:** | | |
| Debt securities, available-for-sale, at fair value (Exchanges - $297,083 and $304,934) | $3,561,032 | $3,139,889 |
| Equity securities, at fair value | 10,949 | 50,341 |
| Short-term investments (Exchanges - $17,328 and $22,279) | 348,549 | 38,266 |
| Other investments (related parties - $233,723 and $347,548) | 306,276 | 421,292 |
| **Total investments** | 4,226,806 | 3,649,788 |
| Cash and cash equivalents (Exchanges - $0 and $5,442) | 193,858 | 292,282 |
| Restricted cash and cash equivalents (Exchanges - $200 and $609) | 39,725 | 65,202 |
| Accrued investment income (related parties - $2,362 and $2,334) (Exchanges - $1,596 and $1,805) | 27,177 | 22,372 |
| Premiums and other receivables, net (Exchanges - $61,327 and $56,792) | 1,399,812 | 1,324,321 |
| Deferred acquisition costs (Exchanges - $20,007 and $20,837) | 251,408 | 216,389 |
| Reinsurance recoverable (related parties - $7,425 and $15,688) (Exchanges - $117,068 and $94,204) | 1,611,738 | 1,294,165 |
| Prepaid reinsurance premiums (Exchanges - $136,433 and $100,980) | 665,674 | 517,122 |
| Premises and equipment, net (Exchanges - $1,695 and $4,269) | 308,004 | 324,049 |
| Intangible assets, net (Exchanges - $3,405 and $3,685) | 379,937 | 404,070 |
| Goodwill | 180,183 | 174,153 |
| Prepaid and other assets (Exchanges - $4,581 and $2,263) | 154,958 | 155,830 |
| **Total assets** | $9,439,280 | $8,439,743 |

*See accompanying notes to consolidated financial statements.*

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

| | December 31, | |
|---|---|---|
| | **2018** | **2017** |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| **Liabilities:** | | |
| Unpaid loss and loss adjustment expense reserves (Exchanges - $178,470 and $143,353) | $2,957,159 | $2,663,557 |
| Unearned premiums and other revenue (Exchanges - $265,763 and $225,395) | 2,280,728 | 2,032,605 |
| Reinsurance payable (Exchanges - $40,393 and $68,275) | 656,265 | 398,047 |
| Accounts payable and accrued expenses (related parties - $69,874 and $140,057) (Exchanges - $7,720 and $8,827) | 398,058 | 399,334 |
| Debt | 675,449 | 713,710 |
| Other liabilities (Exchanges - $61,640 and $41,582) | 270,750 | 279,065 |
| **Total liabilities** | $7,238,409 | $6,486,318 |
| **Commitments and contingencies (Note 14)** | | |
| **Stockholders' equity:** | | |
| Common stock, $0.01 par value - authorized 150,000,000 shares, issued and outstanding 112,940,595 shares - 2018; authorized 150,000,000 shares, issued and outstanding 106,697,648 shares - 2017. | $1,129 | $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. Aggregate liquidation preference $450,000 - 2018, $420,000 - 2017. | 450,000 | 420,000 |
| Additional paid-in capital | 1,057,783 | 917,751 |
| Accumulated other comprehensive income: | | |
| Unrealized foreign currency translation adjustment, net of tax | (14,461) | (7,810) |
| Unrealized losses on investments, net of tax | (37,669) | (302) |
| Total accumulated other comprehensive income (loss) | (52,130) | (8,112) |
| Retained earnings | 764,056 | 597,863 |
| **Total National General Holdings Corp. Stockholders' Equity** | 2,220,838 | 1,928,569 |
| Non-controlling interest | (19,967) | 24,856 |
| **Total stockholders' equity** | $2,200,871 | $1,953,425 |
| **Total liabilities and stockholders' equity** | $9,439,280 | $8,439,743 |

*See accompanying notes to consolidated financial statements.*

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2018** | **2017** | **2016** |
| **Revenues:** | | | |
| Net earned premium | $3,732,202 | $3,654,176 | $2,995,171 |
| Ceding commission income | 224,697 | 116,456 | 45,600 |
| Service and fee income | 561,583 | 502,927 | 380,817 |
| Net investment income | 119,034 | 101,950 | 115,187 |
| Net gain (loss) on investments: | | | |
| Other-than-temporary impairment loss | — | (25) | (22,102) |
| Other net realized gain (loss) on investments | (29,545) | 46,788 | 30,006 |
| Net gain (loss) on investments | (29,545) | 46,763 | 7,904 |
| Other income (expense) | — | (198) | 24,308 |
| **Total revenues** | 4,607,971 | 4,422,074 | 3,568,987 |
| **Expenses:** | | | |
| Loss and loss adjustment expense | 2,662,226 | 2,626,082 | 2,092,280 |
| Acquisition costs and other underwriting expenses | 735,266 | 672,429 | 497,007 |
| General and administrative expenses | 938,046 | 912,996 | 709,148 |
| Interest expense | 51,425 | 47,086 | 40,180 |
| **Total expenses** | 4,386,963 | 4,258,593 | 3,338,615 |
| **Income before provision for income taxes** | 221,008 | 163,481 | 230,372 |
| Provision for income taxes | 53,484 | 61,273 | 33,998 |
| **Net income** | 167,524 | 102,208 | 196,374 |
| Net (income) loss attributable to non-controlling interest | 39,830 | 3,637 | (20,668) |
| **Net income attributable to NGHC** | 207,354 | 105,845 | 175,706 |
| Dividends on preferred stock | (32,492) | (31,500) | (24,333) |
| **Net income attributable to NGHC common stockholders** | $174,862 | $74,345 | $151,373 |
| | | | |
| **Earnings per common share ("EPS"):** | | | |
| Basic EPS | $1.62 | $0.70 | $1.43 |
| Diluted EPS | $1.59 | $0.68 | $1.40 |
| **Dividends declared per common share** | $0.16 | $0.16 | $0.14 |

*See accompanying notes to consolidated financial statements.*

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2018** | **2017** | **2016** |
| **Net income** | $167,524 | $102,208 | $196,374 |
| | | | |
| **Other comprehensive income:** | | | |
| Foreign currency translation adjustment | (8,425) | (6,317) | 2,246 |
| Income tax effect | 1,774 | 827 | (786) |
| Total foreign currency translation adjustment, net of tax | (6,651) | (5,490) | 1,460 |
| | | | |
| Gross unrealized gain (loss) on investments before reclassifications | (71,936) | 41,477 | 37,171 |
| Income tax effect | 15,107 | (8,710) | (13,010) |
| Total change in net unrealized gain (loss) on investments, net of tax | (56,829) | 32,767 | 24,161 |
| Reclassification adjustments for investments gain/loss to net income: | | | |
| Net realized (gain) loss on investments | 18,270 | (63,298) | (11,760) |
| Other-than-temporary impairment loss | — | 25 | 22,102 |
| Income tax effect | (3,837) | 13,288 | (3,620) |
| Total (gain) loss on investments reclassifications to net income, net of tax | 14,433 | (49,985) | 6,722 |
| | | | |
| Other comprehensive income (loss) before income tax effect | (62,091) | (28,113) | 49,759 |
| Income tax effect | 13,044 | 5,405 | (17,416) |
| **Other comprehensive income (loss), net of tax** | (49,047) | (22,708) | 32,343 |
| **Comprehensive income** | 118,477 | 79,500 | 228,717 |
| Comprehensive (income) loss attributable to non-controlling interest | 44,823 | 6,758 | (22,122) |
| **Comprehensive income attributable to NGHC** | $163,300 | $86,258 | $206,595 |

*See accompanying notes to consolidated financial statements.*

**NATIONAL GENERAL HOLDINGS CORP.**
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**
**(In Thousands, Except Shares)**
**Years Ended December 31, 2018, 2017 and 2016**

| | Common Stock | | Preferred Stock | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Shares | $ | Shares | $ | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Non-controlling Interest | Total |
| **Balance January 1, 2016** | 105,554,331 | $ 1,056 | 2,365,000 | $ 220,000 | $ 900,114 | $ (19,414) | $ 402,562 | $ 22,840 | $ 1,527,158 |
| Cumulative-effect adjustment of change in accounting principle | — | — | — | — | — | — | — | (22,619) | (22,619) |
| Net income | — | — | — | — | — | — | 175,706 | 20,668 | 196,374 |
| Foreign currency translation adjustment, net of tax | — | — | — | — | — | 1,460 | — | — | 1,460 |
| Change in unrealized gain on investments, net of tax | — | — | — | — | — | 29,429 | — | 1,454 | 30,883 |
| Exchanges' equity on March 31, 2016, date of consolidation | — | — | — | — | — | — | — | 9,575 | 9,575 |
| Return of capital | — | — | — | — | (150) | — | — | — | (150) |
| Issuance of common stock for acquisition | 272,609 | 2 | — | — | 6,056 | — | — | — | 6,058 |
| Issuance of preferred stock | — | — | 200,000 | 200,000 | (6,482) | — | — | — | 193,518 |
| Common stock dividends declared | — | — | — | — | — | — | (14,821) | — | (14,821) |
| Preferred stock dividends declared | — | — | — | — | — | — | (24,333) | — | (24,333) |
| Common stock issued under employee stock plans and exercises of stock options | 644,939 | 6 | — | — | 5,134 | — | — | — | 5,140 |
| Shares withheld related to net share settlement | (43,787) | — | — | — | (919) | — | — | — | (919) |
| Stock-based compensation | — | — | — | — | 8,221 | — | — | — | 8,221 |
| Tax benefit from stock-based compensation | — | — | — | — | 1,813 | — | — | — | 1,813 |
| **Balance December 31, 2016** | 106,428,092 | 1,064 | 2,565,000 | 420,000 | 913,787 | 11,475 | 539,114 | 31,918 | 1,917,358 |
| Cumulative-effect adjustment of change to AOCI related to tax reform | — | — | — | — | — | — | 1,438 | (61) | 1,377 |
| Net income (loss) | — | — | — | — | — | — | 105,845 | (3,637) | 102,208 |
| Foreign currency translation adjustment, net of tax | — | — | — | — | — | (5,490) | — | — | (5,490) |
| Change in unrealized loss on investments, net of tax | — | — | — | — | — | (14,097) | — | (3,121) | (17,218) |
| Purchase of non-controlling interest | — | — | — | — | (3,843) | — | — | (243) | (4,086) |
| Common stock dividends declared | — | — | — | — | — | — | (17,034) | — | (17,034) |
| Preferred stock dividends declared | — | — | — | — | — | — | (31,500) | — | (31,500) |
| Common stock issued under employee stock plans and exercises of stock options | 347,809 | 3 | — | — | 1,256 | — | — | — | 1,259 |
| Shares withheld related to net share settlement | (78,253) | — | — | — | (1,773) | — | — | — | (1,773) |
| Stock-based compensation | — | — | — | — | 8,324 | — | — | — | 8,324 |
| **Balance December 31, 2017** | 106,697,648 | $ 1,067 | 2,565,000 | $ 420,000 | $ 917,751 | $ (8,112) | $ 597,863 | $ 24,856 | $ 1,953,425 |

*See accompanying notes to consolidated financial statements.*

**NATIONAL GENERAL HOLDINGS CORP.**
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**
**(In Thousands, Except Shares)**
**Years Ended December 31, 2018, 2017 and 2016**

| | Common Stock | | Preferred Stock | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Shares | $ | Shares | $ | Additional Paid-in Capital | Accumulated Other Comprehensive Loss | Retained Earnings | Non-controlling Interest | Total |
| **Balance January 1, 2018** | 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) | — | — | — | — | — | — | 207,354 | (39,830) | 167,524 |
| Foreign currency translation adjustment, net of tax | — | — | — | — | — | (6,651) | — | — | (6,651) |
| Change in unrealized loss on investments, net of tax | — | — | — | — | — | (37,403) | — | (4,993) | (42,396) |
| Issuance of common stock | 5,750,000 | 58 | — | — | 132,172 | — | — | — | 132,230 |
| Issuance of preferred stock | — | — | 120 | 30,000 | (110) | — | — | — | 29,890 |
| Common stock dividends declared | — | — | — | — | — | — | (17,463) | — | (17,463) |
| Preferred stock dividends declared | — | — | — | — | — | — | (32,492) | — | (32,492) |
| Common stock issued under employee stock plans and exercises of stock options | 618,147 | 4 | — | — | 1,974 | — | — | — | 1,978 |
| Shares withheld related to net share settlement | (125,200) | — | — | — | (3,024) | — | — | — | (3,024) |
| Stock-based compensation | — | — | — | — | 9,020 | — | — | — | 9,020 |
| **Balance December 31, 2018** | 112,940,595 | $1,129 | 2,565,120 | $450,000 | $1,057,783 | $ (52,130) | $764,056 | $(19,967) | $2,200,871 |

*See accompanying notes to consolidated financial statements.*

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2018** | **2017** | **2016** |
| **Cash flows from operating activities:** | | | |
| Net income | $167,524 | $102,208 | $196,374 |
| Adjustments to reconcile net income to cash provided by (used in) operating activities: | | | |
| Net (gain) loss on investments | 29,545 | (46,763) | (7,904) |
| Bad debt expense | 74,214 | 63,819 | 35,356 |
| Depreciation, amortization and goodwill impairment | 86,346 | 103,303 | 92,035 |
| Stock-compensation expense | 9,020 | 8,324 | 8,221 |
| Deferred income taxes | 10,444 | 24,726 | (36,176) |
| Other, net | 1,241 | 5,494 | (32,150) |
| Changes in assets and liabilities: | | | |
| Accrued investment income | (7,568) | 5,129 | (8,627) |
| Premiums and other receivables | (168,445) | (276,557) | (127,767) |
| Deferred acquisition costs | (38,713) | 4,751 | (83,089) |
| Reinsurance recoverable | (318,344) | (347,848) | (26,677) |
| Prepaid reinsurance premiums | (148,552) | (360,152) | (17,611) |
| Prepaid expenses and other assets | (17,785) | (17,543) | 18,602 |
| Unpaid loss and loss adjustment expense reserves | 302,730 | 382,299 | 190,864 |
| Unearned premiums and other revenue | 265,102 | 328,753 | 97,210 |
| Reinsurance payable | 259,699 | 298,925 | 22,962 |
| Accounts payable and accrued expenses | 98,276 | (82,188) | (44,773) |
| Other liabilities | (6,601) | 120,621 | 41,296 |
| **Net cash provided by operating activities** | 598,133 | 317,301 | 318,146 |
| **Cash flows from investing activities:** | | | |
| Purchases of: | | | |
| Debt securities, available-for-sale | (1,802,668) | (1,927,018) | (686,095) |
| Debt securities, trading | — | (217,861) | (95,026) |
| Equity securities | (1,297) | (33,374) | (32,170) |
| Short-term investments | (2,919,422) | (5,728,031) | (177,628) |
| Other investments | (37,722) | (59,384) | (197,384) |
| Premises and equipment | (102,390) | (95,668) | (34,640) |
| Proceeds from: | | | |
| Sale and maturity of debt securities, available-for-sale | 1,325,024 | 1,844,699 | 672,691 |
| Sale and maturity of debt securities, trading | — | 261,225 | 62,104 |
| Sale of equity securities | 28,384 | 22,207 | 119,003 |
| Sale of short-term investments | 2,610,788 | 5,707,331 | 165,075 |
| Sale and return of other investments | 121,982 | 73,778 | 17,714 |
| Acquisition of consolidated subsidiaries, net of cash | (13,453) | (19,376) | (275,685) |
| **Net cash used in investing activities** | $(790,774) | $(171,472) | $(462,041) |

*See accompanying notes to consolidated financial statements.*

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2018** | **2017** | **2016** |
| **Cash flows from financing activities:** | | | |
| Securities sold under agreements to repurchase, net | $— | $— | $(52,484) |
| Securities sold but not yet purchased, net | — | — | 5,013 |
| Proceeds from debt | — | 140,000 | 50,000 |
| Repayments of debt and purchase of non-controlling interests | (39,000) | (172,839) | (18,150) |
| Issuance of common stock, net (fees $5,770 - 2018, $0 - 2017, and $0 - 2016) | 132,230 | — | 4,942 |
| Issuance of preferred stock, net (fees $110 - 2018, $0 - 2017, and $6,482 - 2016) | 29,890 | — | 193,518 |
| Issuance of common stock — employee share options | 1,978 | 1,259 | 5,140 |
| Taxes paid related to net share settlement of equity awards | (3,024) | (1,773) | (919) |
| Dividends paid to common shareholders | (17,111) | (17,050) | (13,773) |
| Dividends paid to preferred shareholders | (31,500) | (31,500) | (20,583) |
| **Net cash provided by (used in) financing activities** | 73,463 | (81,903) | 152,704 |
| **Effect of exchange rate changes on cash and cash equivalents** | (4,723) | 7,658 | (5,186) |
| **Net (decrease) increase in cash, cash equivalents, and restricted cash** | (123,901) | 71,584 | 3,623 |
| **Cash, cash equivalents, and restricted cash at beginning of the year** | 357,484 | 285,900 | 282,277 |
| **Cash, cash equivalents, and restricted cash at end of the year** | $233,583 | $357,484 | $285,900 |
| | | | |
| **Supplemental disclosures of cash flow information:** | | | |
| Cash paid for income taxes | $26,763 | $20,800 | $41,646 |
| Cash paid for interest | 44,884 | 49,498 | 32,679 |
| **Supplemental disclosures of non-cash investing and financing activities:** | | | |
| Unsettled securities purchases | 2,562 | 2,526 | 20,936 |
| Unsettled securities sales | 386 | 29,971 | 12,198 |
| Common stock issued for acquisition | — | — | 1,116 |
| Promissory note issued for acquisition | — | — | 178,894 |
| Decrease in non-controlling interest due to deconsolidation of the Exchanges | — | — | 22,619 |
| Increase in non-controlling interest due to consolidation of the Exchanges | — | — | 9,575 |
| Accrued common stock dividends | 4,518 | 4,268 | 4,226 |
| Accrued preferred stock dividends | 8,867 | 7,875 | 7,875 |

*See accompanying notes to consolidated financial statements.*

**NATIONAL GENERAL HOLDINGS CORP.**
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
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## 1. Organization

National General Holdings Corp. (the "Company" or "NGHC") is an insurance holding company formed under the laws of the state of Delaware. The Company provides, through its wholly-owned subsidiaries, 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. The insurance is sold through a network of independent agents, relationships with affinity partners, and direct-response marketing programs and retail storefronts. The Company is licensed to operate throughout the fifty states and the District of Columbia.

## 2. Significant Accounting Policies

*Basis of Presentation*

The accompanying consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and variable interest entities ("VIEs") of which the Company is the primary beneficiary. The consolidated financial statements also 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 "Reciprocal Exchanges" or "Exchanges"), VIEs of which the Company is the primary beneficiary. The Company does not own the Reciprocal Exchanges but is paid a fee to manage them. All significant intercompany transactions and accounts have been eliminated in consolidation.

For the years ended December 31, 2017 and 2016, the Company reclassified Earnings (losses) of equity method investments with related parties as a component of Net investment income in the Consolidated Statements of Income to conform to the current-year presentation. As of December 31, 2017 the Company reclassified certain amounts from Accounts payable and accrued expenses to Other liabilities in the Consolidated Balance Sheets to conform to the current-year presentation.

*Use of Estimates and Assumptions*

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company's principal estimates include unpaid losses and loss adjustment expense reserves; deferred acquisition costs; reinsurance recoverables, including the provision for uncollectible amounts; recording of impairment losses for other-than-temporary declines in fair value; determining the fair value of investments; determining the fair value of share-based awards for stock compensation; the valuation of intangibles and the determination of goodwill and goodwill impairment; and income taxes. In developing the estimates and assumptions, management uses all available evidence. Because of uncertainties associated with estimating the amounts, timing and likelihood of possible outcomes, actual results could differ from estimates.

*Significant Accounting Policies*

*Premiums and Other Receivables*

The Company recognizes earned premium on a pro rata basis over the terms of the policies, generally periods of six or twelve months. Unearned premiums represent the portion of premiums written applicable to the unexpired terms of the policies. Net premiums receivable represent premiums written and not yet collected, net of an allowance for uncollectible premiums. The Company regularly evaluates premiums and other receivables and adjusts its allowance for uncollectible amounts as appropriate. Receivables specifically identified as uncollectible are charged to expense in the period the determination is made.

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*Cash and Cash Equivalents*

The Company's cash and cash equivalents include cash on hand, money market instruments and other debt instruments with a maturity of 90 days or less when purchased. Certain securities with original maturities of 90 days or less that are held as a portion of longer-term investment portfolios are classified as short-term investments.

*Restricted Cash and Cash Equivalents*

Restricted cash and cash equivalents balances relate primarily to deposits in certain states in order to conduct business and certain third-party agreements. The Company also utilizes trust accounts to collateralize business with its reinsurance counterparties. Amounts described as restricted cash and restricted cash equivalents are included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows.

*Deferred Acquisition Costs*

Deferred acquisition costs include commissions, premium taxes, payments to affinity partners, promotional fees, and other direct sales costs that are directly related to successful contract acquisition of insurance policies. These costs, net of ceding allowances, are deferred and amortized to the extent recoverable, over the policy period in which the related premiums are earned. Anticipated investment income is considered in the calculation of premium deficiency losses for short-duration contracts. Management believes that these costs are recoverable.

*Ceding Commission Revenue*

Commissions on reinsurance premiums ceded are earned in a manner consistent with the recognition of the costs to acquire the underlying policies on a pro-rata basis over the terms of the policies reinsured. The portion of ceding commission which represents reimbursement of acquisition costs related to the underlying policies is recorded as an offset to acquisition costs and other underwriting expenses. Commission in excess of acquisition costs is recorded as ceding commission income over the terms of the policies. Certain reinsurance agreements contain provisions whereby the ceding commission rates vary based on the loss experience of the policies covered by the agreements. The Company records ceding commission revenue based on its current estimate of losses on the reinsured policies subject to variable commission rates. The Company records adjustments to the ceding commission revenue in the period that changes in the estimated losses are determined.

*Loss and Loss Adjustment Expenses*

Loss and loss adjustment expenses ("LAE") represent the estimated ultimate net costs of all reported and unreported losses incurred through the period end. The reserves for unpaid losses and LAE represent the accumulation of estimates for both reported losses and those incurred but not reported relating to direct insurance and assumed reinsurance agreements. Estimates for salvage and subrogation recoverables are recognized at the time losses are incurred and netted against the provision for losses. Insurance liabilities are based on estimates, and the ultimate liability may vary from such estimates. These estimates are regularly reviewed and adjustments are included in the period in which adjustments are determined.

*Business Combinations*

The Company accounts for business combinations under the acquisition method of accounting, which requires the Company to record assets acquired, liabilities assumed and any non-controlling interest in the acquiree at their respective fair values as of the acquisition date. The Company accounts for the insurance and reinsurance contracts under the acquisition method as new contracts, which requires the Company to record assets and liabilities at fair value. The Company adjusts the fair value of loss and LAE reserves by recording the acquired loss reserves based on the Company's existing accounting policies and then discounting them based on expected reserve payout patterns using a current risk-free rate of interest. This risk-free interest rate is then adjusted based on different cash flow scenarios that use different payout and ultimate reserve assumptions deemed to be reasonably possible based upon the inherent

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uncertainties present in determining the amount and timing of payment of such reserves. The difference between the acquired loss and LAE reserves and the Company's best estimate of the fair value of such reserves at the acquisition date is recorded as either an intangible asset or another liability, as applicable and is amortized proportionately to the reduction in the related loss reserves (e.g., over the estimated payout period of the acquired loss and LAE reserves). The Company assigns fair values to intangible assets acquired based on valuation techniques including the income and market approaches. The Company records contingent consideration at fair value based on the terms of the purchase agreement with subsequent changes in fair value recorded through earnings. The purchase price is the fair value of the total consideration conveyed to the seller and the Company records the excess of the purchase price over the fair value of the acquired net assets, where applicable, as goodwill. The Company expenses costs associated with the acquisition of a business in the period incurred.

