Conifer Holdings, Inc.
Form 10-Q
May 09, 2018

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

FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2018
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 001-37536

Conifer Holdings, Inc.
(Exact name of registrant as specified in its charter)

Michigan	27-1298795
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

550 West Merrill Street, Suite 200	
Birmingham, Michigan	48009
(Address of principal executive offices)	(Zip code)

(248) 559-0840
(Registrant’s telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company þ	Emerging growth company þ

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

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

The number of outstanding shares of the registrant’s common stock, no par value, as of May 7, 2018, was 8,520,328.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES

Form 10-Q

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PART 1 - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(dollars in thousands)

	March 31, 2018 (Unaudited)	December 31, 2017
Assets		
Investment securities:		
Debt securities, at fair value (amortized cost of $137,025 and $137,004, respectively)	$ 134,711	$ 136,536
Equity securities, at fair value (cost of $8,664 and $8,629, respectively)	9,425	9,687
Short-term investments, at fair value	2,505	11,427
Total investments	146,641	157,650
Cash	14,406	11,868
Premiums and agents' balances receivable, net	19,895	22,845
Receivable from Affiliate	1,783	1,195
Reinsurance recoverables on unpaid losses	20,063	20,066
Reinsurance recoverables on paid losses	4,595	4,473
Prepaid reinsurance premiums	1,050	1,081
Deferred policy acquisition costs	12,050	12,781
Other assets	9,171	7,073
Total assets	$ 229,654	$ 239,032
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid losses and loss adjustment expenses	$ 85,491	$ 87,896
Unearned premiums	53,685	57,672
Reinsurance premiums payable	3,398	3,299
Debt	29,043	29,027
Accounts payable and other liabilities	6,613	8,312
Total liabilities	178,230	186,206
Commitments and contingencies	—	—
Shareholders' equity:		
Common stock, no par value (100,000,000 shares authorized; 8,520,328 issued and outstanding, respectively)	86,430	86,199
Accumulated deficit	(32,318)	(33,010)
Accumulated other comprehensive loss	(2,688)	(363)
Total shareholders' equity	51,424	52,826
Total liabilities and shareholders' equity	$ 229,654	$ 239,032

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations (Unaudited)
(dollars in thousands, except per share data)

	Three Months Ended March 31,	
	2018	2017
Revenue		
Premiums		
Gross earned premiums	$27,724	$28,264
Ceded earned premiums	(3,924)	(4,124)
Net earned premiums	23,800	24,140
Net investment income	802	577
Net realized investment gains (losses)	161	(8)
Change in fair value of equity securities	(297)	—
Other income	357	354
Total revenue	24,823	25,063
Expenses		
Losses and loss adjustment expenses, net	13,328	15,733
Policy acquisition costs	6,513	6,472
Operating expenses	4,187	4,530
Interest expense	619	224
Total expenses	24,647	26,959
Income (loss) before equity earnings of affiliates and income taxes	176	(1,896)
Equity earnings of affiliates, net of tax	55	104
Income tax expense	18	6
Net income (loss)	$213	$(1,798)
Earnings (loss) per common share, basic and diluted	$0.02	$(0.24)
Weighted average common shares outstanding, basic and diluted	8,520,328	7,633,069

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income (Loss) (Unaudited)
(dollars in thousands)

	Three Months Ended March 31,	
	2018	2017
Net income (loss)	$213	$(1,798)
Other comprehensive income (loss), net of tax:		
Unrealized investment gains (losses):		
Unrealized investment gains (losses) during the period	(1,846)	385
Income tax expense (benefit)	—	—
Unrealized investment gains (losses), net of tax	(1,846)	385
Less: reclassification adjustments to:		
Net realized investment gains (losses) included in net income (loss)	—	51
Income tax expense (benefit)	—	—
Total reclassifications included in net income (loss), net of tax	—	51
Other comprehensive income (loss)	(1,846)	334
Total comprehensive income (loss)	$(1,633)	$(1,464)

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
(dollars in thousands)

	No Par, Common Stock				
	Shares	Amount	Accumulated deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances at December 31, 2016	7,633,070	$80,342	$ (11,468)	$ (1,080)	$ 67,794
Net loss	—	—	(1,798)	—	(1,798)
Restricted stock unit expense, net	(1)	243	—	—	243
Other comprehensive income	—	—	—	334	334
Balances at March 31, 2017	7,633,069	80,585	(13,266)	(746)	66,573
Net loss	—	—	(19,744)	—	(19,744)
Issuance of common stock in private placement	800,000	5,000	—	—	5,000
Common stock issuance costs	—	(38)	—	—	(38)
Restricted stock unit expense, net	87,259	652	—	—	652
Other comprehensive income	—	—	—	383	383
Balances at December 31, 2017	8,520,328	86,199	(33,010)	(363)	52,826
Net income	—	—	213	—	213
Restricted stock unit expense, net	—	231	—	—	231
Other comprehensive loss	—	—	—	(1,846)	(1,846)
Cumulative effect of adoption of ASU No. 2016-01, net of taxes	—	—	556	(556)	—
Cumulative effect of adoption of ASU No. 2018-02, net of taxes	—	—	(77)	77	—
Balances at March 31, 2018	8,520,328	$86,430	$ (32,318)	$ (2,688)	$ 51,424

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	Three Months Ended March 31,	
	2018	2017
Cash Flows From Operating Activities		
Net income (loss)	$213	$(1,798)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	88	100
Amortization of bond premium and discount, net	139	175
Net realized investment (gains) losses	(161)	8
Change in fair value of equity securities	297	—
Restricted stock unit expenses	231	243
Other	(55)	104
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Premiums and agents' balances and other receivables	2,362	1,616
Reinsurance recoverables	(119)	(2,688)
Prepaid reinsurance premiums	31	314
Deferred policy acquisition costs	731	334
Other assets	(2,075)	(1,037)
Increase (decrease) in:		
Unpaid losses and loss adjustment expenses	(2,405)	7,484
Unearned premiums	(3,987)	(1,790)
Accounts payable and other liabilities	802	861
Net cash provided by (used in) operating activities	(3,908)	3,926
Cash Flows From Investing Activities		
Purchase of investments	(25,175)	(51,207)
Proceeds from maturities and redemptions of investments	5,079	8,889
Proceeds from sales of investments	26,563	36,729
Purchases of property and equipment	(21)	(9)
Net cash provided by (used in) investing activities	6,446	(5,598)
Cash Flows From Financing Activities		
Repayment of borrowings under debt arrangements	—	(625)
Net cash provided by (used in) financing activities	—	(625)
Net increase (decrease) in cash	2,538	(2,297)
Cash at beginning of period	11,868	12,493
Cash at end of period	$14,406	$10,196
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$619	$128
Net income taxes paid	—	—
Receivable (Payable) for securities - non cash item	3,094	(444)

The accompanying notes are an integral part of the Consolidated Financial Statements.

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CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include accounts, after elimination of intercompany accounts and transactions, of Conifer Holdings, Inc. (the "Company" or "Conifer"), its wholly owned subsidiaries, Conifer Insurance Company ("CIC"), White Pine Insurance Company ("WPIC"), Red Cedar Insurance Company ("RCIC"), and Sycamore Insurance Agency, Inc ("SIA"). CIC, WPIC, and RCIC are collectively referred to as the "Insurance Company Subsidiaries." On a stand-alone basis, Conifer Holdings, Inc. is referred to as the "Parent Company."

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The Company has applied the rules and regulations of the United States Securities and Exchange Commission ("SEC") regarding interim financial reporting and therefore the consolidated financial statements do not include all of the information and notes required by GAAP for annual financial statements. In the opinion of Management, all adjustments, consisting of items of a normal recurring nature, necessary for a fair presentation of the consolidated interim financial statements, have been included. The results of operations for the three months ended March 31, 2018, are not necessarily indicative of the results expected for the year ended December 31, 2018.

These consolidated financial statements and the notes thereto should be read in conjunction with the Company's audited consolidated financial statements and related notes included in its Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC on March 15, 2018.

Business

The Company is engaged in the sale of property and casualty insurance products and has organized its business model around two classes of insurance businesses: commercial and personal lines. The Company underwrites a variety of specialty insurance products, including property, general liability, liquor liability, automobile, homeowners and dwelling policies. The Company markets and sells its insurance products through a network of independent retail agents and managing general agents. Policies are written in all 50 states. The Company's corporate headquarters is located in Birmingham, Michigan with additional office facilities in Florida, Pennsylvania and Tennessee.