*Goodwill and Intangible Assets*

The Company accounts for goodwill and intangible assets in accordance with Financial Accounting Standards Board ("FASB"), Accounting Standards of Codification ("ASC") 350, "Intangibles - Goodwill and Other." A purchase price paid that is in excess of net assets ("goodwill") arising from a business combination is recorded as an asset and is not amortized. Intangible assets with a finite life are amortized over the estimated useful life of the asset. Intangible assets with an indefinite useful life are not amortized. Goodwill and intangible assets are tested for impairment on an annual basis or more frequently if changes in circumstances indicate that the carrying amount may not be recoverable. If the goodwill or intangible asset is impaired, it is written down to its realizable value with a corresponding expense reflected in General and administrative expenses in the Consolidated Statements of Income.

*Investments*

The Company accounts for its investments in accordance with ASC 320, "Investments - Debt Securities," and certain equity investments with ASC 321, "Investments - Equity Securities." In accordance with ASC 320, the Company has classified its debt securities as available for sale measured at fair value with unrealized gains and losses reported as a separate component of comprehensive income. Equity investments (except those accounted for under the equity method, and those that result in consolidation of the investee and certain other investments) are measured at fair value with all gains and losses reported in net income in accordance with ASC 321. The Company may sell its available-for-sale and equity securities in response to changes in interest rates, risk/reward characteristics, liquidity needs or other factors. Available-for-sale and equity securities are reported at their estimated fair values based on quoted market prices or recognized pricing services.

Purchases and sales of investments are recorded on a trade date basis. Realized gains and losses are determined based on the specific identification method. Net investment income is recognized when earned and includes interest and dividend income together with amortization of market premiums and discounts using the effective yield method and is net of investment management fees and other expenses. For mortgage-backed securities and any other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised as necessary. Any adjustments required due to the change in effective yields and maturities are recognized on a prospective basis through yield adjustments.

Quarterly, the Company evaluates each security that has an unrealized loss as of the end of the subject reporting period for other-than-temporary-impairment ("OTTI"). The Company generally considers an investment to be impaired when it has been in a significant unrealized loss position for over 12 months. In addition, the Company uses a set of quantitative and qualitative criteria to review the investment portfolio to evaluate the necessity of recording

impairment losses for other-than-temporary declines in the fair value of the Company's investments. The criteria the Company primarily considers include:

- the current fair value compared to amortized cost;
- the length of time the security's fair value has been below its amortized cost;
- specific credit issues related to the issuer such as changes in credit rating or non-payment of scheduled interest payments;

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- whether management intends to sell the security and, if not, whether it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis;
- the financial condition and near-term prospects of the issuer of the security, including any specific events that may affect its operations or earnings;
- the occurrence of a discrete credit event resulting in the issuer defaulting on a material outstanding obligation or the issuer seeking protection under bankruptcy laws; and
- other items, including management, media exposure, sponsors, marketing and advertising agreements, debt restructurings, regulatory changes, acquisitions and dispositions, pending litigation, distribution agreements and general industry trends.

Impairment of investment securities results in a charge to operations when a market decline below cost is deemed to be other-than-temporary. The Company immediately writes down investments that it considers to be impaired based on the above criteria collectively.

Based on guidance in ASC 320-10-35, in the event of the decline in fair value of a debt security, a holder of that security that does not intend to sell the debt security and for whom it is more likely than not that such holder will be required to sell the debt security before recovery of its amortized cost basis is required to separate the decline in fair value into (a) the amount representing the credit loss and (b) the amount related to other factors. The amount of total decline in fair value related to the credit loss shall be recognized in earnings as an OTTI with the amount related to other factors recognized in accumulated other comprehensive income or loss, net of tax. OTTI credit losses result in a permanent reduction of the cost basis of the underlying investment. The determination of OTTI is a subjective process, and different judgments and assumptions could affect the timing of the loss realization.

As of December 31, 2018 and 2017, the Company had the following major types of investments:

(i) Debt securities are classified as available-for-sale and are carried at fair value. Gains or losses on available-for-sale securities are reported as a component of accumulated other comprehensive income.

(ii) Mortgage and structured securities are carried at fair value. The Company recognizes income using the retrospective adjustment method based on prepayments and the estimated economic lives of the securities. The effective yield reflects actual payments to date plus anticipated future payments. These investments are recorded as Debt securities, available-for-sale in the Consolidated Balance Sheets.

(iii) Equity securities consisted of common stock and non-redeemable preferred stock and are carried at fair value. Gains or losses on equity securities are reported within net gains and losses on investments.

(iv) Short-term investments are carried at amortized cost, which approximates fair value, and includes investments with maturities between 91 days and less than one year at the date of acquisition. Income from short-term investments is reported within net investment income.

(v) Other investments consisted of equity method investments, in which the company has the power to influence the operating or financial decisions but does not require consolidation; notes receivable; long-term certificates of deposits; and other investments carried at fair value and at cost or amortized cost. Income from other investments is reported within net investment income.

*Fair Value of Financial Instruments*

The Company’s estimates of fair value for financial assets and financial liabilities are based on the framework established in ASC 820, “Fair Value Measurements and Disclosures.” The framework is based on the inputs used in valuation and gives the highest priority to quoted prices in active markets and requires that observable inputs be used

in the valuations when available. The disclosure of fair value estimates in the ASC 820 hierarchy is based on whether the significant inputs into the valuation are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions. Additionally, valuation of debt securities investments is more subjective when markets are less liquid due to lack of market-based inputs, which may increase the potential that the estimated fair value of an investment is not reflective of the price at which an actual transaction could occur. Fair values of other financial instruments which are short-term in nature approximate their carrying values.

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ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Additionally, ASC 820 requires an entity to consider all aspects of nonperformance risk, including the entity's own credit standing, when measuring the fair value of a liability.

ASC 820 establishes a three-level hierarchy to be used when measuring and disclosing fair value. An instrument's categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation. Following is a description of the three hierarchy levels:

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.

*Equity Method Investments*

The Company uses the equity method of accounting for investments in which its ownership interest enables the Company to influence operating or financial decisions of the investee, but the Company's interest does not require consolidation. In applying the equity method, the Company records its investment at cost, and subsequently increases or decreases the carrying amount of the investment by its proportionate share of the net earnings or losses and other comprehensive income of the investee. Any dividends or distributions received are recorded as a decrease in the carrying value of the investment. The Company's proportionate share of net income is reported in net investment income.

*Stock Compensation Expense*

The Company recognizes shared-based employee compensation expense including stock options and restricted stock units ("RSUs"), to be measured based on the grant date fair value of the awards, with the resulting expense recognized on a straight-line basis over the period during which the employee is required to perform service in exchange for the award. The majority of the Company's awards are earned over a service period of three or four years.

*Earnings Per Share*

Basic earnings per share are computed by dividing income available to common stockholders by the number of weighted average common shares outstanding. Dilutive earnings per share are computed by dividing income available to common stockholders, adjusted for the effects of the presumed issuance of potential common shares, by the number of weighted average common shares outstanding, plus potentially issuable shares, such as options, unvested share-based payment awards and convertible securities.

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*Impairment of Long-lived Assets*

The carrying value of long-lived assets is evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable from the estimated undiscounted future cash flows expected to result from its use and eventual disposition. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment is measured as the amount by which the carrying amount of the assets exceeds the fair value as estimated by discounted cash flows.

*Income Taxes*

The Company joins its subsidiaries in the filing of a consolidated Federal income tax return and is party to Federal income tax allocation agreements. Under the tax allocation agreements, the Company pays to or receives from its subsidiaries the amount, if any, by which the group's Federal income tax liability was affected by virtue of inclusion of the subsidiary in the consolidated Federal return. The Reciprocal Exchanges are not party to the tax allocation agreements and file separate tax returns.

Deferred income taxes reflect the impact of temporary differences between the amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations. The deferred tax asset and liability primarily consists of book versus tax differences for earned premiums, loss and LAE reserve discounting, deferred acquisition costs, earned but unbilled premiums, and unrealized holding gains and losses on debt securities. Changes in deferred income tax assets and liabilities that are associated with components of other comprehensive income, primarily unrealized investment gains and losses, are recorded directly to other comprehensive income. Otherwise, changes in deferred income tax assets and liabilities are included as a component of income tax expense. In assessing the recoverability of deferred tax assets, management considers whether it is more likely than not that the Company will generate future taxable income during the periods in which those temporary differences become deductible. The Company considers the scheduled reversal of deferred tax liabilities, tax planning strategies and projected future taxable income in making this assessment. If necessary, the Company establishes a valuation allowance to reduce the deferred tax assets to the amounts more likely than not to be realized.

The Company recognizes tax benefits for tax positions that are more likely than not to be sustained upon examination by taxing authorities. The Company's policy is to prospectively classify accrued interest and penalties related to any unrecognized tax benefits in its income tax provision.

*Reinsurance*

The Company cedes insurance risk under various reinsurance agreements. The Company seeks to reduce the loss that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk with other insurance enterprises. The Company remains liable with respect to any insurance ceded if the assuming companies are unable to meet their obligations under these reinsurance agreements.

Reinsurance premiums, losses and LAE ceded to other companies are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Earned premiums and losses and LAE incurred ceded to other companies have been recorded as a reduction of premium revenue and losses and LAE. Commissions allowed by reinsurers on business ceded have been recorded as ceding commission revenue to the extent the ceding commission exceeds acquisition costs. Reinsurance recoverables are reported based on the

portion of reserves and paid losses and LAE that are ceded to other companies. If the Company determines that a reinsurance contract does not transfer sufficient risk, it accounts for the contract under deposit accounting.

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*Premises and Equipment*

Premises and equipment are recorded at cost. Maintenance and repairs are charged to operations as incurred. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets, as follows:

| | |
|---|---|
| Buildings and improvements | 30 years |
| Leasehold improvements | Remaining lease term |
| Other equipment | 3 to 20 years |
| Hardware and software | 3 to 10 years |

The Company capitalizes costs of computer software developed or obtained for internal use that is specifically identifiable, has determinable lives and relates to future use.

*Variable Interest Entities*

A VIE is a legal entity that does not have sufficient equity at risk to finance its activities without additional subordinated financial support or is structured such that equity investors lack the ability to make significant decisions relating to the entity's operations through voting rights or do not substantively participate in the gains and losses of the entity. The Company's consolidation principles require the inclusion of VIEs in which the Company is deemed the primary beneficiary. The primary beneficiary is the entity that has both (1) the power to direct the activities of the VIE that most significantly affect that entity's economic performance and (2) the obligation to absorb losses or the right to receive benefits that could be potentially significant to the VIE.

The Company consolidates the Reciprocal Exchanges as it has determined that these are VIEs of which the Company is the primary beneficiary. The Company manages the business operations of the Reciprocal Exchanges and has the ability to direct their activities. The Company receives a management fee for the services provided to the Reciprocal Exchanges. The Reciprocal Exchanges are insurance carriers organized as unincorporated associations. In the event of dissolution, policyholders would share any residual unassigned surplus in the same proportion as the amount of insurance purchased but are not subject to assessment for any deficit in unassigned surplus of the Reciprocal Exchanges. The assets of the Reciprocal Exchanges can be used only to settle the obligations of the Reciprocal Exchanges and general creditors to their liabilities have no recourse to the Company as primary beneficiary. The Company has no ownership interest in the Reciprocal Exchanges. The results of operations of the Reciprocal Exchanges and the management companies are included in the Company's Property and Casualty ("P&C") segment.

*Non-controlling Interest*

Non-redeemable non-controlling interest is the portion of equity (net assets) not attributable, directly or indirectly, to a parent. The Company has no ownership interest in the Reciprocal Exchanges. Therefore, the difference between the value of their assets and liabilities represent the value of the non-controlling interest.

*Concentration of Credit Risk*

Financial instruments that potentially subject the Company to concentration of credit risk are primarily cash and cash equivalents, investments and premiums and other receivables. Investments are diversified through many industries and geographic regions through the use of an investment manager who employs different investment strategies. The Company limits the amount of credit exposure with any one financial institution and believes that no significant

concentration of credit risk exists with respect to cash and investments. At December 31, 2018 and 2017, the outstanding premiums and other receivables balance was generally diversified due to the Company's diversified customer base. To reduce credit risk, the Company performs ongoing evaluations for uncollectible amounts. The Company also has receivables from its reinsurers, see Note 10, "Reinsurance" for additional information about concentration of credit risk. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company periodically evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. It is the policy of management to review all outstanding receivables at period end as well as the bad debt

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write-offs experienced in the past and establish an allowance for uncollectible accounts, if deemed necessary.

*Foreign Currency Remeasurement and Translation*

Financial statement accounts in currencies other than an operation's functional currency are remeasured into the functional currency and the resulting foreign exchange gains and losses are reflected in Net gains (losses) on investments. Functional currency assets and liabilities expressed in foreign currencies are translated into U.S. dollars using period end exchange rates. The related translation adjustments are recorded as a separate component of Accumulated Other Comprehensive Income ("AOCI"), net of any related taxes. Income statement amounts expressed in functional currencies are translated using average exchange rates.

*Service and Fee Income*

The Company currently generates 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 funds check returns. These fees are generally designed to offset expenses incurred in the administration of the Company's 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 the Company 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. The Company estimates an allowance for doubtful accounts based on a percentage of fee income.

The Company also collects service fees in the form of commission and general agent fees by selling policies issued by third-party insurance companies. The Company does not bear insurance underwriting risk with respect to these policies. Commission income and general agent fees are recognized, net of an allowance for estimated policy cancellations, at the time when the policy is sold. The allowance for estimated third-party cancellations is periodically evaluated and adjusted as necessary.

On January 1, 2018, the Company adopted ASU 2014-09, "Revenue from Contracts with Customers" and all the related amendments ("ASC 606") using the modified retrospective method. The adoption of this new standard impacted the Company's consolidated financial statements, specifically the Accident and Health ("A&H") commission revenues. Under ASC 606, the Company recognizes Medicare-related and other accident and health commission revenues equal to the estimated life-time value of a policy at the time when the policy is sold, as opposed to its past treatment of recognizing revenue initially billed or as of the effective date of the insurance policy, whichever is later. The

Company recorded a cumulative-effect adjustment of applying the standard as an adjustment increasing the opening balance of retained earnings by $8,830 upon adoption.

The Company also collects service fees in the form of group health administrative fees by performing enrollment and claims services for self-funded employer plans. The Company does not bear insurance underwriting risk in these administrative activities. Group health administrative fees are recognized pro-rata over the term of the administrative contract with the employer, which generally covers twelve months.

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The following table summarizes service and fee income by segment and category:

| | Year Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2018 | | | 2017 | | | 2016 | | |
| | Property and Casualty | Accident and Health[1] | Total | Property and Casualty | Accident and Health | Total | Property and Casualty | Accident and Health | Total |
| Commission revenue | $93,235 | $70,086 | $163,321 | $78,678 | $67,015 | $145,693 | $58,498 | $51,845 | $110,343 |
| Finance and processing fees | 121,058 | 4,535 | 125,593 | 117,122 | 7,183 | 124,305 | 80,292 | 8,332 | 88,624 |
| Installment fees | 92,785 | — | 92,785 | 83,883 | — | 83,883 | 43,460 | — | 43,460 |
| Group health administrative fees | — | 79,411 | 79,411 | — | 62,217 | 62,217 | — | 69,689 | 69,689 |
| Late payment fees | 33,765 | 86 | 33,851 | 27,184 | 121 | 27,305 | 16,609 | 128 | 16,737 |
| Other service and fee income | 34,760 | 31,862 | 66,622 | 41,446 | 18,078 | 59,524 | 43,022 | 8,942 | 51,964 |
| Total | $375,603 | $185,980 | $561,583 | $348,313 | $154,614 | $502,927 | $241,881 | $138,936 | $380,817 |
| NGHC | $369,852 | $185,980 | $555,832 | $342,519 | $154,614 | $497,133 | $238,019 | $138,936 | $376,955 |
| Reciprocal Exchanges | 5,751 | — | 5,751 | 5,794 | — | 5,794 | 3,862 | — | 3,862 |
| Total | $375,603 | $185,980 | $561,583 | $348,313 | $154,614 | $502,927 | $241,881 | $138,936 | $380,817 |

[1] The impact to commission revenue for the year ended December 31, 2018 was an increase of $12,588 as a result of applying ASC 606. Prior period amounts have not been adjusted under the modified retrospective method.

*Accounting Standards*

*Recent Accounting Standards, Adopted*

| Standard | Description | Date of Adoption | Effect on the Company |
|---|---|---|---|
| ASU 2014-09, Revenue from Contracts with Customers (Topic 606) and related amendments. | This standard removes inconsistencies and weaknesses in revenue requirements, provides a more robust framework for addressing revenue issues, improves comparability of revenue recognition practices, and provides improved disclosure requirements. | January 1, 2018 | While the guidance excludes revenue from insurance contracts, investments and financial instruments from its scope, the guidance is applicable to certain of the Company's service and fee income. The Company adopted ASC 606 using the modified retrospective method and recorded a cumulative-effect adjustment to the opening balance sheet, increasing retained earnings by $8,830. |
| ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. | This standard provides 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. | January 1, 2018 | The Company 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 presentation, equity securities are presented in a single line in the Consolidated Balance Sheets and Consolidated Statements of Cash Flows. |
| ASU 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. | This standard requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. | 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. |

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| Standard | Description | Date of Adoption | Effect on the Company |
|---|---|---|---|
| ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities. | This standard requires an entity to shorten the amortization period for certain callable debt securities held at a premium so that the premium is amortized to the earliest call date. Early adoption is permitted, and the ASU requires adoption under a modified retrospective basis through a cumulative-effect adjustment to the beginning balance of retained earnings. | January 1, 2018 | The Company early adopted the standard. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or liquidity. |
| ASU 2018-09, Codifications Improvements. | This standard includes clarifications to existing codifications or corrections of unintended application of guidance that is not expected to have a significant effect on current 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. | December 31, 2018 | None of the applicable topics were deemed to have a material impact on the Company's consolidated financial statements. |
| ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement. | This standard modifies the disclosure requirements on fair value measurements. The following disclosure requirements applicable to the Company were removed from Topic 820: (i) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, (ii) the policy for timing of transfers between levels and (iii) the valuation processes for Level 3 fair value measurements. The additional disclosure requires the Company to disclose the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period. | December 31, 2018 | The impact of this standard was limited to disclosure requirements. With the exception of amendments on changes in unrealized gains and losses, all other amendments were applied retrospectively. |

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*Recent Accounting Standards, Not Yet Adopted*

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| Standard | Description | Effective Date | Effect on the Company |
|---|---|---|---|
| ASU 2016-02, Leases (Topic 842) and related amendments. | This standard was issued 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 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. 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, "Leases (Topic 842): 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. | January 1, 2019 | The Company currently estimates that the recognition of the ROU asset and lease liability net of deferred rent and inducement costs will result in an increase in both total assets and liabilities in the Consolidated Balance Sheet of approximately $85,000, net of the deferred tax impact. The Company does not expect the impact of the standard to have a material effect on the Consolidated Statements of Income and will have no impact on cash flows. |
| ASU 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. | This standard significantly changes the impairment model for most financial assets and certain other instruments. ASU 2016-13 will require immediate recognition of estimated credit losses expected to occur over the remaining life of many financial assets, which will generally result in earlier recognition of allowances for credit losses on loans and other financial instruments. Companies will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Companies will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. In November 2018, the FASB issued ASU 2018-19, "Codification Improvements to Topic 326, Financial Instruments-Credit Losses," the amendment to ASU 2016-13 which clarifies that receivables arising from operating leases are not within the scope of Topic 326 and impairment of receivables arising from operating leases should be accounted for in accordance with Topic 842, Leases. | January 1, 2020 | Based on the financial instruments currently held by the Company, there would not be a material effect on the Company's consolidated financial condition, results of operations, cash flows and disclosures if the new guidance were able to be adopted in the current accounting period. The impact on the Company's consolidated financial condition, results of operations, cash flows and disclosures at the date of adoption of the updated guidance will be determined by the financial instruments held by the Company and the economic conditions at that time. |

| Standard | Description | Effective Date | Effect on the Company |
|---|---|---|---|
| ASU 2017-04, Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. | This standard establishes a one-step process for testing the value of the goodwill which an entity carries. ASU 2017-04 requires the goodwill impairment to be measured as the excess of the reporting unit's carrying amount over its fair value. | January 1, 2020 | The Company is currently evaluating the impact this guidance will have on its consolidated financial condition, results of operations, cash flows and disclosures. Based on the goodwill currently held by the Company, there would not be a material |

| | | | |
|---|---|---|---|
| | | | effect on the Company's consolidated financial condition, results of operations, cash flows and disclosures if the new guidance were able to be adopted in the current accounting period. The impact on the Company's consolidated financial condition, results of operations, cash flows and disclosures at the date of adoption of the updated guidance will be determined by the goodwill held by the Company at that time. |
| ASU 2018-12, Financial Services-Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts. | This standard makes targeted improvements to the existing recognition, measurement, presentation and disclosure requirements for long-duration contracts issued by an insurance entity. The 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. | January 1, 2021 | The Company is currently evaluating the impact this guidance will have on its consolidated financial condition, results of operations, cash flows and disclosures. |

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## 3. 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:

| December 31, 2018 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Treasury | $64,829 | $ 1,026 | $(262) | $65,593 |
| Federal agencies | 37,842 | 22 | (389) | 37,475 |
| States and political subdivision bonds | 274,367 | 1,369 | (3,539) | 272,197 |
| Foreign government | 151,443 | 993 | (70) | 152,366 |
| Corporate bonds | 1,283,061 | 3,094 | (25,450) | 1,260,705 |
| Residential mortgage-backed securities | 944,365 | 716 | (19,965) | 925,116 |
| Commercial mortgage-backed securities | 548,192 | 3,757 | (6,974) | 544,975 |
| Asset-backed securities | 60,563 | 705 | (121) | 61,147 |
| Structured securities | 249,947 | 99 | (8,588) | 241,458 |
| Total | $3,614,609 | $ 11,781 | $(65,358) | $3,561,032 |
| NGHC | $3,311,639 | $ 11,206 | $(58,896) | $3,263,949 |
| Reciprocal Exchanges | 302,970 | 575 | (6,462) | 297,083 |
| Total | $3,614,609 | $ 11,781 | $(65,358) | $3,561,032 |
| **December 31, 2017** | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** |
| 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 December 31, 2018 and 2017, the Company had no 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 December 31, 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 | |
|---|---|---|---|---|---|---|
| December 31, 2018 | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Due in one year or less | $38,446 | $38,277 | $475 | $474 | $38,921 | $38,751 |
| Due after one year through five years | 743,915 | 735,967 | 148,074 | 144,666 | 891,989 | 880,633 |
| Due after five years through ten years | 795,043 | 783,409 | 55,397 | 54,039 | 850,440 | 837,448 |
| Due after ten years | 268,387 | 261,350 | 11,752 | 11,612 | 280,139 | 272,962 |
| Mortgage-backed securities | 1,465,848 | 1,444,946 | 87,272 | 86,292 | 1,553,120 | 1,531,238 |
| Total | $3,311,639 | $3,263,949 | $302,970 | $297,083 | $3,614,609 | $3,561,032 |

***(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 | |
|---|---|---|---|---|---|---|
| December 31, 2018 | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury | $474 | $(2) | $21,540 | $(260) | $22,014 | $(262) |
| Federal agencies | 23,729 | (351) | 1,493 | (38) | 25,222 | (389) |
| States and political subdivision bonds | 57,090 | (902) | 119,759 | (2,637) | 176,849 | (3,539) |
| Foreign government | 45,748 | (70) | — | — | 45,748 | (70) |
| Corporate bonds | 586,359 | (12,891) | 321,115 | (12,559) | 907,474 | (25,450) |
| Residential mortgage-backed securities | 234,396 | (1,637) | 551,623 | (18,328) | 786,019 | (19,965) |
| Commercial mortgage-backed securities | 13,229 | (239) | 148,700 | (6,735) | 161,929 | (6,974) |
| Asset-backed securities | 25,978 | (78) | 1,494 | (43) | 27,472 | (121) |
| Structured securities | 222,154 | (8,136) | 6,167 | (452) | 228,321 | (8,588) |
| Total | $1,209,157 | $(24,306) | $1,171,891 | $(41,052) | $2,381,048 | $(65,358) |
| NGHC | $1,115,823 | $(22,668) | $1,018,975 | $(36,228) | $2,134,798 | $(58,896) |
| Reciprocal Exchanges | 93,334 | (1,638) | 152,916 | (4,824) | 246,250 | (6,462) |
| Total | $1,209,157 | $(24,306) | $1,171,891 | $(41,052) | $2,381,048 | $(65,358) |

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| | Less Than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| December 31, 2017 | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury | $21,567 | $(131) | $10,555 | $(99) | $32,122 | $(230) |
| Federal agencies | 10,069 | (11) | 615 | (16) | 10,684 | (27) |
| States and political subdivision bonds | 145,396 | (1,851) | 86,894 | (2,056) | 232,290 | (3,907) |
| Foreign government | — | — | 2,443 | (57) | 2,443 | (57) |
| Corporate bonds | 402,236 | (4,564) | 110,207 | (3,133) | 512,443 | (7,697) |
| Residential mortgage-backed securities | 886,032 | (13,476) | 89,412 | (2,477) | 975,444 | (15,953) |
| Commercial mortgage-backed securities | 50,537 | (727) | 27,072 | (1,089) | 77,609 | (1,816) |
| Asset-backed securities | — | — | 414 | (7) | 414 | (7) |
| Structured securities | 73,561 | (631) | 3,727 | (55) | 77,288 | (686) |
| Total | $1,589,398 | $(21,391) | $331,339 | $(8,989) | $1,920,737 | $(30,380) |
| NGHC | $1,408,081 | $(19,254) | $300,732 | $(8,201) | $1,708,813 | $(27,455) |
| Reciprocal Exchanges | 181,317 | (2,137) | 30,607 | (788) | 211,924 | (2,925) |
| Total | $1,589,398 | $(21,391) | $331,339 | $(8,989) | $1,920,737 | $(30,380) |

There were 1,662 and 1,014 individual security lots at December 31, 2018 and 2017, respectively, that accounted for the gross unrealized loss, none of which are deemed by the Company to be other-than-temporary impairments. As of December 31, 2018 and 2017, of the $41,052 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 reviewed its debt securities at December 31, 2018 and determined that no additional OTTI existed in the gross unrealized holding losses.