The Company also generates other revenues through investment income and other income which mainly consists of installment fees and policy issuance fees generally related to the policies we write. We also generate equity earnings from SIA's 50% owned agency (the "Affiliate"). The Affiliate places small commercial risks mainly for alarm and security guard markets.

Use of Estimates

The preparation of financial statements in conformity 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. While management believes the amounts included in the consolidated financial statements reflect Management's best estimates and assumptions, actual results may differ from these estimates.

Recently Issued Accounting Guidance

Effective January 1, 2018, the Company adopted FASB Accounting Standards Update ("ASU") No. 2016-01, Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities. As a result of adoption of this ASU, equity instruments that do not result in consolidation and are not accounted for under the equity method are measured at fair value and any changes in fair value are recognized in net income. Previously, the Company's equity securities were classified as available-for-sale and changes in fair value were recorded in other comprehensive income. Upon adoption of this ASU, cumulative net unrealized gains on equity securities of $1.1 million, net of deferred income taxes of $0.5 million, were reclassified from accumulated other comprehensive income into accumulated deficit. Prior periods have not been recast to conform to the current presentation. See Note 2

~ Investments for details regarding the change in net unrealized gains on equity securities included in net income for the quarter ended March 31, 2018.
Effective January 1, 2018, the Company early adopted ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The ASU provides an option to reclassify tax effects remaining in accumulated other comprehensive income as a result of the Tax Cuts and Jobs Act (TCJA) to retained earnings. Upon enactment of the TCJA, the U.S. corporate tax rate was reduced from 35% to 21% and the Company's U.S. deferred tax balances were remeasured to the lower enacted U.S. corporate tax rate. GAAP requires the effects of changes in tax rates and laws on deferred tax balances to be recorded as a component of income tax expense in the period of enactment, even if the assets and liabilities relate to items of accumulated other comprehensive

income. As a result of adopting the ASU, the Company reclassified $77,000 of previously recognized deferred taxes from accumulated other comprehensive income into accumulated deficit as of January 1, 2018.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which addresses the financial reporting of leasing transactions. This update will require the recognition of a right-of-use asset and a corresponding lease liability, discounted to the present value, for all leases that extend beyond 12 months. For operating leases, the asset and liability will be expensed over the lease term on a straight-line basis, with all cash flows included in the operating section of the consolidated statement of cash flows. For finance leases, interest on the lease liability will be recognized separately from the amortization of the right-of-use asset in the consolidated statement of operations and the repayment of the principal portion of the lease liability will be classified as a financing activity while the interest component will be included in the operating section of the consolidated statement of cash flows. This ASU is effective for annual and interim reporting periods beginning after December 15, 2018. Early adoption is permitted. Management is currently evaluating the impact of the guidance.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326), which amends the current methodology and timing for recognizing credit losses. This amendment will replace the current GAAP "incurred loss" methodology for credit losses with a methodology based on expected credit losses. The new guidance will also require expanded consideration of a broader range of reasonable and increased supportable information for the credit loss estimates. This ASU is effective for annual and interim reporting periods beginning after December 15, 2019. Early adoption is permitted for years beginning after December 15, 2018. Management is currently evaluating the impact of the guidance.

2. Investments

The cost or amortized cost, gross unrealized gain or loss, and estimated fair value of the investments in securities classified as available for sale at March 31, 2018 and December 31, 2017, were as follows (dollars in thousands):

	March 31, 2018			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt Securities:				
U.S. Government	$15,896	$4	$(222)	$15,678
State and local government	16,668	85	(201)	16,552
Corporate debt	38,806	92	(651)	38,247
Asset-backed securities	25,331	37	(110)	25,258
Mortgage-backed securities	33,981	22	(1,242)	32,761
Commercial mortgage-backed securities	3,935	—	(85)	3,850
Collateralized mortgage obligations	2,408	12	(54)	2,365
Total debt securities available for sale	$137,025	$252	$(2,565)	$134,711