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. 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.

Among the factors that management considers for debt securities are the financial condition of the issuer including receipt of scheduled principal and interest cash flows, and intent to sell, including if it is more likely than not that the Company will be required to sell the investments before recovery. When a debt security has been determined to have an other-than-temporary impairment and the Company does not have the intention to sell, the impairment charge is separated into an amount representing the credit loss, which is recognized in earnings as a realized loss, and the amount related to non-credit factors, which is recognized in AOCI. Future increases or decreases in fair value, if not other-than-temporary, are included in AOCI. For the years ended December 31, 2018, 2017 and 2016, the Company did not recognize any impairment charges due to non-credit factors.

The Company considers different factors to determine the amount of projected future cash flows and discounting methods for corporate bonds and residential and commercial mortgage-backed or structured securities. For corporate bond securities, the split between the credit and non-credit losses is driven principally by assumptions regarding the

amount and timing of projected future cash flows. The net present value is calculated by discounting the Company's best estimate of projected future cash flows at the effective interest rate implicit in the security at the date of acquisition. For residential and commercial mortgage-backed and structured securities, cash flow estimates, including prepayment assumptions, are based on data from widely accepted third-party data sources or internal estimates. In addition to prepayment assumptions, cash flow estimates vary based on assumptions regarding the underlying collateral including default rates, recoveries and changes in value. The net present value is calculated by discounting the Company's best

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estimate of projected future cash flows at the effective interest rate implicit in the debt security prior to impairment at the balance sheet date. The discounted cash flows become the new amortized cost basis of the debt security.

***(c) Equity Securities***

The fair values of equity securities were as follows:

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Common stock | $10,949 | $48,119 |
| Preferred stock | — | 2,222 |
| Total | $10,949 | $50,341 |
| NGHC | $10,949 | $50,341 |
| Reciprocal Exchanges | — | — |
| Total | $10,949 | $50,341 |

***(d) Investment Income***

The components of net investment income consisted of the following:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| Cash and short-term investments | $1,659 | $1,506 | $418 |
| Debt securities | 107,077 | 106,002 | 96,755 |
| Equity securities | 665 | 345 | 1,901 |
| Other, net (related parties - $4,876, $(4,141) and $23,194 in 2018, 2017 and 2016, respectively) | 13,932 | 2,289 | 28,496 |
| Investment income | 123,333 | 110,142 | 127,570 |
| Investment expenses | (4,299) | (8,192) | (12,383) |
| Net investment income | $119,034 | $101,950 | $115,187 |
| NGHC | $110,159 | $92,625 | $106,471 |
| Reciprocal Exchanges | 8,875 | 9,325 | 8,716 |
| Net investment income | $119,034 | $101,950 | $115,187 |

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

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| Debt securities, available-for-sale: | | | |
| Gross gains | $4,590 | $58,405 | $34,577 |
| Gross losses | (22,860) | (3,754) | (10,090) |
| Net realized gain (loss) on debt securities, available-for-sale | (18,270) | 54,651 | 24,487 |
| Debt securities, trading | — | (1,887) | 11,858 |
| Equity securities | (12,305) | (9,562) | (8,489) |
| Short-term and other investments | (288) | 261 | 112 |
| OTTI on investments | (3,000) | (25) | (22,102) |
| Foreign currency transaction | 4,318 | 3,325 | 2,038 |
| Net realized gain (loss) on investments | $(29,545) | $46,763 | $7,904 |
| NGHC | $(26,179) | $40,640 | $7,389 |
| Reciprocal Exchanges | (3,366) | 6,123 | 515 |
| Net realized gain (loss) on investments | $(29,545) | $46,763 | $7,904 |

Impairment charges included in net realized gains and losses were as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| Debt securities - Corporate bonds | $— | $— | $7,238 |
| Equity securities - Common stock | — | 25 | 14,864 |
| Other invested assets | 3,000 | — | — |
| Total OTTI loss recognized in earnings | $3,000 | $ 25 | $22,102 |
| NGHC | $3,000 | $ 25 | $22,102 |
| Reciprocal Exchanges | — | — | — |
| Total OTTI loss recognized in earnings | $3,000 | $ 25 | $22,102 |

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:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | Equity Securities | Equity Securities and Debt Securities | Equity Securities and Debt Securities |
| Net gains (losses) recognized during the year | $(12,305) | $(20,096) | $ 16,096 |
| Less: Net gains (losses) recognized during the year on securities sold during the year | (864) | (11,851) | 4,221 |
| Net gains (losses) recognized during the reporting period on securities still held at the reporting date | $(11,441) | $(8,245) | $ 11,875 |

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***(f) Credit Quality of Investments***

The tables below summarize the credit quality of 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.

| | NGHC | | | | Reciprocal Exchanges | | | |
|---|---|---|---|---|---|---|---|---|
| December 31, 2018 | Amortized Cost | Fair Value | Percentage | | Amortized Cost | Fair Value | Percentage | |
| U.S. Treasury | $52,122 | $52,759 | 1.6 | % | $12,707 | $12,834 | 4.3 | % |
| AAA | 586,639 | 589,078 | 18.0 | % | 18,335 | 18,109 | 6.1 | % |
| AA, AA+, AA- | 1,385,709 | 1,358,528 | 41.6 | % | 142,525 | 140,114 | 47.2 | % |
| A, A+, A- | 591,219 | 581,106 | 17.8 | % | 118,535 | 115,618 | 38.9 | % |
| BBB, BBB+, BBB- | 653,645 | 641,554 | 19.7 | % | 10,834 | 10,374 | 3.5 | % |
| BB+ and lower | 42,305 | 40,924 | 1.3 | % | 34 | 34 | — | % |
| Total | $3,311,639 | $3,263,949 | 100.0 | % | $302,970 | $297,083 | 100.0 | % |

| | NGHC | | | | Reciprocal Exchanges | | | |
|---|---|---|---|---|---|---|---|---|
| December 31, 2017 | Amortized Cost | Fair Value | Percentage | | 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 | % |

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

| December 31, 2018 | AAA | AA+, AA, AA- | A+,A,A- | BBB+, BBB, BBB- | BB+ or Lower | Fair Value | % of Corporate Bonds Portfolio | |
|---|---|---|---|---|---|---|---|---|
| Financial Institutions | — % | 4.3 % | 23.1 % | 14.2 % | 0.9 % | $535,373 | 42.5 | % |
| Industrials | 0.4 % | 6.1 % | 21.5 % | 26.7 % | 0.6 % | 697,324 | 55.3 | % |
| Utilities/Other | — % | — % | 1.8 % | 0.4 % | — % | 28,008 | 2.2 | % |
| Total | 0.4 % | 10.4 % | 46.4 % | 41.3 % | 1.5 % | $1,260,705 | 100.0 | % |
| NGHC | — % | 6.3 % | 37.3 % | 40.6 % | 1.4 % | $1,079,099 | 85.6 | % |
| Reciprocal Exchanges | 0.4 % | 4.1 % | 9.1 % | 0.7 % | 0.1 % | 181,606 | 14.4 | % |
| Total | 0.4 % | 10.4 % | 46.4 % | 41.3 % | 1.5 % | $1,260,705 | 100.0 | % |

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| December 31, 2017 | AAA | AA+, AA, AA- | A+,A,A- | BBB+, BBB, BBB- | BB+ or Lower | Fair Value | % of Corporate Bonds Portfolio |
|---|---|---|---|---|---|---|---|
| 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.

Cash, cash equivalents, and restricted cash are as follows:

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Cash and cash equivalents | $193,858 | $292,282 |
| Restricted cash and cash equivalents | 39,725 | 65,202 |
| Total cash, cash equivalents and restricted cash | $233,583 | $357,484 |

Restricted investments are as follows:

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Securities on deposit with state regulatory authorities | $73,119 | $76,996 |
| Restricted investments to trusts in certain reinsurance transactions | 70,470 | 110,314 |
| Total restricted investments | $143,589 | $187,310 |

***(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.

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The table below summarizes the composition of other investments:

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Equity method investments (related parties - $106,031 and $221,375) | $142,921 | $256,321 |
| Notes receivable (related parties - $127,692 and $126,173) | 128,893 | 126,173 |
| Long-term Certificates of Deposit (CDs), at cost | 20,252 | 20,339 |
| Investments, at fair value | 6,542 | 10,791 |
| Investments, at cost or amortized cost | 7,668 | 7,668 |
| Total | $306,276 | $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. During the years ended December 31, 2018, 2017 and 2016, the Company recorded OTTI on other investments of $3,000, $0 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").

*Limited Liability Companies and Limited Partnerships*

The following entities are considered by the Company to be VIEs, for which the Company is not the primary beneficiary. The Company accounts for these entities using the equity method of accounting. The Company believes its exposure to risk associated with these investments is generally limited to the investment carrying amounts.

*LSC Entity*

The Company has a 50% ownership interest in an entity (the "LSC Entity") initially formed to acquire life settlement contracts, with AmTrust owning the remaining 50%. The LSC Entity 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.

In 2017, the LSC Entity 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 in cash (including an advance of $39,724 on future payments from the limited partnership) and the right to receive certain contingent earn-out payments. As of December 31, 2018 and 2017, the LSC Entity in which the Company has a 50% ownership interest has a 30% non-controlling equity interest in the limited partnership and the carrying value of the LSC Entity's investment in the limited partnership was $86,141 and $68,085, respectively. As of December 31, 2018, the LSC Entity directly held one life settlement contract. The life settlement contract is accounted for using the fair value

method.

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The following table presents the Company's 50% investment activity in the LSC Entity:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| Beginning of the year | $160,683 | $185,992 | $153,661 |
| Distributions | (118,635) | (45,127) | — |
| Contributions | 2,000 | 21,040 | 11,500 |
| Equity in earnings (losses) | 4,276 | (1,222) | 20,831 |
| Change in equity method investments | (112,359) | (25,309) | 32,331 |
| End of the year | $48,324 | $160,683 | $185,992 |

*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 $2,889, $2,812 and $2,733 in rent for the years ended December 31, 2018, 2017 and 2016, respectively. The Company's equity interest in 800 Superior, LLC as of December 31, 2018 and 2017 was $816 and $1,405, respectively. For the years ended December 31, 2018, 2017 and 2016, the Company recorded equity in earnings (losses) from 800 Superior, LLC of $(589), $(74) and $(241), 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 December 31, 2018 and 2017 was $4,309 and $4,251, respectively. For the years ended December 31, 2018, 2017 and 2016, the Company recorded equity in earnings (losses) from East Ninth & Superior of $58, $62 and $50, 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 December 31, 2018 and 2017 was $6,214 and $7,582, respectively. For the years ended December 31, 2018, 2017 and 2016, the Company recorded equity in earnings (losses) from North Dearborn of $(243), $(812) and $(1,168), respectively, and received (distributions) or made contributions of $(1,125), $0 and $1,800, 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 $2,225 and $2,303 in rent for the years ended December 31, 2018 and 2017, respectively. The Company's equity interest in 4455 LBJ Freeway, LLC as of December 31, 2018 and 2017 was $793 and $740, respectively. For the years ended December 31, 2018, 2017 and 2016, the Company recorded equity in earnings (losses) from 4455 LBJ Freeway, LLC of $53, $(160) and $499, respectively, and received distributions of $0, $0 and $10,158, 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 December 31, 2018 and 2017 was $45,575 and $46,715, respectively. For the years ended December 31, 2018, 2017 and 2016, the Company recorded equity in earnings (losses) from Illinois Center of $(3,390), $(6,645) and $(4,047), respectively, made contributions of $2,250, $5,625 and $3,750, respectively, and received distributions of $0, $0 and $1,875, respectively.

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**4. Fair Value of Financial Instruments**

The Company carries certain financial instruments at fair value. Assets and liabilities recorded at fair value in the 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 December 31, 2018 and 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

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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.
- 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:

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Available-for-sale debt securities: | | | | |
| U.S. Treasury | $65,593 | $— | $— | $65,593 |
| Federal agencies | 37,475 | — | — | 37,475 |
| States and political subdivision bonds | — | 268,601 | 3,596 | 272,197 |
| Foreign government | — | 152,366 | — | 152,366 |
| Corporate bonds | — | 1,248,938 | 11,767 | 1,260,705 |
| Residential mortgage-backed securities | — | 925,116 | — | 925,116 |
| Commercial mortgage-backed securities | — | 544,975 | — | 544,975 |
| Asset-backed securities | — | 61,147 | — | 61,147 |
| Structured securities | — | 241,458 | — | 241,458 |
| Total available-for-sale debt securities | 103,068 | 3,442,601 | 15,363 | 3,561,032 |
| Equity securities: | | | | |
| Common stock | 9,898 | — | 1,051 | 10,949 |
| Total equity securities | 9,898 | — | 1,051 | 10,949 |
| Short-term investments | 348,549 | — | — | 348,549 |
| Other investments | — | — | 6,542 | 6,542 |
| Total | $461,515 | $3,442,601 | $22,956 | $3,927,072 |
| NGHC | $429,502 | $3,160,203 | $22,956 | $3,612,661 |
| Reciprocal Exchanges | 32,013 | 282,398 | — | 314,411 |
| Total | $461,515 | $3,442,601 | $22,956 | $3,927,072 |

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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 Level 3 financial assets:

| | States and political subdivision bonds | Corporate bonds | Common stock | Preferred stock | Other investments | Total |
|---|---|---|---|---|---|---|
| Balance as of January 1, 2018 | $ 4,081 | $24,545 | $5,052 | $ 270 | $ 10,782 | $44,730 |
| Transfers into Level 3 | — | — | — | — | — | — |
| Transfers out of Level 3 | — | — | — | — | — | — |
| Total gains (losses) for the period: | | | | | | |
| Included in net income[1] | — | — | (4,001) | (270) | 1,057 | (3,214) |
| Included in other comprehensive income[2] | (485) | (12,778) | — | — | — | (13,263) |
| Purchases | — | — | — | — | — | — |
| Sales | — | — | — | — | (5,297) | (5,297) |
| Balance as of December 31, 2018 | $ 3,596 | $11,767 | $1,051 | $ — | $ 6,542 | $22,956 |
| Change in unrealized gains (losses) for the period included in net income for assets held at the end of the reporting period | $ — | $— | $(4,001) | $ (270) | $ 606 | $(3,665) |
| Change in unrealized gains (losses) for the period included in other comprehensive income for assets held at the end of the reporting period | $ (485) | $(12,778) | $— | $ — | $ — | $(13,263) |

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| | States and political subdivision bonds | Foreign government | Corporate bonds | Residential mortgage-backed securities | Commercial mortgage-backed securities | Structured securities | Common stock | Preferred stock | Other investments | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Balance as of January 1, 2017 | $ 4,732 | $ 1,910 | $ 36,044 | $ 7,423 | $ 4,849 | $ 9,055 | $ 6,297 | $ — | $ 9,427 | $ 79,737 |
| Transfers into Level 3 | — | — | — | — | — | — | 1 | 275 | — | 276 |
| Transfers out of Level 3 | (2) | (1,910) | (1,787) | (7,422) | (4,849) | (7,054) | — | — | — | (23,024) |
| Total gains (losses) for the period: | | | | | | | | | | |
| Included in net income[1] | — | — | — | — | — | — | — | — | 84 | 84 |
| Included in other comprehensive income[2] | (649) | — | 13 | — | — | — | 2,632 | (5) | — | 1,991 |
| Purchases | — | — | — | — | — | — | 4,119 | — | 3,986 | 8,105 |
| Sales | — | — | (9,725) | (1) | — | (2,001) | (7,997) | — | (2,715) | (22,439) |
| Balance as of December 31, 2017 | $ 4,081 | $ — | $ 24,545 | $ — | $ — | $ — | $ 5,052 | $ 270 | $ 10,782 | $ 44,730 |
| Change in unrealized gains (losses) for the period included in net income for assets held at the end of the reporting period | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ 84 | $ 84 |

[1] Gains and losses recognized in net income are reported within Net investment income.
[2] Gains and losses recognized in other comprehensive income are reported within Unrealized gains (losses) on investments, net of tax.

During the year ended December 31, 2018, there were no transfers between Level 2 and Level 3.

During the year ended December 31, 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 active or 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.

At December 31, 2018 and 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. Other than goodwill, the Company did not measure any assets or liabilities at fair value on a nonrecurring basis at December 31, 2018 and 2017. Goodwill is classified as Level 3 in the fair value hierarchy. See Note 8, "Goodwill and Intangible Assets" for additional information on how the Company tested goodwill for impairment.

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

*Debt* - The amount reported in the accompanying Consolidated Balance Sheets for these financial instruments represents the carrying value of the debt. See Note 12, "Debt" for additional information.

As of December 31, 2018, the Company's 6.75% Notes, the Subordinated Debentures and the Credit Agreement were not publicly traded and are 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.

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

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

| | December 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| 6.75% Notes | $346,439 | $353,756 | $345,786 | $366,131 |
| 7.625% Notes | 96,842 | 90,400 | 96,756 | 101,640 |
| Subordinated Debentures | 72,168 | 72,109 | 72,168 | 72,101 |
| Imperial Surplus Notes | — | — | 5,000 | 4,984 |
| SPCIC Surplus Notes | — | — | 4,000 | 3,996 |
| Credit Agreement | 160,000 | 163,222 | 190,000 | 195,420 |
| Total | $675,449 | $679,487 | $713,710 | $744,272 |

## 5. Premiums and Other Receivables

Premiums and other receivables, net consisted of the following:

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Premiums receivable | $1,284,122 | $1,188,170 |
| Commission receivables | 66,111 | 75,777 |
| Investment receivables | 386 | 29,971 |
| Other receivables | 69,401 | 48,949 |
| Allowance for uncollectible amounts | (20,208) | (18,546) |
| Total | $1,399,812 | $1,324,321 |
| NGHC | $1,338,485 | $1,267,529 |
| Reciprocal Exchanges | 61,327 | 56,792 |
| Total | $1,399,812 | $1,324,321 |

## 6. Deferred Acquisition Costs

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

| | Year Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2018 | | | 2017 | | | 2016 | | |
| | Property and Casualty | Accident and Health | Total | Property and Casualty | Accident and Health | Total | Property and Casualty | Accident and Health | Total |
| Beginning of the year | $198,283 | $18,106 | $216,389 | $207,597 | $13,325 | $220,922 | $153,767 | $6,764 | $160,531 |
| Additions | 522,914 | 22,898 | 545,812 | 478,426 | 26,930 | 505,356 | 443,435 | 51,760 | 495,195 |
| Deductions[1] | — | — | — | — | — | — | (23,803) | — | (23,803) |
| Amortization | (495,009) | (15,784) | (510,793) | (487,740) | (22,149) | (509,889) | (365,802) | (45,199) | (411,001) |
| Change in DAC | 27,905 | 7,114 | 35,019 | (9,314) | 4,781 | (4,533) | 53,830 | 6,561 | 60,391 |
| End of the year | $226,188 | $25,220 | $251,408 | $198,283 | $18,106 | $216,389 | $207,597 | $13,325 | $220,922 |
| NGHC | $206,181 | $25,220 | $231,401 | $177,446 | $18,106 | $195,552 | $176,554 | $13,325 | $189,879 |
| Reciprocal Exchanges | 20,007 | — | 20,007 | 20,837 | — | 20,837 | 31,043 | — | 31,043 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| End of the year | $226,188 | $25,220 | $251,408 | $198,283 | $18,106 | $216,389 | $207,597 | $13,325 | $220,922 |

(1) From January 1, 2016 to March 31, 2016 the Reciprocal Exchanges were not consolidated.

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## 7. Premises and Equipment

The composition of premises and equipment consisted of the following:

| | December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2018 | | | 2017 | | |
| | Cost | Accumulated Depreciation | Net Value | Cost | Accumulated Depreciation | Net Value |
| Land | $6,073 | $— | $6,073 | $3,380 | $— | $3,380 |
| Buildings | 31,489 | (2,554) | 28,935 | 24,586 | (1,634) | 22,952 |
| Leasehold improvements | 35,469 | (9,152) | 26,317 | 26,300 | (5,061) | 21,239 |
| Other equipment | 28,774 | (5,670) | 23,104 | 22,510 | (3,986) | 18,524 |
| Hardware and software | 385,059 | (161,484) | 223,575 | 373,081 | (115,127) | 257,954 |
| Total | $486,864 | $(178,860) | $308,004 | $449,857 | $(125,808) | $324,049 |
| NGHC | $477,804 | $(171,495) | $306,309 | $440,798 | $(121,018) | $319,780 |
| Reciprocal Exchanges | 9,060 | (7,365) | 1,695 | 9,059 | (4,790) | 4,269 |
| Total | $486,864 | $(178,860) | $308,004 | $449,857 | $(125,808) | $324,049 |

As of December 31, 2018 and 2017, assets recorded under capital leases, included in buildings, other equipment, hardware and software were $55,719 and $49,569 of cost, less accumulated depreciation of $1,157 and $884, respectively.

Depreciation and amortization expense related to premises and equipment for the years ended December 31, 2018, 2017 and 2016 was $55,928, $39,323 and $19,485, respectively.

## 8. Goodwill and Intangible Assets

Goodwill and intangible assets, net of amortization, are recorded as a consequence of business acquisitions. Goodwill represents the excess, if any, of the purchase price over the fair value of their net assets as of the date of acquisition. Intangible assets are recorded at their fair value as of the acquisition date. Intangible assets that are not deemed to have an indefinite useful life are amortized over their estimated useful lives. Goodwill and intangible assets that have an indefinite useful life are not subject to amortization.

Goodwill and intangible assets deemed to have an indefinite useful life are tested annually in the fourth quarter of every year for impairment. Goodwill and intangible assets are also tested whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. If it is determined that an asset has been impaired, the asset is written down by the amount of the impairment, with a corresponding charge to earnings.

With respect to goodwill, a qualitative assessment is first made to determine whether it is necessary to perform quantitative testing. This initial assessment includes, among other factors, consideration of: (i) past, current and projected future earnings and equity; (ii) recent trends and market conditions; and (iii) valuation metrics involving similar companies that are publicly-traded and acquisitions of similar companies, if available. If this initial qualitative assessment indicates that the fair value of an operating segment may be less than its carrying amount, a second step is taken, involving a comparison between the estimated fair values of the Company’s operating subsidiary with its respective carrying amount including goodwill. If the carrying value exceeds estimated fair value, there is an

indication of impairment.

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The changes in the carrying amounts of goodwill by segments are as follows:

| | Property and Casualty | Accident and Health | Total |
|---|---|---|---|
| Balance as of January 1, 2017 | | | |
| Goodwill | $124,190 | $77,112 | $201,302 |
| Accumulated impairment loss | (30,321) | (12,617) | (42,938) |
| Balance as of January 1, 2017, net | $93,869 | $64,495 | $158,364 |
| Additions | 11,903 | 8,770 | 20,673 |
| Impairment loss | (4,884) | — | (4,884) |
| Balance as of December 31, 2017 | | | |
| Goodwill | 136,093 | 85,882 | 221,975 |
| Accumulated impairment loss | (35,205) | (12,617) | (47,822) |
| Balance as of December 31, 2017, net | $100,888 | $73,265 | $174,153 |
| Additions | — | 6,030 | 6,030 |
| Balance as of December 31, 2018 | | | |
| Goodwill | 136,093 | 91,912 | 228,005 |
| Accumulated impairment loss | (35,205) | (12,617) | (47,822) |
| Balance as of December 31, 2018, net | $100,888 | $79,295 | $180,183 |

The composition of goodwill and intangible assets consisted of the following:

| December 31, 2018 | Gross Balance | Accumulated Amortization | Net Value | Useful Life |
|---|---|---|---|---|
| Agent/Customer relationships | $184,617 | $(72,876) | $111,741 | 2 - 16 years |
| Renewal rights | 51,057 | (36,342) | 14,715 | 3 - 7 years |
| Proprietary technology | 14,346 | (5,455) | 8,891 | 4 - 15 years |
| Leases | 5,523 | (1,091) | 4,432 | 13 years |
| Trademarks | 5,450 | (1,529) | 3,921 | 5 - 15 years |
| Loss reserve discount | 6,942 | (5,964) | 978 | 6 - 9 years |
| Non-compete agreements | 840 | (157) | 683 | 4 - 15 years |
| Affinity partners | 800 | (649) | 151 | 11 years |
| Management contracts | 118,600 | — | 118,600 | indefinite life |
| State licenses | 85,825 | — | 85,825 | indefinite life |
| Trademarks | 30,000 | — | 30,000 | indefinite life |
| Goodwill | 180,183 | — | 180,183 | indefinite life |
| Total | $684,183 | $(124,063) | $560,120 | |
| NGHC | $680,283 | $(123,568) | $556,715 | |
| Reciprocal Exchanges | 3,900 | (495) | 3,405 | |
| Total | $684,183 | $(124,063) | $560,120 | |

As of December 31, 2018, there were no circumstances that indicate that the carrying amount of goodwill and intangible assets deemed to have an indefinite useful life may not be recoverable.

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| December 31, 2017 | Gross Balance | Accumulated Amortization | Net Value | Useful Life |
|---|---|---|---|---|
| Agent/Customer relationships | $178,151 | $ (54,536) | $123,615 | 2 - 16 years |
| Renewal rights | 51,377 | (27,005) | 24,372 | 3 - 7 years |
| Proprietary technology | 14,007 | (3,663) | 10,344 | 3 - 10 years |
| Leases | 5,523 | (668) | 4,855 | 13 years |
| Trademarks | 3,835 | (864) | 2,971 | 5 - 11 years |
| Loss reserve discount | 6,942 | (4,840) | 2,102 | 6 - 9 years |
| Non-compete agreements | 840 | (82) | 758 | 4 - 15 years |
| Affinity partners | 800 | (579) | 221 | 11 years |
| Management contracts | 118,600 | — | 118,600 | indefinite life |
| State licenses | 86,232 | — | 86,232 | indefinite life |
| Trademarks | 30,000 | — | 30,000 | indefinite life |
| Goodwill | 174,153 | — | 174,153 | indefinite life |
| Total | $670,460 | $ (92,237) | $578,223 | |
| NGHC | $666,460 | $ (91,922) | $574,538 | |
| Reciprocal Exchanges | 4,000 | (315) | 3,685 | |
| Total | $670,460 | $ (92,237) | $578,223 | |

Intangible assets amortization expense consisted of the following:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| Amortization of intangible assets | $31,724 | $59,737 | $64,786 |
| Impairment of intangible assets | 275 | 131 | 5,038 |
| Subtotal | 31,999 | 59,868 | 69,824 |
| Amortization of loss reserve premiums | (632) | (1,257) | (899) |
| Total | $31,367 | $58,611 | $68,925 |
| NGHC | $31,323 | $51,729 | $48,130 |
| Reciprocal Exchanges | 44 | 6,882 | 20,795 |
| Total | $31,367 | $58,611 | $68,925 |

The estimated aggregate amortization expense for each of the next five years and thereafter is:

| Year ending | NGHC | Reciprocal Exchanges | Total |
|---|---|---|---|
| 2019 | $26,936 | $ 180 | $27,116 |
| 2020 | 20,009 | 180 | 20,189 |
| 2021 | 16,923 | 45 | 16,968 |
| 2022 | 14,099 | — | 14,099 |
| 2023 | 11,805 | — | 11,805 |
| Thereafter | 55,335 | — | 55,335 |
| Total | $145,107 | $ 405 | $145,512 |

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**9. 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.

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

| | Year Ended December 31, 2018 | | | | |
|---|---|---|---|---|---|
| | Property and Casualty | Accident and Health | NGHC | Reciprocal Exchanges | Total |
| Unpaid losses and LAE, gross of related reinsurance recoverable at beginning of the year | $2,270,551 | $249,653 | $2,520,204 | $143,353 | $2,663,557 |
| Less: Reinsurance recoverable at beginning of the year | (1,067,495) | (9,840) | (1,077,335) | (52,408) | (1,129,743) |
| Net balance at beginning of the year | 1,203,056 | 239,813 | 1,442,869 | 90,945 | 1,533,814 |
| Incurred losses and LAE related to: | | | | | |
| Current year | 2,182,923 | 352,322 | 2,535,245 | 161,015 | 2,696,260 |
| Prior year | (4,760) | (30,977) | (35,737) | 1,703 | (34,034) |
| Total incurred | 2,178,163 | 321,345 | 2,499,508 | 162,718 | 2,662,226 |
| Paid losses and LAE related to: | | | | | |
| Current year | (1,336,359) | (188,014) | (1,524,373) | (110,053) | (1,634,426) |
| Prior year | (720,039) | (117,653) | (837,692) | (43,119) | (880,811) |
| Total paid | (2,056,398) | (305,667) | (2,362,065) | (153,172) | (2,515,237) |
| Effect of foreign exchange rates | — | (8,786) | (8,786) | — | (8,786) |
| Net balance at end of the year | 1,324,821 | 246,705 | 1,571,526 | 100,491 | 1,672,017 |
| Plus: Reinsurance recoverable at end of the year | 1,182,588 | 24,575 | 1,207,163 | 77,979 | 1,285,142 |
| Gross balance at end of the year | $2,507,409 | $271,280 | $2,778,689 | $178,470 | $2,957,159 |

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| | Year Ended December 31, 2017 | | | | |
|---|---|---|---|---|---|
| | Property and Casualty | Accident and Health | NGHC | Reciprocal Exchanges | Total |
| Unpaid losses and LAE, gross of related reinsurance recoverable at beginning of the year | $1,936,391 | $200,400 | $2,136,791 | $137,075 | $2,273,866 |
| Less: Reinsurance recoverable at beginning of the year | (827,672) | (10,933) | (838,605) | (42,192) | (880,797) |
| Net balance at beginning of the year | 1,108,719 | 189,467 | 1,298,186 | 94,883 | 1,393,069 |
| Incurred losses and LAE related to: | | | | | |
| Current year | 2,172,506 | 327,289 | 2,499,795 | 118,938 | 2,618,733 |
| Prior year | 15,273 | (8,826) | 6,447 | 902 | 7,349 |
| Total incurred | 2,187,779 | 318,463 | 2,506,242 | 119,840 | 2,626,082 |
| Paid losses and LAE related to: | | | | | |
| Current year | (1,364,011) | (166,669) | (1,530,680) | (81,371) | (1,612,051) |
| Prior year | (729,431) | (107,992) | (837,423) | (42,407) | (879,830) |
| Total paid | (2,093,442) | (274,661) | (2,368,103) | (123,778) | (2,491,881) |
| Effect of foreign exchange rates | — | 6,544 | 6,544 | — | 6,544 |
| Net balance at end of the year | 1,203,056 | 239,813 | 1,442,869 | 90,945 | 1,533,814 |
| Plus: Reinsurance recoverable at end of the year | 1,067,495 | 9,840 | 1,077,335 | 52,408 | 1,129,743 |
| Gross balance at end of the year | $2,270,551 | $249,653 | $2,520,204 | $143,353 | $2,663,557 |

| | Year Ended December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Property and Casualty | Accident and Health | NGHC | Reciprocal Exchanges | Total |
| Unpaid losses and LAE, gross of related reinsurance recoverable at beginning of the year | $1,479,953 | $150,230 | $1,630,183 | $132,392 | $1,762,575 |
| Less: Reinsurance recoverable at beginning of the year | (793,508) | (583) | (794,091) | (39,085) | (833,176) |
| Net balance at beginning of the year | 686,445 | 149,647 | 836,092 | 93,307 | 929,399 |
| Incurred losses and LAE related to: | | | | | |
| Current year | 1,716,729 | 291,900 | 2,008,629 | 70,113 | 2,078,742 |
| Prior year | 5,125 | 9,310 | 14,435 | (897) | 13,538 |
| Total incurred | 1,721,854 | 301,210 | 2,023,064 | 69,216 | 2,092,280 |
| Paid losses and LAE related to: | | | | | |
| Current year | (1,070,080) | (181,957) | (1,252,037) | (45,607) | (1,297,644) |
| Prior year | (521,912) | (84,824) | (606,736) | (22,417) | (629,153) |
| Total paid | (1,591,992) | (266,781) | (1,858,773) | (68,024) | (1,926,797) |
| Acquired outstanding loss and loss adjustment reserve | 292,412 | 9,682 | 302,094 | 384 | 302,478 |
| Effect of foreign exchange rates | — | (4,291) | (4,291) | — | (4,291) |
| Net balance at end of the year | 1,108,719 | 189,467 | 1,298,186 | 94,883 | 1,393,069 |
| Plus: Reinsurance recoverable at end of the year | 827,672 | 10,933 | 838,605 | 42,192 | 880,797 |
| Gross balance at end of the year | $1,936,391 | $200,400 | $2,136,791 | $137,075 | $2,273,866 |

Gross unpaid losses and loss adjustment expense reserves at December 31, 2018 increased by $293,602 from December 31, 2017, primarily reflecting increases from organic growth in the property and casualty segment. Gross unpaid losses and loss adjustment expense reserves at December 31, 2017 increased by $389,691 from December 31, 2016, primarily reflecting increases in organic growth in the property and casualty segment.

*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 year ended December 31, 2018 included $34,034 of favorable development on prior accident year loss and LAE reserves driven by $3,057 of favorable development in the property and casualty segment (including $1,703 of unfavorable development for the Reciprocal Exchanges), and $30,977 of favorable development

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in the accident and health segment primarily driven by favorable development in the domestic accident and health stop loss and short-term medical products.

*2017.* Loss and LAE for the year ended December 31, 2017 included $7,349 of unfavorable development on prior accident year loss and LAE reserves. The $16,175 of unfavorable development in the property and casualty segment (including $902 of unfavorable development for the Reciprocal Exchanges) was primarily driven by higher than expected development in auto liability coverages, while the $8,826 of favorable development in the accident and health segment was primarily driven by favorable development in the Company's domestic products.

*2016.* Loss and LAE for the year ended December 31, 2016 included $13,538 of unfavorable development on prior accident year loss and LAE reserves. The $4,228 of unfavorable development in the property and casualty segment (including $897 of favorable development for the Reciprocal Exchanges) was primarily driven by higher than expected unfavorable development in private passenger auto bodily injury coverage, while the $9,310 of unfavorable development in the accident and health segment was primarily driven by unfavorable development in the domestic stop loss, short-term medical products and European A&H policies.

*Short-duration contracts*

The following is information by reserving subgroups within segments about incurred and paid claims development as of December 31, 2018, net of reinsurance, as well as cumulative claim frequency and the total of incurred-but-not-reported liabilities ("IBNR") plus expected development on reported claims included within the net incurred claims amounts. The information about incurred and paid claims development for the years ended prior to December 31, 2018, is presented as unaudited supplementary information. Due to the revaluation of the historical information to constant-currency rates in the Company's European A&H policies, the accident and health triangle will not match prior years.

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*Property and Casualty - auto liability, including recreational vehicles and motorcycles:*

| | Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | | December 31, 2018 | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Total of IBNR Plus Expected Development on Reported Claims | Cumulative Number of Reported Claims |
| | (unaudited) | | | | | | | | | | |
| 2010 | $ 596,995 | $ 593,187 | $ 592,353 | $ 593,992 | $ 594,348 | $ 595,763 | $ 595,337 | $ 595,157 | $ 595,215 | $ 61 | 241,670 |
| 2011 | | 490,230 | 485,762 | 489,010 | 494,922 | 493,873 | 497,109 | 497,324 | 496,408 | 50 | 238,283 |
| 2012 | | | 511,797 | 522,296 | 529,140 | 527,386 | 528,090 | 527,531 | 529,885 | 66 | 249,856 |
| 2013 | | | | 544,833 | 556,262 | 556,290 | 563,834 | 567,410 | 572,538 | 767 | 250,051 |
| 2014 | | | | | 740,531 | 759,577 | 760,566 | 766,640 | 779,992 | 6,150 | 269,900 |
| 2015 | | | | | | 820,213 | 838,040 | 849,051 | 872,064 | 17,352 | 291,338 |
| 2016 | | | | | | | 932,350 | 940,849 | 976,749 | 51,322 | 300,680 |
| 2017 | | | | | | | | 929,211 | 912,371 | 93,880 | 292,748 |
| 2018 | | | | | | | | | 1,047,041 | 380,720 | 283,045 |
| Total (A) | | | | | | | | | $ 6,782,263 | | |

| | Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| | (unaudited) | | | | | | | | |
| 2010 | $ 287,058 | $ 474,640 | $ 534,107 | $ 562,918 | $ 579,237 | $ 590,417 | $ 592,932 | $ 594,168 | $ 594,696 |
| 2011 | | 224,676 | 385,749 | 442,365 | 468,059 | 482,861 | 489,191 | 494,145 | 495,833 |
| 2012 | | | 242,285 | 413,018 | 470,515 | 501,819 | 518,079 | 523,703 | 527,695 |
| 2013 | | | | 259,665 | 440,751 | 504,569 | 540,497 | 559,064 | 567,949 |
| 2014 | | | | | 342,710 | 601,980 | 694,002 | 728,256 | 757,933 |
| 2015 | | | | | | 385,592 | 679,461 | 761,150 | 820,007 |
| 2016 | | | | | | | 400,052 | 737,927 | 855,407 |
| 2017 | | | | | | | | 392,084 | 706,152 |
| 2018 | | | | | | | | | 429,231 |
| Total (B) | | | | | | | | | $ 5,754,903 |
| Unpaid loss and allocated loss adjustment expense reserves before 2010, net of reinsurance (C) | | | | | | | | | 2,063 |
| Unpaid loss and allocated loss adjustment expense reserves, net of reinsurance (A) - (B) + (C) | | | | | | | | | $ 1,029,423 |

| Average Annual Percentage Payout of Accident Year Incurred Claims by Age, Net of Reinsurance | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Years | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| | (unaudited) | | | | | | | | |
| Property and Casualty - auto liability, including recreational vehicles and motorcycles | 43.7 % | 33.7 % | 11.0 % | 5.8 % | 3.3 % | 1.5 % | 0.6 % | 0.3 % | 0.3 % |

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*Property and Casualty - auto physical damage, including recreational vehicles, motorcycles and lender placed auto:*

| | Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | | December 31, 2018 | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Total of IBNR Plus Expected Development on Reported Claims | Cumulative Number of Reported Claims |
| | (unaudited) | | | | | | | | | | |
| 2010 | $ 389,966 | $ 382,067 | $ 381,499 | $ 381,748 | $ 381,818 | $ 381,826 | $ 381,795 | $ 381,410 | $ 381,138 | $ 10 | 309,112 |
| 2011 | | 315,273 | 308,729 | 308,298 | 308,486 | 308,760 | 308,512 | 308,536 | 308,249 | (20 ) | 298,029 |
| 2012 | | | 308,056 | 298,208 | 295,984 | 296,257 | 296,050 | 295,970 | 295,026 | 6 | 292,483 |
| 2013 | | | | 335,454 | 329,049 | 328,748 | 328,284 | 328,262 | 328,010 | 13 | 285,737 |
| 2014 | | | | | 496,227 | 487,302 | 486,206 | 486,383 | 486,373 | 77 | 311,580 |
| 2015 | | | | | | 541,008 | 544,097 | 544,769 | 544,510 | (13 ) | 329,054 |
| 2016 | | | | | | | 626,643 | 622,456 | 621,717 | 131 | 337,670 |
| 2017 | | | | | | | | 600,813 | 570,699 | 1,988 | 384,399 |
| 2018 | | | | | | | | | 548,063 | 39,000 | 347,326 |
| Total (A) | | | | | | | | | $ 4,083,785 | | |

| | Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| | (unaudited) | | | | | | | | |
| 2010 | $ 351,865 | $ 382,575 | $ 381,955 | $ 381,926 | $ 381,829 | $ 381,811 | $ 381,789 | $ 381,425 | $ 381,128 |
| 2011 | | 283,501 | 308,824 | 308,634 | 308,608 | 308,578 | 308,571 | 308,557 | 308,266 |
| 2012 | | | 268,989 | 298,381 | 295,978 | 295,975 | 296,029 | 295,995 | 294,975 |
| 2013 | | | | 291,064 | 328,832 | 328,456 | 328,299 | 328,280 | 327,976 |
| 2014 | | | | | 430,998 | 487,531 | 486,364 | 486,309 | 486,251 |
| 2015 | | | | | | 478,268 | 544,754 | 544,707 | 544,485 |
| 2016 | | | | | | | 542,970 | 622,930 | 621,529 |
| 2017 | | | | | | | | 533,907 | 568,639 |
| 2018 | | | | | | | | | 483,149 |
| Total (B) | | | | | | | | | $ 4,016,398 |
| Unpaid loss and allocated loss adjustment expense reserves before 2010, net of reinsurance (C) | | | | | | | | | 3 |
| Unpaid loss and allocated loss adjustment expense reserves, net of reinsurance (A) - (B) + (C) | | | | | | | | | $ 67,390 |

Average Annual Percentage Payout of Accident Year Incurred Claims by Age, Net of Reinsurance

| Years | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
|---|---|---|---|---|---|---|---|---|---|
| | (unaudited) | | | | | | | | |
| Property and Casualty - auto physical damage, including recreational vehicles, motorcycles and lender placed auto | 89.7 % | 10.5 % | (0.1 )% | — % | — % | — % | (0.1 )% | — % | (0.1 )% |

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*Property and Casualty - homeowners & other property, including lender placed homeowners:*

| | Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | | December 31, 2018 | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Total of IBNR Plus Expected Development on Reported Claims | Cumulative Number of Reported Claims |
| | (unaudited) | | | | | | | | | | |
| 2010 | $ 422,123 | $ 414,378 | $ 413,664 | $ 413,623 | $ 412,187 | $ 411,689 | $ 411,304 | $ 410,997 | $ 411,290 | $ 10 | 86,459 |
| 2011 | | 506,352 | 499,170 | 498,050 | 498,184 | 497,244 | 495,246 | 494,825 | 495,170 | 19 | 107,854 |
| 2012 | | | 485,454 | 480,353 | 478,880 | 477,577 | 476,538 | 474,649 | 476,166 | 36 | 112,028 |
| 2013 | | | | 306,761 | 300,868 | 299,561 | 296,618 | 296,907 | 296,756 | 100 | 75,831 |
| 2014 | | | | | 318,488 | 306,471 | 303,925 | 304,496 | 304,237 | 474 | 73,367 |
| 2015 | | | | | | 357,023 | 349,559 | 351,747 | 353,688 | 6,312 | 69,636 |
| 2016 | | | | | | | 350,737 | 341,762 | 340,711 | 3,690 | 60,486 |
| 2017 | | | | | | | | 402,798 | 365,092 | 14,807 | 57,547 |
| 2018 | | | | | | | | | 327,463 | 42,891 | 54,127 |
| Total (A) | | | | | | | | | $ 3,370,573 | | |

| | Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| | (unaudited) | | | | | | | | |
| 2010 | $ 247,802 | $ 370,301 | $ 393,226 | $ 404,490 | $ 408,195 | $ 409,781 | $ 410,875 | $ 410,994 | $ 411,249 |
| 2011 | | 314,139 | 457,480 | 485,054 | 489,778 | 493,408 | 494,198 | 494,525 | 494,904 |
| 2012 | | | 300,271 | 452,589 | 466,266 | 471,084 | 473,190 | 473,781 | 475,765 |
| 2013 | | | | 219,937 | 279,743 | 289,302 | 293,101 | 295,332 | 296,382 |
| 2014 | | | | | 198,781 | 278,255 | 289,456 | 297,640 | 301,741 |
| 2015 | | | | | | 233,264 | 319,284 | 336,921 | 342,156 |
| 2016 | | | | | | | 227,650 | 320,564 | 331,102 |
| 2017 | | | | | | | | 258,234 | 338,065 |
| 2018 | | | | | | | | | 227,907 |
| Total (B) | | | | | | | | | $ 3,219,271 |
| Unpaid loss and allocated loss adjustment expense reserves before 2010, net of reinsurance (C) | | | | | | | | | 177 |
| Unpaid loss and allocated loss adjustment expense reserves, net of reinsurance (A) - (B) + (C) | | | | | | | | | $ 151,479 |

Average Annual Percentage Payout of Accident Year Incurred Claims by Age, Net of Reinsurance

| Years | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
|---|---|---|---|---|---|---|---|---|---|
| | (unaudited) | | | | | | | | |
| Property and Casualty - homeowners & other property, including lender placed homeowners | 66.1 % | 26.4 % | 4.2 % | 1.6 % | 1.1 % | 0.3 % | 0.2 % | % | 0.1 % |