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

	December 31, 2017			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt Securities:				
U.S. Government	$17,179	$10	$(99)	$17,090
State and local government	17,302	255	(54)	17,503
Corporate debt	38,947	170	(209)	38,908
Asset-backed securities	23,539	36	(35)	23,540
Mortgage-backed securities	33,942	38	(522)	33,458
Commercial mortgage-backed securities	3,532	3	(44)	3,491
Collateralized mortgage obligations	2,563	19	(36)	2,546
Total debt securities available for sale	137,004	531	(999)	136,536
Equity Securities (1)	8,629	1,240	(182)	9,687
Total securities available for sale	$145,633	$1,771	$(1,181)	$146,223

(1) Effective January 1, 2018, the Company adopted ASU No. 2016-01. As a result, equity securities are no longer classified as available-for-sale. Prior periods have not been recast to conform to the current presentation. Refer to Note 1 ~ Summary of Significant Accounting Policies for further details.

The following table summarizes the aggregate fair value and gross unrealized losses, by security type, of the available-for-sale securities in unrealized loss positions. The table segregates the holdings based on the length of time that individual securities have been in a continuous unrealized loss position, as follows (dollars in thousands):

	March 31, 2018								
	Less than 12 months			Greater than 12 months			Total		
	No. of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses	No. of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses	No. of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses
Fixed Maturity Securities:									
U.S. Government	12	$ 12,889	$ (175)	6	$ 1,960	$ (47)	18	$ 14,849	$ (222)
State and local government	39	10,338	(145)	7	1,380	(56)	46	11,718	(201)
Corporate debt	62	21,989	(284)	10	6,350	(367)	72	28,339	(651)
Asset-backed securities	23	14,448	(101)	3	793	(9)	26	15,241	(110)
Mortgage-backed securities	11	8,175	(191)	27	23,390	(1,051)	38	31,565	(1,242)
Commercial mortgage-backed securities	4	2,732	(32)	2	667	(53)	6	3,399	(85)
Collateralized mortgage obligations	9	1,869	(54)	—	—	—	9	1,869	(54)
Total debt securities available for sale	160	$ 72,440	$ (982)	55	$ 34,540	$ (1,583)	215	$ 106,980	$ (2,565)

	December 31, 2017								
	Less than 12 months			Greater than 12 months			Total		
	No. of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses	No. of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses	No. of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses
Fixed Maturity Securities:									
U.S. Government	12	$ 11,555	$ (64)	7	$ 2,207	$ (35)	19	$ 13,762	$ (99)
State and local government	10	3,511	(20)	7	1,424	(34)	17	4,935	(54)
Corporate debt	38	15,236	(46)	10	6,555	(163)	48	21,791	(209)
Asset-backed securities	20	13,948	(29)	3	915	(6)	23	14,863	(35)
Mortgage-backed securities	6	4,935	(19)	26	24,939	(503)	32	29,874	(522)
Commercial mortgage-backed securities	3	2,026	(12)	2	722	(32)	5	2,748	(44)
Collateralized mortgage obligations	8	1,870	(36)	—	—	—	8	1,870	(36)
Total debt securities available for sale	97	53,081	(226)	55	36,762	(773)	152	89,843	(999)
Equity Securities (1)	13	436	(75)	4	266	(107)	17	702	(182)
Total securities	110	$ 53,517	$ (301)	59	$ 37,028	$ (880)	169	$ 90,545	$ (1,181)

(1) Effective January 1, 2018, the Company adopted ASU No. 2016-01. As a result, equity securities are no longer classified as available-for-sale. Prior periods have not been recast to conform to the current presentation. Refer to Note 1 ~ Summary of Significant Accounting Policies for further details.

The Company analyzed its investment portfolio in accordance with its other-than-temporary impairment ("OTTI") review procedures and determined the Company did not need to record a credit-related OTTI loss in net income, nor recognize a non-credit related OTTI loss in other comprehensive income for the three months ended March 31, 2018 and 2017.

The Company’s sources of net investment income are as follows (dollars in thousands):

	Three Months Ended March 31,	
	2018	2017
Debt securities	$826	$601
Equity securities	27	25
Cash and short-term investments	23	11
Total investment income	876	637
Investment expenses	(74)	(60)
Net investment income	$802	$577

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

The following table summarizes the gross realized gains and losses from sales or maturities of available-for-sale fixed maturity and equity securities (dollars in thousands):

	Three Months Ended March 31, 2018	2017
Debt securities:		
Gross realized gains	$2	$—
Gross realized losses	(5)	(7)
Total debt securities	(3)	(7)
Equity securities:		
Gross realized gains	170	29
Gross realized losses	(6)	(30)
Total equity securities	164	(1)
Total net realized gains (losses)	$161	$(8)

Proceeds from the sales of debt and equity securities available for sale, maturities and other redemptions (primarily the return of capital) were $8.1 million and $6.6 million for the three months ended March 31, 2018 and 2017, respectively.

Effective January 1, 2018, the Company adopted ASU No. 2016-01. As a result, equity securities are no longer classified as available-for-sale with unrealized gains and losses recognized in other comprehensive income; rather, all changes in fair value of equity securities are now recognized in net income. The change in fair value of equity securities included in net income for the quarter ended March 31, 2018, was a $297 thousand loss, prior periods have not been recast for the adoption of this guidance.

The table below summarizes the amortized cost and fair value of available-for-sale debt securities by contractual maturity at March 31, 2018. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties (dollars in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	$13,283	$13,258
Due after one year through five years	36,167	35,701
Due after five years through ten years	12,271	12,011
Due after ten years	9,649	9,507
Securities with contractual maturities	71,370	70,477
Asset-backed securities	25,331	25,258
Mortgage-backed securities	33,981	32,761
Commercial mortgage-backed securities	3,935	3,850
Collateralized mortgage obligations	2,408	2,365
Total debt securities	$137,025	$134,711

At March 31, 2018 and December 31, 2017, the Insurance Company Subsidiaries had an aggregate of $7.8 million and $8.2 million, respectively, on deposit in trust accounts to meet the deposit requirements of various state insurance departments. At March 31, 2018 and December 31, 2017, the Company had $29.4 million and $18.4 million, respectively, held in trust accounts to meet collateral requirements with other third-party insurers, relating to various fronting arrangements. There are withdrawal and other restrictions on these deposits, including the type of investments that may be held, however, the Company may generally invest in high-grade bonds and short-term investments and earn interest on the funds.

3. Fair Value Measurements

The Company's financial instruments include assets and liabilities carried at fair value, as well as assets and liabilities carried at cost or amortized cost but disclosed at fair value in these consolidated financial statements. Fair value is defined as the price that would be received for an asset or paid to transfer a liability in the principally most advantageous market for the asset or liability in an orderly transaction between market participants. In determining fair value, the Company applies the market approach, which uses prices and other relevant data based on market transactions involving identical or comparable

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

assets and liabilities. The inputs to valuation techniques used to measure fair value are prioritized into a three-level hierarchy. The hierarchy gives the highest priority to quoted prices from sources independent of the reporting entity ("observable inputs") and the lowest priority to prices determined by the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances ("unobservable inputs"). The fair value hierarchy is as follows:

Level 1—Valuations that are based on quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2—Valuations that are based on observable inputs (other than Level 1 prices) such as quoted prices for similar assets or liabilities at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3—Unobservable inputs that are supported by little or no market activity. The unobservable inputs represent the Company's best assumption of how market participants would price the assets or liabilities.

The following tables present the Company's assets and liabilities measured at fair value on a recurring basis, classified by the valuation hierarchy as of March 31, 2018 and December 31, 2017 (dollars in thousands):

	March 31, 2018 Fair Value Measurements Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Debt Securities:				
U.S. Government	$15,678	$—	$15,678	$ —
State and local government	16,552	—	16,552	—
Corporate debt	38,247	—	38,247	—
Asset-backed securities	25,258	—	25,258	—
Mortgage-backed securities	32,761	—	32,761	—
Commercial mortgage-backed securities	3,850	—	3,850	—
Collateralized mortgage obligations	2,365	—	2,365	—
Total debt securities	134,711	—	134,711	—
Equity Securities	5,327	5,082	245	—
Short-term investments	2,505	2,505	—	—
Total marketable investments measured at fair value	$142,543	$7,587	$134,956	$ —
Investments measured at NAV:				
Investment in limited partnership	$4,098			
Total investments measured at NAV	$4,098			
Total assets measured at fair value	146,641			