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## *Accident and Health*

Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance

| Accident Year | Year Ended December 31, 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | December 31, 2018 Total of IBNR Plus Expected Development on Reported Claims | Cumulative Number of Reported Claims |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | (unaudited) | | | | | | | | | | |
| 2010 | $ 21,110 | $ 21,886 | $ 23,665 | $ 24,328 | $ 25,361 | $ 26,677 | $ 26,282 | $ 26,500 | $ 26,648 | $ 78 | 23,800 |
| 2011 | | 19,863 | 25,848 | 26,398 | 28,016 | 30,391 | 29,506 | 30,201 | 29,682 | 184 | 25,766 |
| 2012 | | | 21,237 | 28,128 | 31,183 | 34,822 | 33,906 | 36,252 | 35,071 | 290 | 29,006 |
| 2013 | | | | 46,293 | 57,384 | 60,829 | 62,297 | 66,232 | 64,182 | 408 | 57,713 |
| 2014 | | | | | 80,718 | 88,738 | 91,433 | 97,733 | 95,864 | 509 | 97,789 |
| 2015 | | | | | | 212,071 | 226,857 | 232,084 | 232,966 | 908 | 275,549 |
| 2016 | | | | | | | 259,281 | 249,637 | 252,038 | 2,175 | 361,175 |
| 2017 | | | | | | | | 273,288 | 248,038 | 11,775 | 343,273 |
| 2018 | | | | | | | | | 301,198 | 120,225 | 244,828 |
| Total (A) | | | | | | | | | $ 1,285,687 | | |

Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance

| Accident Year | Year Ended December 31, 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|
| | (unaudited) | | | | | | | | |
| 2010 | $ 11,408 | $ 17,907 | $ 20,708 | $ 22,754 | $ 23,942 | $ 24,511 | $ 24,754 | $ 25,146 | $ 25,410 |
| 2011 | | 11,684 | 21,437 | 24,260 | 26,281 | 27,425 | 27,845 | 28,305 | 28,586 |
| 2012 | | | 13,809 | 23,294 | 27,402 | 29,554 | 30,570 | 31,578 | 32,115 |
| 2013 | | | | 27,808 | 49,334 | 54,254 | 56,632 | 58,144 | 58,964 |
| 2014 | | | | | 46,857 | 78,463 | 83,109 | 85,782 | 87,441 |
| 2015 | | | | | | 140,431 | 208,738 | 216,424 | 218,925 |
| 2016 | | | | | | | 147,952 | 235,572 | 244,270 |
| 2017 | | | | | | | | 132,451 | 218,237 |
| 2018 | | | | | | | | | 167,833 |
| Total (B) | | | | | | | | | $ 1,081,781 |
| Unpaid loss and allocated loss adjustment expense reserves before 2010, net of reinsurance (C) | | | | | | | | | 2,238 |
| Unpaid loss and allocated loss adjustment expense reserves, net of reinsurance (A) - (B) + (C) | | | | | | | | | $ 206,144 |

Average Annual Percentage Payout of Accident Year Incurred Claims by Age, Net of Reinsurance

| Years | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
|---|---|---|---|---|---|---|---|---|---|
| | (unaudited) | | | | | | | | |
| Accident and Health (excluding DE captive subsidiaries) | 54.5 % | 32.2 % | 4.4 % | (0.2 )% | (0.3 )% | 1.4 % | 1.3 % | 2.2 % | 2.2 % |

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*Reciprocal Exchanges - auto liability:*

| | Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | | December 31, 2018 | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Total of IBNR Plus Expected Development on Reported Claims | Cumulative Number of Reported Claims |
| | (unaudited) | | | | | | | | | | |
| 2010 | $ 61,956 | $ 59,169 | $ 57,079 | $ 56,991 | $ 57,453 | $ 57,268 | $ 57,218 | $ 57,222 | $ 57,568 | $ — | 5,854 |
| 2011 | | 47,666 | 47,834 | 47,459 | 48,841 | 51,107 | 50,898 | 50,998 | 51,161 | — | 5,089 |
| 2012 | | | 44,834 | 47,275 | 48,044 | 48,665 | 50,370 | 50,767 | 50,303 | — | 5,016 |
| 2013 | | | | 43,684 | 44,341 | 45,479 | 50,180 | 51,263 | 49,854 | (1 ) | 5,090 |
| 2014 | | | | | 38,656 | 40,850 | 45,930 | 48,246 | 49,168 | 500 | 4,845 |
| 2015 | | | | | | 35,573 | 33,409 | 34,390 | 34,615 | 1,732 | 4,366 |
| 2016 | | | | | | | 24,619 | 24,460 | 26,109 | 4,879 | 4,055 |
| 2017 | | | | | | | | 26,214 | 28,762 | 5,361 | 5,071 |
| 2018 | | | | | | | | | 32,339 | 14,089 | 5,940 |
| Total (A) | | | | | | | | | $ 379,879 | | |

| | Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| | (unaudited) | | | | | | | | |
| 2010 | $ 18,879 | $ 32,181 | $ 41,020 | $ 49,764 | $ 53,635 | $ 55,155 | $ 55,700 | $ 56,522 | $ 56,961 |
| 2011 | | 15,857 | 26,603 | 35,911 | 41,931 | 46,559 | 49,570 | 50,481 | 50,979 |
| 2012 | | | 13,568 | 29,286 | 37,241 | 42,768 | 46,358 | 48,990 | 49,836 |
| 2013 | | | | 14,683 | 29,218 | 35,105 | 41,787 | 47,449 | 48,449 |
| 2014 | | | | | 13,925 | 26,070 | 32,382 | 39,328 | 46,001 |
| 2015 | | | | | | 11,910 | 19,501 | 24,614 | 29,538 |
| 2016 | | | | | | | 7,516 | 13,478 | 16,994 |
| 2017 | | | | | | | | 9,111 | 17,136 |
| 2018 | | | | | | | | | 10,755 |
| Total (B) | | | | | | | | | $ 326,649 |
| Unpaid loss and allocated loss adjustment expense reserves before 2010, net of reinsurance (C) | | | | | | | | | 5 |
| Unpaid loss and allocated loss adjustment expense reserves, net of reinsurance (A) - (B) + (C) | | | | | | | | | $ 53,235 |

| Average Annual Percentage Payout of Accident Year Incurred Claims by Age, Net of Reinsurance | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Years | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| | (unaudited) | | | | | | | | |
| Reciprocal Exchanges - auto liability | 30.6 % | 25.1 % | 14.4 % | 13.7 % | 9.3 % | 3.8 % | 1.3 % | 0.8 % | 0.8 % |

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*Reciprocal Exchanges - auto physical damage:*

| | Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | | December 31, 2018 | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Total of IBNR Plus Expected Development on Reported Claims | Cumulative Number of Reported Claims |
| | (unaudited) | | | | | | | | | | |
| 2010 | $ 29,664 | $ 24,572 | $ 24,652 | $ 24,700 | $ 24,682 | $ 24,665 | $ 24,659 | $ 24,653 | $ 24,653 | $ — | 12,374 |
| 2011 | | 26,936 | 26,055 | 26,022 | 26,060 | 26,037 | 26,029 | 26,023 | 26,028 | — | 12,041 |
| 2012 | | | 25,752 | 26,459 | 26,189 | 25,914 | 25,842 | 25,841 | 25,845 | — | 11,301 |
| 2013 | | | | 23,375 | 25,214 | 25,292 | 24,709 | 24,703 | 24,704 | — | 11,072 |
| 2014 | | | | | 29,240 | 27,424 | 25,806 | 25,588 | 25,882 | (1) | 11,557 |
| 2015 | | | | | | 21,247 | 18,592 | 18,673 | 18,789 | (39) | 10,328 |
| 2016 | | | | | | | 12,270 | 12,921 | 12,985 | (170) | 8,752 |
| 2017 | | | | | | | | 15,301 | 15,410 | (731) | 10,691 |
| 2018 | | | | | | | | | 19,146 | (218) | 13,002 |
| Total (A) | | | | | | | | | $ 193,442 | | |

| | Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| | (unaudited) | | | | | | | | |
| 2010 | $ 25,583 | $ 24,873 | $ 24,725 | $ 24,701 | $ 24,681 | $ 24,665 | $ 24,661 | $ 24,654 | $ 24,653 |
| 2011 | | 28,274 | 26,269 | 26,106 | 26,056 | 26,037 | 26,033 | 26,027 | 26,028 |
| 2012 | | | 23,760 | 26,651 | 26,172 | 25,914 | 25,854 | 25,850 | 25,845 |
| 2013 | | | | 22,651 | 25,088 | 24,549 | 24,725 | 24,716 | 24,704 |
| 2014 | | | | | 24,528 | 26,165 | 25,772 | 25,427 | 25,685 |
| 2015 | | | | | | 19,080 | 18,797 | 18,750 | 18,748 |
| 2016 | | | | | | | 12,579 | 13,147 | 13,079 |
| 2017 | | | | | | | | 15,438 | 16,141 |
| 2018 | | | | | | | | | 18,925 |
| Total (B) | | | | | | | | | $ 193,808 |
| Unpaid loss and allocated loss adjustment expense reserves before 2010, net of reinsurance (C) | | | | | | | | | — |
| Unpaid loss and allocated loss adjustment expense reserves, net of reinsurance (A) - (B) + (C) | | | | | | | | | $ (366 ) |

| Average Annual Percentage Payout of Accident Year Incurred Claims by Age, Net of Reinsurance | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Years | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| | (unaudited) | | | | | | | | |
| Reciprocal Exchanges - auto physical damage | 98.6 % | 3.0 % | (1.5 )% | (0.4 )% | 0.1 % | 0.1 % | % | % | % |

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*Reciprocal Exchanges - homeowners & other property:*

| | Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | | December 31, 2018 | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Total of IBNR Plus Expected Development on Reported Claims | Cumulative Number of Reported Claims |
| | (unaudited) | | | | | | | | | | |
| 2010 | $ 38,125 | $ 37,831 | $ 37,161 | $ 36,347 | $ 36,691 | $ 35,788 | $ 35,723 | $ 35,639 | $ 35,181 | $ — | 5,049 |
| 2011 | | 38,470 | 28,869 | 28,511 | 28,209 | 27,954 | 27,950 | 28,002 | 28,075 | — | 6,640 |
| 2012 | | | 25,289 | 20,625 | 21,184 | 19,971 | 20,403 | 20,876 | 20,251 | — | 8,422 |
| 2013 | | | | 22,638 | 21,232 | 20,132 | 20,309 | 20,615 | 20,367 | — | 3,148 |
| 2014 | | | | | 27,706 | 24,846 | 25,625 | 26,614 | 27,141 | 174 | 4,226 |
| 2015 | | | | | | 30,081 | 21,031 | 21,527 | 22,007 | 509 | 5,443 |
| 2016 | | | | | | | 36,838 | 35,274 | 34,851 | 1,065 | 4,745 |
| 2017 | | | | | | | | 48,222 | 50,871 | 939 | 8,630 |
| 2018 | | | | | | | | | 76,925 | 10,886 | 16,930 |
| Total (A) | | | | | | | | | $ 315,669 | | |

| | Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | | | |
| Accident Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| | (unaudited) | | | | | | | | |
| 2010 | $ 23,881 | $ 31,051 | $ 32,488 | $ 34,587 | $ 35,265 | $ 35,428 | $ 35,388 | $ 35,497 | $ 35,101 |
| 2011 | | 21,474 | 24,997 | 25,799 | 26,700 | 27,661 | 27,656 | 27,692 | 27,758 |
| 2012 | | | 11,087 | 18,021 | 19,367 | 19,847 | 19,961 | 20,668 | 20,121 |
| 2013 | | | | 11,277 | 17,435 | 18,107 | 19,104 | 19,653 | 19,626 |
| 2014 | | | | | 15,344 | 22,834 | 23,820 | 25,230 | 26,170 |
| 2015 | | | | | | 12,979 | 18,518 | 19,834 | 20,339 |
| 2016 | | | | | | | 20,978 | 30,615 | 31,632 |
| 2017 | | | | | | | | 33,166 | 46,003 |
| 2018 | | | | | | | | | 55,519 |
| Total (B) | | | | | | | | | $ 282,269 |
| Unpaid loss and allocated loss adjustment expense reserves before 2010, net of reinsurance (C) | | | | | | | | | 2,157 |
| Unpaid loss and allocated loss adjustment expense reserves, net of reinsurance (A) - (B) + (C) | | | | | | | | | $ 35,557 |

| Average Annual Percentage Payout of Accident Year Incurred Claims by Age, Net of Reinsurance | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Years | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| | (unaudited) | | | | | | | | |
| Reciprocal Exchanges - homeowners & other property | 65.2 % | 22.6 % | 3.3 % | 4.2 % | 3.0 % | 1.3 % | 0.1 % | 0.4 % | 0.1 % |

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The reconciliation of the net incurred and paid claims development tables to the liability for unpaid loss and loss adjustment expense reserves is as follows:

| | December 31, 2018 |
|---|---|
| Net outstanding liabilities: | |
| Property and Casualty - Auto Liability | $ 1,029,423 |
| Property and Casualty - Auto Physical Damage | 67,390 |
| Property and Casualty - Homeowners and Other Property | 151,479 |
| Accident and Health | 206,144 |
| Reciprocal Exchanges - Auto Liability | 53,235 |
| Reciprocal Exchanges - Auto Physical Damage | (366 ) |
| Reciprocal Exchanges - Homeowners and Other Property | 35,557 |
| Net reserve for claims and allocated claim adjustment expenses | $ 1,542,862 |
| | |
| Reinsurance recoverable:[1] | |
| Property and Casualty - Auto Liability | $ 877,907 |
| Property and Casualty - Auto Physical Damage | 16,413 |
| Property and Casualty - Homeowners and Other Property | 288,268 |
| Accident and Health | 24,575 |
| Reciprocal Exchanges - Auto Liability | 37,180 |
| Reciprocal Exchanges - Auto Physical Damage | 105 |
| Reciprocal Exchanges - Homeowners and Other Property | 40,694 |
| Reinsurance recoverable on unpaid claims and allocated claim adjustment expenses | $ 1,285,142 |
| | |
| Insurance lines other than short-duration | $ 31,048 |
| Unallocated claims adjustment expenses (“ULAE”) | 98,107 |
| Subtotal | $ 129,155 |
| | |
| Gross reserve for claims and claim adjustment expenses | $ 2,957,159 |

[1] Reinsurance recoverable on unpaid losses for Property and Casualty primarily include $590,188 from MCCA and $134,916 from NCRF. See Note 10, “Reinsurance” for additional information.

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The reconciliation of the net incurred and paid loss information in the loss reserve rollforward table and development tables with respect to the current accident year is as follows:

| | 2018 - Current Accident Year Incurred | | | | 2018 - Current Accident Year Paid | | | |
|---|---|---|---|---|---|---|---|---|
| | Property and Casualty | Accident and Health | Reciprocal Exchanges | Total | Property and Casualty | Accident and Health | Reciprocal Exchanges | Total |
| Rollforward table | $2,182,923 | $352,322 | $161,015 | $2,696,260 | $1,336,359 | $188,014 | $110,053 | $1,634,426 |
| Development tables | 1,922,567 | 301,198 | 128,410 | 2,352,175 | 1,140,287 | 167,833 | 85,199 | 1,393,319 |
| Variance | $260,356 | $51,124 | $32,605 | $344,085 | $196,072 | $20,181 | $24,854 | $241,107 |
| | | | | | | | | |
| Unallocated claims adjustment expenses | $260,356 | $13,280 | $32,605 | $306,241 | $196,072 | $6,572 | $24,854 | $227,498 |
| Long-duration contracts | — | 34,937 | — | 34,937 | — | 17,944 | — | 17,944 |
| Effect of foreign exchange rates | — | 2,907 | — | 2,907 | — | (4,335) | — | (4,335) |
| Variance | $260,356 | $51,124 | $32,605 | $344,085 | $196,072 | $20,181 | $24,854 | $241,107 |

The reconciliation of the net incurred and paid loss information in the loss reserve rollforward table and development tables with respect to the prior accident year is as follows:

| | 2018 - Prior Accident Year Incurred | | | | 2018 - Prior Accident Year Incurred | | | |
|---|---|---|---|---|---|---|---|---|
| | Property and Casualty | Accident and Health | Reciprocal Exchanges | Total | Property and Casualty | Accident and Health | Reciprocal Exchanges | Total |
| Rollforward table | $(4,760) | $(30,977) | $1,703 | $(34,034) | $720,039 | $117,653 | $43,119 | $880,811 |
| Development tables | (5,899) | (27,438) | 6,548 | (26,789) | 669,687 | 100,546 | 41,190 | 811,423 |
| Variance | $1,139 | $(3,539) | $(4,845) | $(7,245) | $50,352 | $17,107 | $1,929 | $69,388 |
| | | | | | | | | |
| Unallocated claims adjustment expenses | $412 | $2,246 | $(5,622) | $(2,964) | $49,019 | $3,758 | $788 | $53,565 |
| Accident years prior to 2010 | 727 | — | 777 | 1,504 | 1,333 | 736 | 1,141 | 3,210 |
| Delaware captive subsidiaries | — | 19 | — | 19 | — | 77 | — | 77 |
| Long-duration contracts | — | (5,285) | — | (5,285) | — | 6,628 | — | 6,628 |
| Effect of foreign exchange rates | — | (519) | — | (519) | — | 5,908 | — | 5,908 |
| Variance | $1,139 | $(3,539) | $(4,845) | $(7,245) | $50,352 | $17,107 | $1,929 | $69,388 |

The $5,899 of favorable prior year development for Property and Casualty on a combined basis for the incurred development tables relates to Loss and Allocated Claims Adjustment Expenses (“ALAE”), which does not include ULAE and other items excluded from the development tables as identified in the reconciliation table and further identified in the prior accident year incurred reconciliation table above. The reserve rollforward table shows prior year development for Loss and LAE, which includes development from ULAE and other items excluded from the development tables as identified in the reconciliation table and further identified in the prior accident year incurred reconciliation table above. Unfavorable prior year development of $1,139 in total attributable to liabilities excluded from the incurred development tables resulted in total P&C Loss and LAE favorable prior year development of $4,760 shown in the reserve rollforward table.

The $27,438 of favorable prior year development for Accident and Health shown in the incurred development table relates to Loss and ALAE, which does not include ULAE and other items excluded from the development tables as identified in the reconciliation table and further identified in the prior accident year incurred reconciliation table above. The reserve rollforward table shows prior year development for Loss and LAE, which includes prior year

development from ULAE and other items excluded from the development tables as identified in the reconciliation table and further identified in the prior accident year incurred reconciliation table above. Favorable prior year development of $3,539 in total attributable to liabilities excluded from the incurred development table resulted in total Accident and Health Loss and LAE favorable prior year development of $30,977 shown in the reserve rollforward table.

The $6,548 of unfavorable prior year development for the Reciprocal Exchanges on a combined basis for the incurred development tables relates to Loss and ALAE, which does not include ULAE and other items excluded from the development tables as identified in the reconciliation table and further identified in the prior accident year incurred

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reconciliation table above. The reserve rollforward table shows prior year development for Loss and LAE, which includes development from ULAE and other items excluded from the development tables as identified in the reconciliation table and further identified in the prior accident year incurred reconciliation table above. Favorable prior year development of $4,845 in total attributable to liabilities excluded from the incurred development tables resulted in total Reciprocal Exchanges Loss and LAE unfavorable prior year development of $1,703 shown in the reserve rollforward table.

*Methodology for Estimating Incurred-But-Not-Reported Reserves*

Loss and loss adjustment expense reserves represent management's estimate of the ultimate liability for claims that have been reported and claims that have been incurred but not yet reported as of the balance sheet date. Because the establishment of loss and loss adjustment expense reserves is a process involving estimates and judgment, currently estimated reserves may change. The Company reflects changes to the reserves in the results of operations for the period during which the estimates are changed.

Incurred-but-not-reported reserve estimates are generally calculated by first projecting the ultimate cost of all claims that have occurred and then subtracting reported losses and loss expenses. Reported losses include cumulative paid losses and loss expenses plus case reserves. Therefore, the IBNR also includes provision for expected development on reported claims.

The Company’s internal actuarial analysis of the historical data provides the factors the Company uses in its actuarial analysis in estimating its loss and LAE reserves. These factors are implicit measures over time of claims reported, average case incurred amounts, case development, severity and payment patterns. However, these factors cannot be directly used as they do not take into consideration changes in business mix, claims management, regulatory issues, medical trends, and other subjective factors. The Company generally uses a combination of actuarial factors and subjective assumptions in the development of up to seven of the following actuarial methodologies:

- Paid Development Method - uses historical, cumulative paid losses by accident year and develops those actual losses to estimated ultimate losses based upon the assumption that each accident year will develop to estimated ultimate cost in a manner that is analogous to prior years.
- Paid Generalized Cape Cod Method - combines the Paid Development Method with the expected loss method, where the expected loss ratios are estimated from exposure and claims experience weighted across multiple accident periods. The selected expected loss ratio for a given accident year is derived by giving some weight to all of the accident years in the experience history rather than treating each accident year independently.
- Paid Bornhuetter-Ferguson Method - a combination of the Paid Development Method and the Expected Loss Method, the Paid Bornhuetter-Ferguson Method estimates ultimate losses by adding actual paid losses and projected future unpaid losses. The amounts produced are then added to cumulative paid losses to produce the final estimates of ultimate incurred losses.
- Incurred Development Method - uses historical, cumulative incurred losses by accident year and develops those actual losses to estimated ultimate losses based upon the assumption that each accident year will develop to estimated ultimate cost in a manner that is analogous to prior years.
- Incurred Generalized Cape Cod Method - combines the Incurred Development Method with the expected loss method, where the expected loss ratios are estimated from exposure and claims experience weighted across multiple accident periods. The selected expected loss ratio for a given accident year is derived by giving some weight to all of the accident years in the experience history rather than treating each accident year independently.
-

Incurred Bornhuetter - Ferguson Method - a combination of the Incurred Development Method and the Expected Loss Method, the Incurred Bornhuetter-Ferguson Method estimates ultimate losses by adding actual incurred losses and projected future unreported losses. The amounts produced are then added to cumulative incurred losses to produce an estimate of ultimate incurred losses.

- Expected Loss Method - utilizes an expected ultimate loss ratio based on historical experience adjusted for trends multiplied by earned premium to project ultimate losses.

For each method, losses are projected to the ultimate amount to be paid. The Company then analyzes the results and may emphasize or deemphasize some or all of the outcomes to reflect actuarial judgment regarding their

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reasonableness in relation to supplementary information and operational and industry changes. These outcomes are then aggregated to produce a single selected point estimate that is the basis for the internal actuary's point estimate for loss reserves.

*Methodology for Determining Cumulative Number of Reported Claims*

When the Company is notified of an incident of potential liability that may lead to demand for payment(s), a claim file is created. Methods used to summarize claim counts have not changed significantly over the time periods reported in the tables above. The methodology of counting claims for each of the Company's segments may be summarized as follows:

Property and Casualty

The Company's P&C claims are counted by claim number assigned to each claimant per insured event. However, if an insured event occurs and demand for payment is made with respect to more than one coverage (e.g., an automobile claim arising from the same incident demanding separate payment for liability and physical damage), there would be one claim counted for each coverage for which a demand for payment was made. Claims closed without payment are included in the cumulative number of reported P&C claims.

Accident and Health

The Company's A&H claims are counted by claim number assigned to each claimant per illness, injury or death, regardless of number of services rendered for each incident. Claims closed without payment are not included in the cumulative number of reported A&H claims.

Reciprocal Exchanges

The Company's Reciprocal Exchanges claims are counted by claim number assigned to each claimant per insured event. However, if an insured event occurs and demand for payment is made with respect to more than one statutory annual statement line of business (e.g., an automobile claim arising from the same incident demanding separate payment for liability and physical damage), there would be one claim counted for each line of business for which a demand for payment was made. Claims closed without payment are not included in the cumulative number of reported Reciprocal Exchanges claims.

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**10. 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 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.

Reinsurance recoverable summary is as follows:

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Reinsurance recoverable on paid losses | $326,596 | $164,422 |
| Reinsurance recoverable on unpaid losses | 1,285,142 | 1,129,743 |
| Reinsurance recoverable | $1,611,738 | $1,294,165 |

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

| | December 31, | | | |
|---|---|---|---|---|
| | 2018 | | 2017 | |
| | Assumed | Ceded | Assumed | Ceded |
| Unpaid Loss and LAE reserves | $84,469 | $1,285,142 | $134,246 | $1,129,743 |
| Unearned premiums | 21,015 | 665,674 | 45,182 | 517,122 |

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

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | 2016 | |
| Premium: | Written | Earned | Written | Earned | Written | Earned |
| Direct | $5,317,742 | $5,049,512 | $4,637,911 | $4,233,184 | $2,964,188 | $2,718,103 |
| Assumed | 99,097 | 123,265 | 118,074 | 239,230 | 536,710 | 687,829 |
| Total Gross Premium | 5,416,839 | 5,172,777 | 4,755,985 | 4,472,414 | 3,500,898 | 3,405,932 |
| Ceded | (1,589,126 ) | (1,440,575 ) | (1,178,390 ) | (818,238 ) | (428,202 ) | (410,761 ) |
| Net Premium | $3,827,713 | $3,732,202 | $3,577,595 | $3,654,176 | $3,072,696 | $2,995,171 |

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | 2016 | |
| | Assumed | Ceded | Assumed | Ceded | Assumed | Ceded |

| | | | | | | |
|---|---|---|---|---|---|---|
| Loss and LAE | $29,290 | $1,041,286 | $128,418 | $790,524 | $409,046 | $463,603 |

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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 of 30.0% and to decrease the cession percentage to a minimum cession of 10.0% during 2018 and 5.0% during 2019. Effective January 1, 2019, the Company cedes 7.0% of net liability under new and renewal auto policies written on or after January 1, 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, 2018, the Company's reinsurance property catastrophe excess of loss program, protecting the Company against catastrophic events and other large losses, provides a total of $575,000 in coverage with a $70,000 retention, with one reinstatement. Effective July 1, 2018, the casualty program provides $35,000 in coverage in excess of a $5,000 retention. The Company pays a premium as consideration for ceding the risk.

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.

*Industry Pools and Facilities*

The Company's reinsurance transactions include premiums written under state-mandated involuntary plans for commercial vehicles and premiums ceded to state-provided reinsurance facilities such as Michigan Catastrophic Claims Association ("MCCA") and North Carolina Reinsurance Facility ("NCRF" or "the Facility") (collectively, "State Plans"), for which it retains no loss indemnity risk. Prepaid reinsurance premiums are earned on a pro rata basis over the period of risk, based on a daily earnings convention, which is consistent with premiums written.

MCCA is a reinsurance mechanism that covers no-fault first party medical losses of retentions in excess of $545 in the first half of 2017 and $555 until June 30, 2019. Insurers are reimbursed for their covered losses in excess of this

threshold. All automobile insurers doing business in Michigan are required to participate in MCCA. Funding for MCCA comes from assessments against automobile insurers based upon their share of insured automobiles in the state. Insurers are allowed to pass along this cost to Michigan automobile policyholders.

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Reinsurance recoverables from MCCA are as follows:

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Reinsurance recoverable on paid losses | $7,470 | $7,948 |
| Reinsurance recoverable on unpaid losses | 590,188 | 661,562 |

The following is a summary of premiums and losses ceded to MCCA:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| Ceded earned premiums | $9,676 | $9,323 | $9,404 |
| Ceded Loss and LAE | (54,105) | 14,304 | 26,510 |

NCRF is a mechanism for pooling of insurance risks for insureds who cannot obtain coverage by ordinary methods. Under the Facility law, licensed and writing carriers and agents must accept and insure any eligible applicant for coverages and limits which may be ceded to the Facility. The Facility accepts cession of bodily injury and property damage liability, medical payments, and uninsured and combined uninsured/underinsured motorist's coverages. Funding for the NCRF comes from collected premiums from automobile insurers based upon the provided coverage of the insured automobiles in the state.

Reinsurance recoverables from NCRF are as follows:

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Reinsurance recoverable on paid losses | $36,418 | $34,698 |
| Reinsurance recoverable on unpaid losses | 134,916 | 118,701 |

The following is a summary of premiums and losses ceded to NCRF:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| Ceded earned premiums | $232,270 | $190,809 | $165,491 |
| Ceded Loss and LAE | 210,297 | 186,051 | 173,926 |

The Company believes that it is unlikely to incur any material loss as a result of non-payment of amounts owed to the Company by MCCA and NCRF because (i) the payment obligations are extended over many years, resulting in relatively small current payment obligations, (ii) both MCCA and NCRF are supported by assessments permitted by statute, and (iii) the Company has not historically incurred losses as a result of non-payment. Because MCCA and NCRF are supported by assessments permitted by statute, and there have been no significant and uncollectible balances from MCCA and NCRF, the Company believes that it has no significant exposure to uncollectible reinsurance balances from these entities.

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The Company has a concentration of credit risk associated with its reinsurance recoverables and premiums ceded to reinsurers. The following tables present information for each reinsurer by reinsurance recoverable, prepaid reinsurance and funds held balances:

| December 31, 2018 | A.M. Best Rating | Recoverable on Unpaid Losses | Recoverable on Paid Losses | Prepaid Reinsurance | Funds Held | Net |
|---|---|---|---|---|---|---|
| Reinsurer: | | | | | | |
| MCCA | NR | $590,188 | $7,470 | $ 3,894 | $— | $601,552 |
| NCRF | NR | 134,916 | 36,418 | 82,550 | — | 253,884 |
| Hannover Ruck SE | A+ | 182,184 | 120,624 | 192,700 | (282,129) | 213,379 |
| Related Parties | Various | 5,681 | 1,744 | — | — | 7,425 |
| Other reinsurers' balances - each less than 5% of total | A- or higher | 372,173 | 160,340 | 386,530 | (4,861) | 914,182 |
| Total | | $1,285,142 | $326,596 | $ 665,674 | $(286,990) | $1,990,422 |
| NGHC | | $1,207,163 | $287,507 | $ 529,241 | $(286,990) | $1,736,921 |
| Reciprocal Exchanges | | 77,979 | 39,089 | 136,433 | — | 253,501 |
| Total | | $1,285,142 | $326,596 | $ 665,674 | $(286,990) | $1,990,422 |

| December 31, 2017 | A.M. Best Rating | Recoverable on Unpaid Losses | Recoverable on Paid Losses | Prepaid Reinsurance | Funds Held | Net |
|---|---|---|---|---|---|---|
| Reinsurer: | | | | | | |
| MCCA | NR | $661,562 | $7,948 | $ 3,948 | $— | $673,458 |
| NCRF | NR | 118,701 | 34,698 | 78,105 | — | 231,504 |
| Hannover Ruck SE | A+ | 97,208 | 40,725 | 169,704 | (180,222) | 127,415 |
| Related Parties | Various | 11,301 | 4,387 | — | — | 15,688 |
| Other reinsurers' balances - each less than 5% of total | A- or higher | 240,971 | 76,664 | 265,365 | (6,742) | 576,258 |
| Total | | $1,129,743 | $164,422 | $ 517,122 | $(186,964) | $1,624,323 |
| NGHC | | $1,077,335 | $122,626 | $ 416,142 | $(186,942) | $1,429,161 |
| Reciprocal Exchanges | | 52,408 | 41,796 | 100,980 | (22) | 195,162 |
| Total | | $1,129,743 | $164,422 | $ 517,122 | $(186,964) | $1,624,323 |

Funds held for reinsurers are recorded within reinsurance payable in the Consolidated Balance Sheets. Additionally, collateral is available to the Company in the form of letters of credit and trust agreements in the amounts of $165,004 and $93,176, as of December 31, 2018 and 2017, respectively. See Note 13, “Related Party Transactions” for additional information about reinsurance agreements with related parties.

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## 11. 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 among the Company and its subsidiaries.

Federal income tax expense consisted of the following:

| | Year Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2018 | | | 2017 | | | 2016 | | |
| | NGHC | Reciprocal Exchanges | Total | NGHC | Reciprocal Exchanges | Total | NGHC | Reciprocal Exchanges | Total |
| Current tax expense (benefit) | | | | | | | | | |
| Federal | $27,039 | $(2,290) | $24,749 | $13,876 | $2,840 | $16,716 | $61,893 | $857 | $62,750 |
| Foreign | 1,376 | — | 1,376 | 2,057 | — | 2,057 | 5,119 | — | 5,119 |
| Total current tax expense (benefit) | $28,415 | $(2,290) | $26,125 | $15,933 | $2,840 | $18,773 | $67,012 | $857 | $67,869 |
| Deferred tax expense (benefit) | | | | | | | | | |
| Federal | $28,015 | $(1,260) | $26,755 | $59,304 | $(8,485) | $50,819 | $(4,195) | $(10,648) | $(14,843) |
| Foreign | 604 | — | 604 | (8,319) | — | (8,319) | (19,028) | — | (19,028) |
| Total deferred tax expense (benefit) | $28,619 | $(1,260) | $27,359 | $50,985 | $(8,485) | $42,500 | $(23,223) | $(10,648) | $(33,871) |
| Provision (benefit) for income taxes | $57,034 | $(3,550) | $53,484 | $66,918 | $(5,645) | $61,273 | $43,789 | $(9,791) | $33,998 |

The domestic and foreign components of income before taxes are as follows:

| | Year Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2018 | | | 2017 | | | 2016 | | |
| | NGHC | Reciprocal Exchanges | Total | NGHC | Reciprocal Exchanges | Total | NGHC | Reciprocal Exchanges | Total |
| Domestic | $244,463 | $(43,380) | $201,083 | $221,833 | $(9,282) | $212,551 | $201,372 | $10,764 | $212,136 |
| Foreign | 19,925 | — | 19,925 | (49,070) | — | (49,070) | 18,236 | — | 18,236 |
| Income (loss) | $264,388 | $(43,380) | $221,008 | $172,763 | $(9,282) | $163,481 | $219,608 | $10,764 | $230,372 |

The Tax Cuts and Jobs Act was enacted on December 22, 2017 (the "TCJA"). The TCJA reduced the U.S. federal corporate tax rate from 35% to 21%, and enacted other changes to the tax code impacting the Company and the overall insurance industry. This included a one-time transition tax on earnings of certain foreign subsidiaries that were previously deferred, new taxes on certain foreign sourced earnings, limitations on deductibility of executive compensation, and changes to loss reserve discounting. These provisions will result in an increase in the Company's taxable income in the tax years occurring after December 31, 2017. As of December 31, 2017, the Company was able to record provisional amounts under Staff Accounting Bulletin No. 118 for the effects of the TCJA in the amount of $25,783 for NGHC and $(5,194) for the Reciprocals Exchanges. As of December 31, 2018, the Company has completed the accounting for the tax effects of enactment of the TCJA. For the year ended December 31, 2018, the Company recognized additional provision (benefit) for income tax of $(951) for NGHC and $(366) for the Reciprocal Exchanges.

Broader application of the TCJA include the reduction or elimination of certain items such as a limitation on deductibility of certain executive compensation costs and disallowance of entertainment expenses. These provisions resulted in an increase in the Company's taxable income in the tax years occurring after December 31, 2017. As of

December 31, 2018, the Company has completed the accounting for the tax effects of enactment of the TCJA. For the years ended December 31, 2018 and 2017, the Company recognized additional provision (benefit) for income tax of $(1,317) and $20,589, respectively, related to the TCJA.

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Under the TCJA, undistributed Post-1986 earnings and profits ("E&P") previously deferred from U.S. income taxes are subject to a one-time transition tax. The Company finalized its calculations during 2018, and accumulated E&P deficit of $114,417 based on these results the Company was not subject to the newly enacted transition tax.

The TCJA includes provisions for Global Intangible Low-Taxed Income ("GILTI"), which imposes a minimum tax on global intangible low-tax income, defined as the excess income of foreign subsidiaries over a 10 percent rate of routine return on tangible business assets, and for Base Erosion and Anti-Abuse tax ("BEAT") which imposes tax on certain base eroding payments to affiliated foreign companies. Consistent with accounting guidance, the Company will treat both GITLI and BEAT as an in period tax charge when incurred in future periods for which no deferred taxes need be provided. The Company analyzed the impact of both GILTI and BEAT on its operations for the period and determined that for the year ended December 31, 2018, the Company was not subject to either tax.

Deferred income taxes are recognized for the future tax consequences of temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. The tax effects of temporary differences that give rise to the net deferred tax asset or liability are presented below based upon the 2018 enacted rate of 21%.

| | December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2018 | | | 2017 | | |
| | NGHC | Reciprocal Exchanges | Total | NGHC | Reciprocal Exchanges | Total |
| Deferred tax assets: | | | | | | |
| Accrued expenses | $6,481 | $— | $6,481 | $8,195 | $5,249 | $13,444 |
| Unearned premiums and other revenue | 57,573 | 4,128 | 61,701 | 60,298 | 4,279 | 64,577 |
| Bad debt | 4,021 | 222 | 4,243 | 3,887 | 33 | 3,920 |
| Depreciation | — | 93 | 93 | 3,878 | 53 | 3,931 |
| Loss reserve discount | 9,902 | 767 | 10,669 | 10,509 | 953 | 11,462 |
| Net operating loss carryforwards | 87,457 | 11,403 | 98,860 | 35,921 | 3,905 | 39,826 |
| Capital loss carryforwards | — | — | — | 4,037 | 190 | 4,227 |
| Foreign currency translation | 3,850 | — | 3,850 | 2,076 | — | 2,076 |
| Unrealized capital losses | 10,013 | 1,236 | 11,249 | — | — | — |
| Other | 10,672 | 712 | 11,384 | 7,646 | 1,062 | 8,708 |
| Gross deferred tax assets | 189,969 | 18,561 | 208,530 | 136,447 | 15,724 | 152,171 |
| Less: Valuation allowance | (53,716) | (6,628) | (60,344) | — | (5,410) | (5,410) |
| Total deferred tax assets | 136,253 | 11,933 | 148,186 | 136,447 | 10,314 | 146,761 |
| Deferred tax liabilities: | | | | | | |
| Deferred acquisition costs | 47,415 | 4,201 | 51,616 | 43,311 | 4,376 | 47,687 |
| Intangible assets | 42,264 | 918 | 43,182 | 46,103 | 914 | 47,017 |
| Loss reserve discount earnout | — | — | — | 3,649 | 313 | 3,962 |
| Goodwill | 3,007 | — | 3,007 | 1,893 | — | 1,893 |
| Premises and equipment | 18,920 | — | 18,920 | 2,040 | — | 2,040 |
| Surplus note interest | — | 12,355 | 12,355 | — | 13,003 | 13,003 |
| Other | 1,090 | 255 | 1,345 | 777 | 91 | 868 |
| Gross deferred tax liabilities | 112,696 | 17,729 | 130,425 | 97,773 | 18,697 | 116,470 |
| Deferred tax asset | $23,557 | $— | $23,557 | $38,674 | $— | $38,674 |
| Deferred tax liability | $— | $(5,796) | $(5,796) | $— | $(8,383) | $(8,383) |

Excluding the Reciprocal Exchanges, there were $53,716 and $0 of deferred tax asset valuation allowances as of December 31, 2018 and 2017, respectively. In assessing the reliability of gross deferred tax assets, management considers whether it is more likely than not that some portion or all of the gross deferred tax assets will not be realized. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. During 2018 the Company recognized significant increases in its Net Operating Loss

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carryforwards ("NOL") related to foreign operations. Management believes that it is more likely than not that the results of future operations will not generate sufficient taxable income to realize all of the deferred tax assets related to the NOLs from foreign operations within a reasonable time period. As such, the Company recorded a valuation allowance of $53,716 against these NOLs.

For the Reciprocal Exchanges, the Company had a partial valuation allowance against the net deferred tax assets as of December 31, 2018 and 2017, respectively, and no tax benefit from consolidated pre-tax losses generated for the years ended December 31, 2018 and 2017, was recognized. For the year ended December 31, 2018, for the New Jersey Skylands Insurance Association consolidated group ("NJSIA"), has negative evidence in the form of a multi-year history of net operating losses for tax purposes that supported the determination that the realized net deferred tax asset should be fully reserved.

Excluding the Reciprocal Exchanges, the Company had U.S. federal NOLs of $58,082, $64,795 and $65,237 available for tax purposes for the years ended December 31, 2018, 2017 and 2016, respectively. The NOLs expire between December 31, 2029 and December 31, 2036.

The Reciprocal Exchanges had NOLs of $54,300, $18,592 and $16,157 available for the years ended December 31, 2018, 2017 and 2016, respectively. The NOLs expire between December 31, 2019 and December 31, 2038.

The Company's income tax expense (benefit) differs from the statutory U.S. federal amount computed by applying the federal income tax rate of 21% for the year ended December 31, 2018 and 35% for the years ending December 31, 2017 and 2016. The reasons for such differences are as follows:

| | Year Ended December 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | NGHC | Tax Rate | Reciprocal Exchanges | Tax Rate | Total | Tax Rate |
| Income (loss) before provision for income taxes | $264,388 | | $(43,380) | | $221,008 | |
| Tax rate | 21.0 % | | 21.0 % | | 21.0 % | |
| Computed "expected" tax expense | $55,521 | 21.0 % | $(9,110) | 21.0 % | $46,411 | 21.0 % |
| Tax effects resulting from: | | | | | | |
| Tax-exempt interest | (910) | (0.3) | (30) | 0.1 | (940) | (0.4) |
| Effect of foreign operations | 2,807 | 1.1 | — | — | 2,807 | 1.3 |
| State taxes | 4,578 | 1.7 | — | — | 4,578 | 2.1 |
| Change in valuation allowance | 53,716 | 20.3 | 1,218 | (2.8) | 54,934 | 24.9 |
| Benefits of operating loss carryforwards | (53,716) | (20.3) | — | — | (53,716) | (24.3) |
| Effects of TCJA | (951) | (0.4) | (366) | 0.8 | (1,317) | (0.6) |
| Other permanent items | (4,011) | (1.5) | 4,738 | (10.9) | 727 | 0.2 |
| Provision (benefit) for income taxes | $57,034 | 21.6 % | $(3,550) | 8.2 % | $53,484 | 24.2 % |

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| | Year Ended December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | NGHC | Tax Rate | Reciprocal Exchanges | Tax Rate | Total | Tax Rate |
| Income (loss) before provision for income taxes | $ 172,763 | | $ (9,282 ) | | $ 163,481 | |
| Tax rate | 35.0 % | | 35.0 % | | 35.0 % | |
| Computed "expected" tax expense | $ 60,467 | 35.0 % | $ (3,249 ) | 35.0 % | $ 57,218 | 35.0 % |
| Tax effects resulting from: | | | | | | |
| Tax-exempt interest | (2,634 ) | (1.5 ) | (110 ) | 1.2 | (2,744 ) | (1.7 ) |
| Effect of foreign operations | (4,940 ) | (2.9 ) | — | — | (4,940 ) | (3.0 ) |
| Goodwill impairment | 1,709 | 1.0 | — | — | 1,709 | 1.0 |
| Statutory equalization reserves | (8,319 ) | (4.8 ) | — | — | (8,319 ) | (5.1 ) |
| Change in valuation allowance | — | — | (1,725 ) | 18.6 | (1,725 ) | (1.1 ) |
| Effects of TCJA | 25,783 | 14.9 | (5,194 ) | 56.0 | 20,589 | 12.6 |
| Other permanent items | (5,148 ) | (3.0 ) | 4,633 | (50.0 ) | (515 ) | (0.2 ) |
| Provision (benefit) for income taxes | $ 66,918 | 38.7 % | $ (5,645 ) | 60.8 % | $ 61,273 | 37.5 % |

| | Year Ended December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | NGHC | Tax Rate | Reciprocal Exchanges | Tax Rate | Total | Tax Rate |
| Income before provision for income taxes | $ 219,608 | | $ 10,764 | | $ 230,372 | |
| Tax rate | 35.0 % | | 35.0 % | | 35.0 % | |
| Computed "expected" tax expense | $ 76,862 | 35.0 % | $ 3,767 | 35.0 % | $ 80,629 | 35.0 % |
| Tax effects resulting from: | | | | | | |
| Tax-exempt interest | (3,212 ) | (1.5 ) | (149 ) | (1.4 ) | (3,361 ) | (1.5 ) |
| Effect of foreign operations | (13,416 ) | (6.1 ) | — | — | (13,416 ) | (5.8 ) |
| Goodwill impairment | 1,023 | 0.5 | — | — | 1,023 | 0.4 |
| Statutory equalization reserves | (5,898 ) | (2.7 ) | — | — | (5,898 ) | (2.6 ) |
| State taxes | 4,824 | 2.2 | — | — | 4,824 | 2.1 |
| Change in valuation allowance | — | — | (10,160 ) | (94.4 ) | (10,160 ) | (4.4 ) |
| Bargain purchase gain | (8,508 ) | (3.9 ) | — | — | (8,508 ) | (3.7 ) |
| Other permanent items | (7,886 ) | (3.6 ) | (3,249 ) | (30.2 ) | (11,135 ) | (4.7 ) |
| Provision (benefit) for income taxes | $ 43,789 | 19.9 % | $ (9,791 ) | (91.0 )% | $ 33,998 | 14.8 % |

As permitted by ASC 740, "Income Taxes," the Company recognizes interest and penalties, if any, related to unrecognized tax positions in its income tax provision. To date the Company does not have any unrecognized tax positions and, therefore, has not recorded any related interest and penalties, as of December 31, 2018. No interest or penalties have been recorded by the Company for the years ended December 31, 2018, 2017 and 2016. The Company does not anticipate any significant changes to its total unrecognized tax liabilities in the next 12 months.

All tax liabilities are payable to the Internal Revenue Service ("IRS") and various state and local taxing agencies. The Company's subsidiaries are currently under audit by the IRS for the year ended December 31, 2015, and open to audit 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.

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**12. Debt**

*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 years ended December 31, 2018, 2017 and 2016, was $23,625, $23,688 and $23,625, 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 December 31, 2018.

*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 years ended December 31, 2018, 2017 and 2016, was $7,625, $7,454 and $7,625, 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 December 31, 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

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the Company at a redemption price equal to 100% of their principal amount. Interest expense on the Subordinated Debentures for the years ended December 31, 2018, 2017 and 2016 was $4,346, $3,768 and $546, 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 years ended December 31, 2018, 2017 and 2016 was $108, $265 and $240, 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 years ended December 31, 2018, 2017 and 2016 was $58, $217 and $51, respectively.

*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 currently a $245,000 base revolving credit facility with a letter of credit sublimit of $112,500 and a remaining expansion feature of up to $30,000. 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 December 31, 2018).

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As of December 31, 2018, there was $160,000 outstanding under the Credit Agreement. The weighted average interest rate on the amount outstanding as of December 31, 2018 was 4.58%. 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 years ended December 31, 2018, 2017 and 2016 was $7,491, $4,229 and $945 respectively. The Company was in compliance with all of the covenants under the Credit Agreement as of December 31, 2018.