Liabilities:				
Debt *	$29,804	$—	$—	$ 29,804
Total Liabilities measured at fair value	$29,804	$—	$—	$ 29,804

* Carried at cost or amortized cost on the consolidated balance sheet

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CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

	December 31, 2017 Fair Value Measurements Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Debt Securities:				
U.S. Government	$17,090	$—	$ 17,090	$ —
State and local government	17,503	—	17,503	—
Corporate debt	38,908	—	38,908	—
Asset-backed securities	23,540	—	23,540	—
Mortgage-backed securities	33,458	—	33,458	—
Commercial mortgage-backed securities	3,491	—	3,491	—
Collateralized mortgage obligations	2,546	—	2,546	—
Total debt securities	136,536	—	136,536	—
Equity Securities	5,627	5,381	246	—
Short-term investments	11,427	8,429	2,998	—
Total assets measured at fair value	$153,590	$13,810	$ 139,780	$ —
Investments measured at NAV:				
Investment in limited partnership	$4,060			
Total investments measured at NAV	$4,060			
Total assets measured at fair value	$157,650			
Liabilities:				
Debt *	$29,888	$—	$—	$ 29,888
Total Liabilities measured at fair value	$29,888	$—	$—	$ 29,888

* Carried at cost or amortized cost on the consolidated balance sheet

Level 1 investments consist of equity securities traded in an active exchange market. The Company uses unadjusted quoted prices for identical instruments to measure fair value. Level 1 also includes money market funds and other interest-bearing deposits at banks, which are reported as short-term investments. The fair value measurements that were based on Level 1 inputs comprise 5.2% of the fair value of the total investment portfolio as of March 31, 2018.

Level 2 investments include debt securities, which consist of U.S. government agency securities, state and local municipal bonds (including those held as restricted securities), corporate debt securities, mortgage-backed and asset-backed securities. The fair value of securities included in the Level 2 category were based on the market values obtained from a third party pricing service that were evaluated using pricing models that vary by asset class and incorporate available trade, bid and other observable market information. The third party pricing service monitors market indicators, as well as industry and economic events. The fair value measurements that were based on Level 2 inputs comprise 92.0% of the fair value of the total investment portfolio as of March 31, 2018.

The Company obtains pricing for each security from independent pricing services, investment managers or consultants to assist in determining fair value for its Level 2 investments. To validate that these quoted prices are reasonable estimates of fair value, the Company performs various quantitative and qualitative procedures, such as (i) evaluation of the underlying methodologies, (ii) analysis of recent sales activity, (iii) analytical review of our fair values against current market prices and (iv) comparison of the pricing services' fair value to other pricing services' fair value for the same investment. No markets for the investments were determined to be inactive at period-ends. Based on these procedures, the Company did not adjust the prices or quotes provided from independent pricing services, investment managers or consultants.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

As of March 31, 2018, Level 3 is entirely comprised of the Company's subordinated debt. In determining the fair value of the subordinated debt outstanding at March 31, 2018, the security attributes (issue date, maturity, coupon, calls, etc.) and market rates on September 29, 2017 (the date of issuance) were fed into a valuation model. A lognormal trinomial interest rate lattice was created within the model to compute the option adjusted spread (“OAS”) which is the amount, in basis points, of interest rate required to be paid under the debt agreement over the risk-free U.S. Treasury rates. The OAS was then fed back into the model along with the March 31, 2018, U.S. Treasury rates. A new lattice was generated and the fair value was computed from the OAS. There were no changes in assumptions of credit risk from the issuance date.

The Company’s policy on recognizing transfers between hierarchy levels is applied at the end of each reporting period. There were no transfers between Levels 1, 2 and 3 for the three months ended March 31, 2018 and 2017, respectively.

4. Deferred Policy Acquisition Costs

The Company defers costs incurred which are incremental and directly related to the successful acquisition of new or renewal insurance business, net of corresponding amounts of ceded reinsurance commissions. Net deferred policy acquisition costs are amortized and charged to expense in proportion to premium earned over the estimated policy term. The Company anticipates that its deferred policy acquisition costs will be fully recoverable and there were no premium deficiencies for the