On February 25, 2019 the Company repaid the Credit Agreement and entered into a new credit agreement (the "2019 Credit Agreement"), among JPMorgan Chase Bank, N.A., as Administrative Agent, KeyBank National Association and Fifth Third Bank, as Syndication Agents, and the various lending institutions party thereto. The 2019 Credit Agreement is currently a $340,000 base revolving credit facility with a letter of credit sublimit of $150,000 and a expansion feature of up to $50,000. Any borrowing under the 2019 Credit Agreement will bear interest at LIBOR plus 1.75% and a commitment fee of 0.225% depending on our leverage ratio. The 2019 Credit Agreement has a maturity date of February 24, 2023. As of February 25, 2019, there was $160,000 outstanding under the 2019 Credit Agreement.

Maturities of the Company's debt for the five years subsequent to December 31, 2018 are as follows:

| December 31, | 2019 | 2020 | 2021 | 2022 | 2023 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| 6.75% Notes | $ — | $ — | $ — | $ — | $ — | $ 350,000 | $ 350,000 |
| 7.625% Notes | — | — | — | — | — | 100,000 | 100,000 |
| 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 | | | | | | | (6,719 ) |
| Carrying amount of debt | | | | | | | $ 675,449 |

## 13. 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 $2,155, $4,716 and $3,436 for the years ended December 31, 2018, 2017 and 2016, respectively. As of December 31, 2018 and 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

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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 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 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 and the previously existing master services agreement of $10,952, $41,540 and $51,446 for the years ended December 31, 2018, 2017 and 2016, 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 $7,425 and $15,688 at December 31, 2018 and 2017, respectively. The net recovery under the agreement was $2,157, $3,356 and $13,271 during the years ended December 31, 2018, 2017 and 2016, respectively.

ACP Re and Maiden held assets in trust for the benefit of the Company in the amount of $3,796 and $8,644, respectively, as of December 31, 2018 and $6,530 and $13,834, respectively, as of December 31, 2017.

*Equity Method Investments*

The Company has an ownership interest in an LSC Entity, limited liability companies and limited partnerships with related parties. See Note 3, "Investments - Equity Method Investments - Related Parties" for additional information.

*Agreements with ACP Re*

*Credit Agreement*

The Company is party to a credit agreement (the "ACP Re Credit Agreement") by and among AmTrust, as administrative agent, ACP Re Holdings, LLC, a Delaware limited liability company owned by a related party trust, the Michael Karfunkel Family 2005 Trust (the "Trust"), as borrower, and AmTrust and the Company, as lenders of $250,000 ($125,000 each lender). The amounts borrowed are secured by equity interests, cash and, other investments held by ACP Re Holdings, LLC in an amount equal to 115% of the value of the then outstanding loan balance. The maturity date of the loan is September 20, 2036. The interest rate on the outstanding principal balance is a fixed annual rate of 3.7%, provided that up to 1.2% thereof may be paid in kind. The Trust is required to 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"). 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 December 31, 2018 and 2017 the Company had a receivable related to the ACP Re Credit Agreement of $127,692 and $126,173, respectively. The Company recorded interest income of $4,711, $4,654 and $7,593 for the years ended December 31, 2018, 2017 and 2016, respectively, under the ACP Re Credit Agreement. Management determined no impairment reserve was needed for the carrying value of the loan at December 31, 2018 and 2017 based on the collateral levels maintained.

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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 $830 and $783 in rent for the years ended December 31, 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 2025. The Company paid $302 and $297 in rent for the years ended December 31, 2018 and 2017, respectively.

*Use of the Company Aircraft*

In April 2017, the Company and Barry Karfunkel, Chief Executive Officer of the Company, entered into a time sharing agreement for the use of the Company's plane. During the years ended December 31, 2018 and 2017, Mr. Barry Karfunkel reimbursed the Company $29 and $93, respectively, for his personal use of the company-owned aircraft.

## 14. Commitments and Contingencies

*Lease Commitments*

The Company has various lease agreements for office space, store fronts and other assets. The Company is obligated under leases for office space and store fronts expiring at various dates through 2029. The office space and store fronts lease expense for the years ended December 31, 2018, 2017 and 2016 was $35,723, $35,435 and $24,772, respectively. Future minimum lease payments as of December 31, 2018, for each of the next five years and thereafter are as follows:

| December 31, | Operating Leases | Capital Leases | Total |
|---|---|---|---|
| 2019 | $32,056 | $11,146 | $43,202 |
| 2020 | 26,583 | 10,951 | 37,534 |
| 2021 | 20,993 | 5,990 | 26,983 |
| 2022 | 16,571 | 959 | 17,530 |
| 2023 | 14,237 | 640 | 14,877 |
| Thereafter | 40,777 | 660 | 41,437 |
| Total | $151,217 | $30,346 | $181,563 |

*Litigation*

The Company's insurance subsidiaries are named as defendants in various legal actions arising principally from claims made under insurance policies and contracts. Those actions are considered by the Company in estimating the loss and LAE reserves. The Company's management believes the resolution of those actions will not have a material adverse effect on the Company's financial position or results of operations.

The Company is a defendant in a consolidated multi-district class action litigation in the United States District Court for the Central District of California alleging improper practices in the placement of insurance in the historical and no longer existing collateral protection insurance program for Wells Fargo. Management believes that the Company's actions were, at all times, in compliance with applicable requirements and that the Company has a meritorious defense in the litigation. Management estimates the probable net pre-tax impact to the Company to resolve this matter is $10,000.

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*Employment Agreements*

The Company has entered into employment agreements with certain individuals. The employment agreements provide for bonuses, executive benefits and severance payments under certain circumstances. Amounts payable under these agreements for the next five years are as follows:

| December 31, | |
|---|---|
| 2019 | $4,928 |
| 2020 | 2,186 |
| 2021 | 990 |
| 2022 | 990 |
| 2023 | 355 |
| Total | $9,449 |

**15. Stockholders' Equity**

*Common Stock*

On November 19, 2018, the Company issued 5,750,000 shares of common stock in a public offering. The common stock offering was priced at $24 per share, resulting in net proceeds of approximately $132,230, after deducting underwriting discount and issuance expenses. Underwriting discount and issuance expenses of approximately $5,770 were charged to additional paid-in capital.

*Preferred Stock*

In 2014, the Company completed a public offering of 2,200,000 shares of 7.50% Non-Cumulative Preferred Stock, Series A, $0.01 par value per share (the "Series A Preferred Stock"). Dividends will be payable on the liquidation preference amount of $25 per share, on a non-cumulative basis, when, as and if declared by the Board of Directors, quarterly in arrears on the 15th day of January, April, July and October of each year at an annual rate of 7.50%. Dividends on the Series A Preferred Stock are not cumulative. Accordingly, in the event dividends are not declared on the Series A Preferred Stock for payment on any dividend payment date, then those dividends will not accumulate and will not be payable. If the Company has not declared a dividend before the dividend payment date for any dividend period, the Company will have no obligation to pay dividends for that dividend period, whether or not dividends on the Series A Preferred Stock are declared for any future dividend payment. The Series A Preferred Stock is not redeemable prior to July 15, 2019. After that date, the Company may redeem at its option, in whole or in part, the Series A Preferred Stock at a redemption price of $25 per share, plus any declared and unpaid dividends for prior dividend periods and accrued but unpaid dividends (whether or not declared) for the then current dividend period.

In 2015, the Company completed a public offering of 6,600,000 of its depositary shares, each representing a 1/40th interest in a share of its 7.50% Non-Cumulative Preferred Stock, Series B, $0.01 par value per share (the "Series B Preferred Stock"), with a liquidation preference of $1,000 per share (equivalent to $25 per depositary share). Each depositary share entitles the holder to a proportional fractional interest in all rights and preferences of the Series B Preferred Stock represented thereby (including any dividend, liquidation, redemption and voting rights). Dividends on the Series B Preferred Stock represented by the depositary shares will be payable on the liquidation preference amount, on a non-cumulative basis, when, as and if declared by the Company's Board of Directors, at a rate of 7.50%

per annum, quarterly in arrears, on January 15, April 15, July 15, and October 15 of each year. Dividends on the Series B Preferred Stock are not cumulative. Accordingly, in the event dividends are not declared on the Series B Preferred Stock for payment on any dividend payment date, then those dividends will not accumulate and will not be payable. If the Company has not declared a dividend before the dividend payment date for any dividend period, the Company will have no obligation to pay dividends for that dividend period, whether or not dividends on the Series B Preferred Stock are declared for any future dividend payment. The Series B Preferred Stock represented by the depositary shares is not redeemable prior to April 15, 2020. After that date, the Company may redeem at its option, in whole or in part, the

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Series B Preferred Stock represented by the depositary shares at a redemption price of $1,000 per share (equivalent to $25 per depositary share) plus any declared and unpaid dividends for prior dividend periods and accrued but unpaid dividends (whether or not declared) for the then current dividend period. A total of 6,600,000 depositary shares (equivalent to 165,000 shares of Series B Preferred Stock) were issued.

In 2016, the Company completed a public offering of 8,000,000 of its depositary shares, each representing a 1/40th interest in a share of its 7.50% Non-Cumulative Preferred Stock, Series C, $0.01 par value per share (the "Series C Preferred Stock"), with a liquidation preference of $1,000 per share (equivalent to $25 per depositary share). Each depositary share entitles the holder to a proportional fractional interest in all rights and preferences of the Series C Preferred Stock represented thereby (including any dividend, liquidation, redemption and voting rights). Dividends on the Series C Preferred Stock represented by the depositary shares will be payable on the liquidation preference amount, on a non-cumulative basis, when, as and if declared by the Company's Board of Directors, at a rate of 7.50% per annum, quarterly in arrears, on January 15, April 15, July 15, and October 15 of each year. Dividends on the Series C Preferred Stock are not cumulative. Accordingly, in the event dividends are not declared on the Series C Preferred Stock for payment on any dividend payment date, then those dividends will not accumulate and will not be payable. If the Company has not declared a dividend before the dividend payment date for any dividend period, the Company will have no obligation to pay dividends for that dividend period, whether or not dividends on the Series C Preferred Stock are declared for any future dividend payment. The Series C Preferred Stock represented by the depositary shares is not redeemable prior to July 15, 2021. After that date, the Company may redeem at its option, in whole or in part, the Series C Preferred Stock represented by the depositary shares at a redemption price of $1,000 per share (equivalent to $25 per depositary share) plus any declared and unpaid dividends for prior dividend periods and accrued but unpaid dividends (whether or not declared) for the then current dividend period. A total of 8,000,000 depositary shares (equivalent to 200,000 shares of Series C Preferred Stock) were issued.

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 below.

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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**16. Benefits Plan**

A significant number of the Company's employees participate in a defined contribution plan. Employer contributions vary based on criteria specific to the plan. Contribution expense was $9,292, $8,049 and $5,251 for the years ended December 31, 2018, 2017 and 2016, respectively.

**17. Statutory Financial Data, Risk-Based Capital and Dividend Restrictions**

The Company's insurance subsidiaries file financial statements in accordance with statutory accounting practices ("SAP") prescribed or permitted by domestic or foreign insurance regulatory authorities. The differences between statutory financial statements and financial statements prepared in accordance with GAAP vary between domestic and foreign jurisdictions. The principal differences relate to: (1) acquisition costs incurred in connection with acquiring new business which are charged to expense under SAP but under GAAP are deferred and amortized as the related premiums are earned; (2) ceding commission revenues are earned when ceded premiums are written except for ceding commission revenues in excess of anticipated acquisition costs, which are deferred and amortized as ceded premiums are earned. GAAP requires that all ceding commission revenues be earned as the underlying ceded premiums are earned over the term of the reinsurance agreements; (3) certain assets including certain receivables, a portion of the net deferred tax asset, prepaid expenses and furniture and equipment are not admitted; (4) limitation on net deferred tax assets created by the tax effects of temporary differences; (5) unpaid losses and loss expense, and unearned premium reserves are presented gross of reinsurance with a corresponding asset recorded; and (6) debt securities portfolios that are carried at fair value and changes in fair value are reflected directly in unassigned surplus, net of related deferred taxes.

*Risk-Based Capital*

Insurance companies in the U.S. are subject to certain Risk-Based Capital ("RBC") requirements as specified by the National Association of Insurance Commissioners ("NAIC"). Under such requirements, the amount of statutory capital and surplus maintained by an insurance company is to be determined on asset risk, underwriting risk and other risk factors. As of December 31, 2018 and 2017, the statutory capital and surplus of all of the Company's insurance subsidiaries domiciled in the U.S. exceeded the RBC requirements.

National General Re Ltd., the Company's foreign reinsurance subsidiary, is a Class 3A insurer. As a result, the revised regulations require that the available statutory capital and surplus be equal to or exceed the value of both its Minimum Margin of Solvency ("MMS") and the Enhanced Capital Requirement ("ECR"). The capital and solvency return will be filed with the Bermuda monetary authority on April 30, 2019 and the ECR based on the economic balance sheet will not be available until this filing is completed. The capital and surplus requirement is based on the statutory capital MMS prior to the ECR and the 25% of ECR criteria being calculated. The required MMS on this basis was $228,142 and $316,548 as of December 31, 2018 and 2017, respectively.

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*Statutory Financial Data*

The following table presents the statutory capital and surplus for the Company's property and casualty, and life insurance companies in accordance with SAP:

| | December 31, | |
|---|---|---|
| Statutory capital and surplus | 2018 | 2017 |
| Property and Casualty Insurance Companies: | | |
| Domestic | $1,359,042 | $1,329,301 |
| Foreign | 656,205 | 686,784 |
| Total | $2,015,247 | $2,016,085 |
| Life Insurance Companies: | | |
| Domestic | $41,939 | $36,326 |
| Foreign | 49,763 | 60,650 |
| Total | $91,702 | $96,976 |

The following table presents the statutory net income (loss) for the Company's property and casualty, and life insurance companies in accordance with SAP:

| | Year Ended December 31, | | |
|---|---|---|---|
| Statutory net income (loss) | 2018 | 2017 | 2016[1] |
| Property and Casualty Insurance Companies: | | | |
| Domestic | $23,539 | $190,607 | $67,831 |
| Foreign | 47,411 | (133,757) | 6,470 |
| Total | $70,950 | $56,850 | $74,301 |
| Life Insurance Companies: | | | |
| Domestic | $8,919 | $10,148 | $6,259 |
| Foreign | (2,526) | (19,456) | 3,414 |
| Total | $6,393 | $(9,308) | $9,673 |

[1] In 2016 the Company acquired seven domestic property and casualty insurance companies and one domestic life insurance company.

*Reciprocal Exchanges*

The Reciprocal Exchanges prepare their statutory basis financial statements in accordance with SAP. As of December 31, 2018 and 2017, the Reciprocal Exchanges had combined statutory capital and surplus of $124,942 and $138,776, respectively. For the years ended December 31, 2018, 2017 and 2016, the Reciprocal Exchanges had combined SAP net income (loss) of $(24,357), $364 and $23,884, respectively. The Reciprocal Exchanges are required to maintain minimum capital and surplus in accordance with regulatory requirements. As of December 31, 2018 and 2017, the capital and surplus levels of the Reciprocal Exchanges exceeded such required levels. The Reciprocal Exchanges are not owned by the Company, but managed through management agreements. Accordingly, the Reciprocal Exchanges' net assets are not available to the Company.

*Dividend Restrictions*

The Company's insurance subsidiaries are subject to statutory and regulatory restrictions, applicable to insurance companies, imposed by the states of domicile, which limit the amount of cash dividends or distributions that they may pay unless special permission is received from the state of domicile. This limit was approximately $287,896 and

$387,620 as of December 31, 2018 and 2017, respectively. During the years ended December 31, 2018, 2017 and 2016, there were $156,660, $339,398 and $29,500 of dividends and return of capital paid by the Company's insurance subsidiaries to their parent company or the Company, respectively.

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**18. 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 December 31, 2018, 521,311 shares of the Company's common stock remained available for grants under the Plans.

The Company recognizes compensation expense for its share-based payments based on the fair value of the awards. The Company grants stock options at exercise prices equal to the fair market value of the Company's stock on the dates the options are granted. The options have a maximum term of ten years from the date of grant and vest primarily in equal annual installments over a range of one to five years following the date of grant for employee options. If a participant's employment relationship ends, the participant's vested awards will remain exercisable for the shorter of a period of 30 days or the period ending on the latest date on which such award could have been exercisable. The fair value of each option grant is separately estimated for each grant date. The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the award and each vesting date. The Company has estimated the fair value of all stock option awards as of the date of the grant by applying the Black-Scholes-Merton multiple-option pricing valuation model. The application of this valuation model involves assumptions that are judgmental and highly sensitive in the determination of compensation expense.

The Company grants RSUs with a grant date value equal to the closing stock price of the Company's stock on the dates the units are granted and the RSUs vest over a period of three or four years. RSUs are net share settled. Under net settlement procedures, upon each settlement date, RSUs were withheld to cover the required withholding tax, which is based on the value of the RSU on the settlement date as determined by the closing price of the Company's common stock on the trading day immediately preceding the applicable settlement date. The remaining amounts are delivered to the recipient as shares of the Company's common stock. The amount remitted to the tax authorities for the employees' tax obligation to the tax authorities is reflected as a financing activity in the Consolidated Statements of Cash Flows. These shares withheld by the Company as a result of the net settlement of RSUs are no longer considered outstanding on a diluted basis, thereby reducing the Company's diluted shares used to calculate earnings per share. These shares are available for future issuance under the Plans.

A summary of the stock option awards is shown below:

| | Shares Subject to Options Outstanding | | | |
|---|---|---|---|---|
| Year Ended December 31, 2018 | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value [1] |
| Outstanding at beginning of year | 3,450,585 | $ 9.37 | | |
| Exercised | (266,233 ) | 7.43 | | |
| Outstanding and exercisable at end of year | 3,184,352 | $ 9.53 | 4.0 | $ 46,752 |

[1] 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 $24.21, as reported on the Nasdaq Global Select Market on December 31, 2018.

No options were granted, forfeited or expired during the year ended December 31, 2018. The total intrinsic value of the options exercised during the years ended December 31, 2018, 2017 and 2016 was $5,011, $1,782 and $6,533, respectively. The total fair value of stock options vested for the years ended December 31, 2018, 2017 and 2016 was $783, $501 and $1,847, respectively.

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A summary of the RSUs is shown below:

| | RSUs | |
|---|---|---|
| Year Ended December 31, 2018 | Number of RSUs | Weighted-Average Grant Date Fair Value |
| Non-vested at beginning of year | 845,459 | $ 21.83 |
| Granted | 458,850 | 21.36 |
| Vested | (351,914 ) | 20.08 |
| Forfeited | (13,600 ) | 19.92 |
| Non-vested at end of year | 938,795 | $ 22.28 |

The weighted-average grant-date fair value of RSUs granted for the years ended December 31, 2018, 2017 and 2016 was $21.36, $24.06 and $20.11, respectively. The total fair value of the RSUs vested for the years ended December 31, 2018, 2017 and 2016 was $7,068, $3,661 and $1,714, respectively.

Compensation expense, included in general and administrative expenses, for all share-based compensation plans was $9,020, $8,324 and $8,221 for the years ended December 31, 2018, 2017 and 2016, respectively.

As of December 31, 2018, the Company had approximately $14,075 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 1.5 years based on vesting under the award service conditions.

## 19. Earnings Per Share

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| Numerator: | | | |
| Net income attributable to NGHC | $ 207,354 | $ 105,845 | $ 175,706 |
| Preferred stock dividends - nonconvertible | (31,500 ) | (31,500 ) | (24,333 ) |
| Preferred stock dividends - convertible | (992 ) | — | — |
| Numerator for basic EPS | 174,862 | 74,345 | 151,373 |
| Effect of dilutive securities: | | | |
| Preferred stock dividends - convertible | 992 | — | — |
| Numerator for diluted EPS - after assumed conversions | $ 175,854 | $ 74,345 | $ 151,373 |
| | | | |
| Denominator: | | | |
| Denominator for basic EPS - weighted-average shares outstanding | 107,659,813 | 106,588,402 | 105,951,752 |
| Effect of dilutive securities: | | | |
| Employee stock options | 2,053,681 | 1,947,546 | 1,891,083 |
| RSUs | 319,089 | 216,314 | 435,483 |
| Convertible preferred stock | 789,473 | — | — |
| Dilutive potential common shares | 3,162,243 | 2,163,860 | 2,326,566 |
| Denominator for diluted EPS - weighted-average shares outstanding and assumed conversions | 110,822,056 | 108,752,262 | 108,278,318 |

| | | | |
|---|---|---|---|
| Basic EPS | $ 1.62 | $ 0.70 | $ 1.43 |
| Diluted EPS | $ 1.59 | $ 0.68 | $ 1.40 |

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## 20. 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 profits attributable to the performance of activities within the segment 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 operating segments:

| | Year Ended December 31, 2018 | | | |
|---|---|---|---|---|
| | Property and Casualty | Accident and Health | Corporate and Other | Total |
| Underwriting revenues: | | | | |
| Gross premium written | $4,718,730 | $698,109 | $— | $5,416,839 |
| Ceded premiums | (1,517,556) | (71,570) | — | (1,589,126) |
| Net premium written | 3,201,174 | 626,539 | — | 3,827,713 |
| Change in unearned premium | (85,385) | (10,126) | — | (95,511) |
| Net earned premium | 3,115,789 | 616,413 | — | 3,732,202 |
| Ceding commission income | 217,694 | 7,003 | — | 224,697 |
| Service and fee income | 375,603 | 185,980 | — | 561,583 |
| Total underwriting revenues | 3,709,086 | 809,396 | — | 4,518,482 |
| Underwriting expenses: | | | | |
| Loss and loss adjustment expense | 2,340,881 | 321,345 | — | 2,662,226 |
| Acquisition costs and other underwriting expenses | 550,540 | 184,726 | — | 735,266 |
| General and administrative expenses | 726,238 | 201,808 | 10,000 | 938,046 |
| Total underwriting expenses | 3,617,659 | 707,879 | 10,000 | 4,335,538 |
| Underwriting income | 91,427 | 101,517 | (10,000) | 182,944 |
| Net investment income | — | — | 119,034 | 119,034 |
| Net loss on investments | — | — | (29,545) | (29,545) |
| Interest expense | — | — | (51,425) | (51,425) |
| Provision for income taxes | — | — | (53,484) | (53,484) |
| Net (income) loss attributable to non-controlling interest | — | — | 39,830 | 39,830 |
| Net income attributable to NGHC | $91,427 | $101,517 | $14,410 | $207,354 |

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| | Year Ended December 31, 2017 | | | |
|---|---|---|---|---|
| | Property and Casualty | Accident and Health | Corporate and Other | Total |
| Underwriting revenues: | | | | |
| Gross premium written | $4,174,583 | $581,402 | $— | $4,755,985 |
| Ceded premiums | (1,132,284) | (46,106) | — | (1,178,390) |
| Net premium written | 3,042,299 | 535,296 | — | 3,577,595 |
| Change in unearned premium | 78,594 | (2,013) | — | 76,581 |
| Net earned premium | 3,120,893 | 533,283 | — | 3,654,176 |
| Ceding commission income | 115,443 | 1,013 | — | 116,456 |
| Service and fee income | 348,313 | 154,614 | — | 502,927 |
| Total underwriting revenues | 3,584,649 | 688,910 | — | 4,273,559 |
| Underwriting expenses: | | | | |
| Loss and loss adjustment expense | 2,307,619 | 318,463 | — | 2,626,082 |
| Acquisition costs and other underwriting expenses | 517,550 | 154,879 | — | 672,429 |
| General and administrative expenses | 741,499 | 171,497 | — | 912,996 |
| Total underwriting expenses | 3,566,668 | 644,839 | — | 4,211,507 |
| Underwriting income | 17,981 | 44,071 | — | 62,052 |
| Net investment income | — | — | 101,950 | 101,950 |
| Net gain on investments | — | — | 46,763 | 46,763 |
| Other income (expense) | — | — | (198) | (198) |
| Interest expense | — | — | (47,086) | (47,086) |
| Provision for income taxes | — | — | (61,273) | (61,273) |
| Net (income) loss attributable to non-controlling interest | — | — | 3,637 | 3,637 |
| Net income attributable to NGHC | $17,981 | $44,071 | $43,793 | $105,845 |

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| | Year Ended December 31, 2016 | | | |
|---|---|---|---|---|
| | Property and Casualty | Accident and Health | Corporate and Other | Total |
| Underwriting revenues: | | | | |
| Gross premium written | $3,036,888 | $464,010 | $— | $3,500,898 |
| Ceded premiums | (382,860) | (45,342) | — | (428,202) |
| Net premium written | 2,654,028 | 418,668 | — | 3,072,696 |
| Change in unearned premium | (73,284) | (4,241) | — | (77,525) |
| Net earned premium | 2,580,744 | 414,427 | — | 2,995,171 |
| Ceding commission income | 44,269 | 1,331 | — | 45,600 |
| Service and fee income | 241,881 | 138,936 | — | 380,817 |
| Total underwriting revenues | 2,866,894 | 554,694 | — | 3,421,588 |
| Underwriting expenses: | | | | |
| Loss and loss adjustment expense | 1,791,070 | 301,210 | — | 2,092,280 |
| Acquisition costs and other underwriting expenses | 394,277 | 102,730 | — | 497,007 |
| General and administrative expenses | 580,815 | 128,333 | — | 709,148 |
| Total underwriting expenses | 2,766,162 | 532,273 | — | 3,298,435 |
| Underwriting income | 100,732 | 22,421 | — | 123,153 |
| Net investment income | — | — | 115,187 | 115,187 |
| Net gain on investments | — | — | 7,904 | 7,904 |
| Other income | — | — | 24,308 | 24,308 |
| Interest expense | — | — | (40,180) | (40,180) |
| Provision for income taxes | — | — | (33,998) | (33,998) |
| Net (income) attributable to non-controlling interest | — | — | (20,668) | (20,668) |
| Net income attributable to NGHC | $100,732 | $22,421 | $52,553 | $175,706 |

The following tables summarize the financial position of the operating segments:

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Property and Casualty | Accident and Health | Corporate and Other | Total |
| Premiums and other receivables, net | $1,245,530 | $153,896 | $386 | $1,399,812 |
| Deferred acquisition costs | 226,188 | 25,220 | — | 251,408 |
| Reinsurance recoverable | 1,585,008 | 26,730 | — | 1,611,738 |
| Prepaid reinsurance premiums | 665,660 | 14 | — | 665,674 |
| Intangible assets, net and Goodwill | 443,163 | 116,957 | — | 560,120 |
| Prepaid and other assets | 20,941 | 22,472 | 111,545 | 154,958 |
| Corporate and other assets | — | — | 4,795,570 | 4,795,570 |
| Total assets | $4,186,490 | $345,289 | $4,907,501 | $9,439,280 |

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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 table shows an analysis of the premiums by geographical location:

| | Year Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2018 | | | 2017 | | | 2016 | | |
| | NGHC | Reciprocal Exchanges | Total | NGHC | Reciprocal Exchanges | Total | NGHC | Reciprocal Exchanges | Total |
| Gross premium written - North America | $4,817,658 | $ 448,923 | $5,266,581 | $4,252,691 | $ 383,773 | $4,636,464 | $3,156,393 | $ 241,540 | $3,397,933 |
| Gross premium written - Europe | 150,258 | — | 150,258 | 119,521 | — | 119,521 | 102,965 | — | 102,965 |
| Total | $4,967,916 | $ 448,923 | $5,416,839 | $4,372,212 | $ 383,773 | $4,755,985 | $3,259,358 | $ 241,540 | $3,500,898 |
| | | | | | | | | | |
| Net premium written - North America | $3,523,060 | $ 183,565 | $3,706,625 | $3,282,425 | $ 175,649 | $3,458,074 | $2,849,183 | $ 120,548 | $2,969,731 |
| Net premium written - Europe | 121,088 | — | 121,088 | 119,521 | — | 119,521 | 102,965 | — | 102,965 |
| Total | $3,644,148 | $ 183,565 | $3,827,713 | $3,401,946 | $ 175,649 | $3,577,595 | $2,952,148 | $ 120,548 | $3,072,696 |
| | | | | | | | | | |
| Net earned premium - North America | $3,434,386 | $ 186,761 | $3,621,147 | $3,367,695 | $ 169,871 | $3,537,566 | $2,787,244 | $ 110,395 | $2,897,639 |
| Net earned premium - Europe | 111,055 | — | 111,055 | 116,610 | — | 116,610 | 97,532 | — | 97,532 |
| Total | $3,545,441 | $ 186,761 | $3,732,202 | $3,484,305 | $ 169,871 | $3,654,176 | $2,884,776 | $ 110,395 | $2,995,171 |

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The following tables show an analysis of premiums by product type:

| | Year Ended December 31, | | |
|---|---|---|---|
| Gross Premium Written | 2018 | 2017 | 2016 |
| Property and Casualty | | | |
| Personal Auto | $2,637,176 | $2,334,838 | $1,548,365 |
| Homeowners | 688,006 | 558,827 | 410,565 |
| RV/Packaged | 208,394 | 187,475 | 165,919 |
| Small Business Auto | 319,299 | 316,958 | 257,075 |
| Lender-placed insurance | 363,056 | 345,354 | 376,058 |
| Other | 53,876 | 47,358 | 37,366 |
| Property and Casualty | $4,269,807 | $3,790,810 | $2,795,348 |
| Accident and Health | 698,109 | 581,402 | 464,010 |
| NGHC Total | $4,967,916 | $4,372,212 | $3,259,358 |
| | | | |
| Reciprocal Exchanges | | | |
| Personal Auto | $153,129 | $132,844 | $73,680 |
| Homeowners | 291,907 | 247,460 | 161,510 |
| Other | 3,887 | 3,469 | 6,350 |
| Reciprocal Exchanges Total | $448,923 | $383,773 | $241,540 |
| | | | |
| Total | $5,416,839 | $4,755,985 | $3,500,898 |

| | Year Ended December 31, | | |
|---|---|---|---|
| Net Premium Written | 2018 | 2017 | 2016 |
| Property and Casualty | | | |
| Personal Auto | $2,016,858 | $1,824,932 | $1,380,125 |
| Homeowners | 331,120 | 275,013 | 369,810 |
| RV/Packaged | 206,740 | 185,993 | 165,025 |
| Small Business Auto | 233,456 | 246,072 | 234,101 |
| Lender-placed insurance | 202,069 | 313,124 | 363,896 |
| Other | 27,366 | 21,516 | 20,523 |
| Property and Casualty | $3,017,609 | $2,866,650 | $2,533,480 |
| Accident and Health | 626,539 | 535,296 | 418,668 |
| NGHC Total | $3,644,148 | $3,401,946 | $2,952,148 |
| | | | |
| Reciprocal Exchanges | | | |
| Personal Auto | $61,759 | $68,292 | $44,661 |
| Homeowners | 120,875 | 105,536 | 71,367 |
| Other | 931 | 1,821 | 4,520 |
| Reciprocal Exchanges Total | $183,565 | $175,649 | $120,548 |
| | | | |
| Total | $3,827,713 | $3,577,595 | $3,072,696 |

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| | Year Ended December 31, | | |
|---|---|---|---|
| Net Earned Premium | 2018 | 2017 | 2016 |
| Property and Casualty | | | |
| Personal Auto | $1,927,667 | $1,828,304 | $1,292,563 |
| Homeowners | 329,850 | 349,709 | 353,228 |
| RV/Packaged | 197,258 | 175,888 | 158,256 |
| Small Business Auto | 237,587 | 251,576 | 217,919 |
| Lender-placed insurance | 215,811 | 321,995 | 422,645 |
| Other | 20,855 | 23,550 | 25,738 |
| Property and Casualty | $2,929,028 | $2,951,022 | $2,470,349 |
| Accident and Health | 616,413 | 533,283 | 414,427 |
| NGHC Total | $3,545,441 | $3,484,305 | $2,884,776 |
| | | | |
| Reciprocal Exchanges | | | |
| Personal Auto | $59,923 | $66,565 | $42,225 |
| Homeowners | 125,806 | 101,648 | 61,748 |
| Other | 1,032 | 1,658 | 6,422 |
| Reciprocal Exchanges Total | $186,761 | $169,871 | $110,395 |
| | | | |
| Total | $3,732,202 | $3,654,176 | $2,995,171 |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
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## 21. Selected Quarterly Financial Data (Unaudited)

The following tables summarize quarterly financial data:

| | 2018 | | | |
|---|---|---|---|---|
| | March 31, | June 30, | September 30, | December 31, |
| Total revenues | $1,117,257 | $1,135,106 | $1,168,843 | $1,186,765 |
| Total expenses | 1,045,035 | 1,091,655 | 1,097,096 | 1,153,177 |
| Provision for income taxes | 16,202 | 6,541 | 15,518 | 15,223 |
| Net income | 56,020 | 36,910 | 56,229 | 18,365 |
| Net income attributable to NGHC | 68,208 | 44,548 | 68,382 | 26,216 |
| Net income attributable to NGHC common stockholders | 60,333 | 36,673 | 60,507 | 17,349 |
| Basic EPS | $0.57 | $0.34 | $0.56 | $0.16 |
| Diluted EPS | $0.55 | $0.34 | $0.55 | $0.16 |

| | 2017 | | | |
|---|---|---|---|---|
| | March 31, | June 30, | September 30, | December 31, |
| Total revenues | $1,101,854 | $1,147,693 | $1,105,783 | $1,066,744 |
| Total expenses | 1,060,267 | 1,123,033 | 1,028,352 | 1,046,941 |
| Provision for income taxes | 10,789 | 11,487 | 18,475 | 20,522 |
| Net income (loss) | 30,798 | 13,173 | 58,956 | (719) |
| Net income (loss) attributable to NGHC | 36,923 | 13,332 | 57,645 | (2,055) |
| Net income (loss) attributable to NGHC common stockholders | 29,048 | 5,457 | 49,770 | (9,930) |
| Basic EPS | $0.27 | $0.05 | $0.47 | $(0.09) |
| Diluted EPS | $0.27 | $0.05 | $0.46 | $(0.09) |

Due to changes in number of shares outstanding from quarter to quarter, the total earnings per share of the four quarters may not necessarily equal the earnings per share for the year.

**Schedule I**
**NATIONAL GENERAL HOLDINGS CORP.**
**SUMMARY OF INVESTMENTS**
**OTHER THAN INVESTMENTS IN RELATED PARTIES**
**(In Thousands)**

| December 31, 2018 | Cost[1] | Value | Amount at which shown in the Balance Sheet |
|---|---|---|---|
| Debt Securities: | | | |
| Bonds: | | | |
| U.S. government and government agencies and authorities | $102,671 | $103,068 | $103,068 |
| States, municipalities and political subdivisions | 274,367 | 272,197 | 272,197 |
| Foreign governments | 151,443 | 152,366 | 152,366 |
| Public utilities | 28,161 | 28,008 | 28,008 |
| All other corporate bonds[2] | 3,057,967 | 3,005,393 | 3,005,393 |
| Certificates of deposit | 20,252 | 20,252 | 20,252 |
| Total Debt Securities | 3,634,861 | 3,581,284 | 3,581,284 |
| | | | |
| Equity Securities: | | | |
| Common stock: | | | |
| Industrial, miscellaneous and all other | 31,213 | 10,949 | 10,949 |
| Total Equity Securities | 31,213 | 10,949 | 10,949 |
| | | | |
| Other Investments[3] | 52,301 | 52,301 | 52,301 |
| Other Short-term Investments[3] | 348,549 | 348,549 | 348,549 |
| Total Investments (other than investments in related parties) | $4,066,924 | $3,993,083 | $3,993,083 |

(1) Original cost of equity securities and, as to debt securities, original cost reduced by repayments and adjusted for amortization of premiums or accrual of discounts.
(2) Includes structured securities, residential and commercial mortgage-backed securities.
(3) Approximates market value.

**Schedule II**
**NATIONAL GENERAL HOLDINGS CORP.**
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**
**BALANCE SHEETS — PARENT COMPANY ONLY**
**(In Thousands)**

| | December 31, | |
|---|---|---|
| | **2018** | **2017** |
| **ASSETS** | | |
| **Investments:** | | |
| Debt securities, available-for-sale, at fair value (amortized cost - $79,454 and $27,695) | $78,365 | $27,538 |
| Short-term investments | 117,135 | — |
| Other investments | 4,310 | 4,250 |
| Equity investment in subsidiaries | 2,491,024 | 2,471,989 |
| **Total investments** | 2,690,834 | 2,503,777 |
| Cash and cash equivalents | 3,956 | 4,029 |
| Accrued investment income | 728 | 228 |
| Software, net | 172,943 | 186,716 |
| Prepaid and other assets | 30,688 | 41,034 |
| **Total assets** | $2,899,149 | $2,735,784 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| **Liabilities:** | | |
| Accounts payable and accrued expenses | $94,997 | $149,817 |
| Debt | 603,281 | 632,542 |
| **Total liabilities** | $698,278 | $782,359 |
| **Stockholders' equity:** | | |
| **Total stockholders' equity** | $2,200,871 | $1,953,425 |
| **Total liabilities and stockholders' equity** | $2,899,149 | $2,735,784 |

*See accompanying notes to condensed financial statements.*

**Schedule II**
**NATIONAL GENERAL HOLDINGS CORP.**
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**
**STATEMENTS OF INCOME AND COMPREHENSIVE INCOME — PARENT COMPANY ONLY**
**(In Thousands)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2018** | **2017** | **2016** |
| **Revenues:** | | | |
| Service and fee income | $44,932 | $9,256 | $— |
| Investment income | 1,205 | 3,004 | 8,777 |
| Net gain (loss) on investments | (1,571) | 4,032 | 793 |
| Equity in undistributed net income of subsidiaries and partially-owned companies | 232,101 | 116,367 | 218,639 |
| **Total revenues** | 276,667 | 132,659 | 228,209 |
| **Expenses:** | | | |
| Interest expense | 39,380 | 40,954 | 38,817 |
| Other (income) expense, net | 30,847 | 7,236 | (4,246) |
| **Total expenses** | 70,227 | 48,190 | 34,571 |
| **Income before provision (benefit) for income taxes** | 206,440 | 84,469 | 193,638 |
| Provision (benefit) for income taxes | (914) | (21,376) | 17,932 |
| **Net income attributable to NGHC** | 207,354 | 105,845 | 175,706 |
| Dividends on preferred stock | (32,492) | (31,500) | (24,333) |
| **Net income attributable to NGHC common stockholders** | $174,862 | $74,345 | $151,373 |
| | | | |
| **Net income attributable to NGHC** | $207,354 | $105,845 | $175,706 |
| Other comprehensive income (loss), net of tax | (44,054) | (19,587) | 30,889 |
| **Comprehensive income attributable to NGHC** | $163,300 | $86,258 | $206,595 |

*See accompanying notes to condensed financial statements.*

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**Schedule II**
**NATIONAL GENERAL HOLDINGS CORP.**
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**
**STATEMENTS OF CASH FLOWS — PARENT COMPANY ONLY**
**(In Thousands)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2018** | **2017** | **2016** |
| **Cash flows from operating activities:** | | | |
| Net income attributable to NGHC | $207,354 | $105,845 | $175,706 |
| Adjustments to reconcile net income to cash provided by (used in) operating activities: | | | |
| Net (gain) loss on investments | 1,571 | (4,032) | (793) |
| Depreciation and amortization | 20,668 | 4,799 | — |
| Net amortization of premium net of discount on debt securities | 581 | 842 | 1,008 |
| Stock-compensation expense | 9,020 | 8,324 | 8,221 |
| Equity in undistributed net income of subsidiaries and partially-owned companies | (232,101) | (116,367) | (230,279) |
| Changes in assets and liabilities: | | | |
| Accrued investment income | (500) | 6 | 624 |
| Other assets | 23,334 | (13,007) | (23,966) |
| Other liabilities | 8,993 | (6,057) | 14,098 |
| **Net cash provided by (used in) operating activities** | 38,920 | (19,647) | (55,381) |
| **Cash flows from investing activities:** | | | |
| Purchases of: | | | |
| Debt securities, available-for-sale | (70,308) | (235,837) | (478,502) |
| Short-term investments | (342,137) | — | — |
| Premises and equipment | (73,563) | (58,181) | — |
| Proceeds from: | | | |
| Sale and maturity of debt securities, available-for-sale | 18,260 | 250,102 | 672,323 |
| Sale of short-term investments | 225,395 | — | — |
| Investment in subsidiaries | 130,772 | 126,051 | (297,164) |
| Acquisition of subsidiaries, net of cash | (9,875) | (210) | — |
| **Net cash (used in) provided by investing activities** | (121,456) | 81,925 | (103,343) |
| **Cash flows from financing activities:** | | | |
| Securities sold under agreements to repurchase, net | — | — | (52,484) |
| Proceeds from debt | — | 140,000 | 50,000 |
| Repayments of debt and return of capital | (30,000) | (172,794) | (150) |
| Issuances of common and preferred stock, net of fees | 162,120 | — | 198,460 |
| Issuance of common stock — employee share options | 1,978 | 1,259 | 5,140 |
| Taxes paid related to net share settlement of equity awards | (3,024) | (1,773) | (919) |
| Dividends paid to common and preferred shareholders | (48,611) | (48,550) | (34,356) |
| **Net cash provided by (used in) financing activities** | 82,463 | (81,858) | 165,691 |
| **Net (decrease) increase in cash and cash equivalents** | (73) | (19,580) | 6,967 |
| **Cash and cash equivalents, beginning of the year** | 4,029 | 23,609 | 16,642 |
| **Cash and cash equivalents, end of the year** | $3,956 | $4,029 | $23,609 |

*See accompanying notes to condensed financial statements.*

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**Schedule II**
**NATIONAL GENERAL HOLDINGS CORP.**
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**
**NOTES — PARENT COMPANY ONLY**

**1. Basis of Presentation**

In the parent-company-only financial statements, the Company's investment in subsidiaries is stated at cost plus equity in undistributed earnings of subsidiaries since the date of acquisition. The Company's share of net income of its unconsolidated subsidiaries is included in consolidated income using the equity method. The parent-company-only financial statements should be read in conjunction with the Company's Consolidated Financial Statements. Certain prior period amounts have been reclassified to conform to the current-year presentation.

**2. Debt**

For information relating to debt, see Note 12, "Debt" in the notes to the Company's Consolidated Financial Statements.

**3. Dividends**

For information relating to cash dividends paid to the registrant or the Company by its consolidated subsidiaries and investees accounted for by the equity method, see Note 17, "Statutory Financial Data, Risk-Based Capital and Dividend Restrictions" in the notes to the Company's Consolidated Financial Statements.

**Schedule III**
**NATIONAL GENERAL HOLDINGS CORP.**
**SUPPLEMENTARY INSURANCE INFORMATION**
**(In Thousands)**

| | As of December 31, | | | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Segment | Deferred Acquisition Costs | Unpaid Loss and Loss Adjustment Expense Reserves | Unearned Premiums | Net Earned Premium | Net Investment Income | Loss and Loss Adjustment Expense Incurred | Deferred Acquisition Costs Amortization | Other Operating Expenses | Net Written Premium |
| 2018 | | | | | | | | | |
| Property and casualty | $ 226,188 | $ 2,685,879 | $ 2,120,283 | $ 3,115,789 | $ — | $ 2,340,881 | $ 495,009 | $ 55,531 | $ 3,201,174 |
| Accident and health | 25,220 | 271,280 | 36,554 | 616,413 | — | 321,345 | 15,784 | 168,942 | 626,539 |
| Corporate and other | — | — | — | — | 119,034 | — | — | — | — |
| Total | $ 251,408 | $ 2,957,159 | $ 2,156,837 | $ 3,732,202 | $ 119,034 | $ 2,662,226 | $ 510,793 | $ 224,473 | $ 3,827,713 |
| 2017 | | | | | | | | | |
| Property and casualty | $ 198,283 | $ 2,413,904 | $ 1,886,359 | $ 3,120,893 | $ — | $ 2,307,619 | $ 487,740 | $ 29,810 | $ 3,042,299 |
| Accident and health | 18,106 | 249,653 | 37,226 | 533,283 | — | 318,463 | 22,149 | 132,730 | 535,296 |
| Corporate and other | — | — | — | — | 101,950 | — | — | — | — |
| Total | $ 216,389 | $ 2,663,557 | $ 1,923,585 | $ 3,654,176 | $ 101,950 | $ 2,626,082 | $ 509,889 | $ 162,540 | $ 3,577,595 |
| 2016 | | | | | | | | | |
| Property and casualty | $ 207,597 | $ 2,073,466 | $ 1,613,213 | $ 2,580,744 | $ — | $ 1,791,070 | $ 365,802 | $ 28,475 | $ 2,654,028 |
| Accident and health | 13,325 | 200,400 | 22,412 | 414,427 | — | 301,210 | 45,199 | 57,531 | 418,668 |
| Corporate and other | — | — | — | — | 115,187 | — | — | — | — |
| Total | $ 220,922 | $ 2,273,866 | $ 1,635,625 | $ 2,995,171 | $ 115,187 | $ 2,092,280 | $ 411,001 | $ 86,006 | $ 3,072,696 |

**Schedule IV**
**NATIONAL GENERAL HOLDINGS CORP.**
**REINSURANCE**
**(In Thousands)**

| Year Ended December 31, | Gross Amount | Ceded to Other Companies | Assumed from Other Companies | Net Amount | Percent of Amount Assumed to Net |
|---|---|---|---|---|---|
| 2018 | | | | | |
| Earned Premiums | $5,049,512 | $(1,440,575) | $123,265 | $3,732,202 | 3.3 % |
| 2017 | | | | | |
| Earned Premiums | $4,233,184 | $(818,238) | $239,230 | $3,654,176 | 6.5 % |
| 2016 | | | | | |
| Earned Premiums | $2,718,103 | $(410,761) | $687,829 | $2,995,171 | 23.0 % |

**Schedule V**
**NATIONAL GENERAL HOLDINGS CORP.**
**VALUATION AND QUALIFYING ACCOUNTS**
**(In Thousands)**

| Year Ended December 31, | Balance at beginning of the year | Additions Charge (Benefit) to costs and expenses | Charge to other accounts | Additions (Deductions) | Balance at end of the year |
|---|---|---|---|---|---|
| 2018 | | | | | |
| Allowance for uncollectible accounts | $ 18,546 | $ 74,214 | $ — | $ (72,552 ) | $ 20,208 |
| Valuation allowance for deferred taxes | 5,410 | 54,934 | — | — | 60,344 |
| 2017 | | | | | |
| Allowance for uncollectible accounts | $ 16,219 | $ 63,819 | $ — | $ (61,492 ) | $ 18,546 |
| Valuation allowance for deferred taxes | 7,135 | (1,725 ) | — | — | 5,410 |
| 2016 | | | | | |
| Allowance for uncollectible accounts | $ 13,433 | $ 35,356 | $ — | $ (32,570 ) | $ 16,219 |
| Valuation allowance for deferred taxes | 17,295 | (10,160 ) | — | — | 7,135 |

**Schedule VI**
**NATIONAL GENERAL HOLDINGS CORP.**
**SUPPLEMENTAL INFORMATION CONCERNING**
**PROPERTY-CASUALTY INSURANCE OPERATIONS**
**(In Thousands)**

| Year Ended December 31, | Losses and Loss Adjustment Expenses Incurred Related to | | Paid Losses and Loss Adjustment Expenses |
|---|---|---|---|
| | Current Year | Prior Years | |
| 2018 | $2,696,260 | $(34,034) | $2,515,237 |
| 2017 | $2,618,733 | $7,349 | $2,491,881 |
| 2016 | $2,078,742 | $13,538 | $1,926,797 |