

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

National General Holdings Corp.

Form 10-K

February 25, 2019

false--12-31FY20182018-12-3110-K0001578735112952595YesfalseLarge Accelerated Filer1569279980National General Holdings Corp.falsefalseNoYesNGHC0000.3750.500.45P3DP12MP6M0.25225395000265763000140057000882700069874000772000 0001578735 2018-01-01 2018-12-31 0001578735 2018-06-30 0001578735 2019-02-20 0001578735 2017-12-31 0001578735 2018-12-31 0001578735 srt:AffiliatedEntityMember 2017-12-31 0001578735 srt:AffiliatedEntityMember 2018-12-31 0001578735 us-gaap:VariableInterestEntityPrimaryBeneficiaryMember 2017-12-31 0001578735 us-gaap:VariableInterestEntityPrimaryBeneficiaryMember 2018-12-31 0001578735 2017-01-01 2017-12-31 0001578735 2016-01-01 2016-12-31 0001578735 us-gaap:CommonStockMember 2018-01-01 2018-12-31 0001578735 us-gaap:NoncontrollingInterestMember 2018-01-01 2018-12-31 0001578735 us-gaap:NoncontrollingInterestMember 2017-12-31 0001578735 us-gaap:RetainedEarningsMember 2017-12-31 0001578735 us-gaap:SeriesDPreferredStockMember us-gaap:AdditionalPaidInCapitalMember 2018-01-01 2018-12-31 0001578735 us-gaap:CommonStockMember 2017-12-31 0001578735 us-gaap:CommonStockMember 2018-12-31 0001578735 us-gaap:RetainedEarningsMember 2018-12-31 0001578735 us-gaap:PreferredStockMember 2017-12-31 0001578735 us-gaap:NoncontrollingInterestMember 2018-12-31 0001578735 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2018-12-31 0001578735 us-gaap:SeriesDPreferredStockMember us-gaap:PreferredStockMember 2018-01-01 2018-12-31 0001578735 us-gaap:AdditionalPaidInCapitalMember 2018-01-01 2018-12-31 0001578735 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2017-12-31 0001578735 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2018-01-01 2018-12-31 0001578735 us-gaap:SeriesDPreferredStockMember 2018-01-01 2018-12-31 0001578735 us-gaap:AdditionalPaidInCapitalMember 2017-12-31 0001578735 us-gaap:PreferredStockMember 2018-12-31 0001578735 us-gaap:RetainedEarningsMember 2018-01-01 2018-12-31 0001578735 us-gaap:AdditionalPaidInCapitalMember 2018-12-31 0001578735 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2017-01-01 2017-12-31 0001578735 us-gaap:SeriesCPreferredStockMember 2016-01-01 2016-12-31 0001578735 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2016-01-01 2016-12-31 0001578735 us-gaap:SeriesCPreferredStockMember us-gaap:PreferredStockMember 2016-01-01 2016-12-31 0001578735 us-gaap:RetainedEarningsMember 2017-01-01 2017-12-31 0001578735 us-gaap:AdditionalPaidInCapitalMember 2016-01-01 2016-12-31 0001578735 us-gaap:AdditionalPaidInCapitalMember 2016-12-31 0001578735 us-gaap:AdditionalPaidInCapitalMember 2017-01-01 2017-12-31 0001578735 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2015-12-31 0001578735 us-gaap:RetainedEarningsMember 2016-01-01 2016-12-31 0001578735 2016-12-31 0001578735 us-gaap:CommonStockMember 2017-01-01 2017-12-31 0001578735 us-gaap:CommonStockMember 2016-01-01 2016-12-31 0001578735 us-gaap:NoncontrollingInterestMember 2016-01-01 2016-12-31 0001578735 us-gaap:NoncontrollingInterestMember 2017-01-01 2017-12-31 0001578735 us-gaap:PreferredStockMember 2016-12-31 0001578735 us-gaap:CommonStockMember 2016-12-31 0001578735 us-gaap:CommonStockMember 2015-12-31 0001578735 us-gaap:SeriesCPreferredStockMember us-gaap:AdditionalPaidInCapitalMember 2016-01-01 2016-12-31 0001578735 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2016-12-31 0001578735 us-gaap:RetainedEarningsMember 2016-12-31 0001578735 us-gaap:PreferredStockMember 2015-12-31 0001578735 us-gaap:NoncontrollingInterestMember 2016-12-31 0001578735 us-gaap:NoncontrollingInterestMember 2015-12-31 0001578735 us-gaap:AdditionalPaidInCapitalMember 2015-12-31 0001578735 us-gaap:RetainedEarningsMember 2015-12-31 0001578735 2015-12-31 0001578735 us-gaap:PreferredStockMember 2018-01-01 2018-12-31 0001578735 us-gaap:PreferredStockMember 2016-01-01 2016-12-31 0001578735 us-gaap:PreferredStockMember 2017-01-01 2017-12-31 0001578735 nghc:CommissionrevenueMember 2018-01-01 2018-12-31 0001578735 us-gaap:AccountingStandardsUpdate201409Member 2018-01-01 2018-12-31 0001578735 nghc:FinancingandprocessingfeesMember 2017-01-01 2017-12-31 0001578735 nghc:CommissionrevenueMember us-gaap:PropertyLiabilityAndCasualtyInsuranceSegmentMember 2017-01-01 2017-12-31 0001578735 nghc:GrouphealthadministrativefeesMember 2017-01-01 2017-12-31 0001578735

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us-gaap:PropertyLiabilityAndCasualtyInsuranceSegmentMember 2017-12-31 0001578735  
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us-gaap:AccidentAndHealthInsuranceSegmentMember 2015-12-31 0001578735  
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us-gaap:VariableInterestEntityPrimaryBeneficiaryMember 2010-12-31 0001578735  
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[illegible]

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[illegible]

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us-gaap:ShortDurationInsuranceContractsAccidentYear2018Member 2018-01-01 2018-12-31 0001578735  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

### FORM 10-K

☒ 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

☐ 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

Depository Shares, each Representing 1/40th of a Share of 7.50% Non-Cumulative Preferred Stock, Series B

The Nasdaq Stock Market LLC

Depository 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 ☐ No ☒

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 ☐ No ☒

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

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

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

Large Accelerated Filer ☒ Accelerated Filer ☐

Non-Accelerated Filer ☐ Smaller Reporting Company ☐

Emerging Growth Company ☐

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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 Act). Yes ☐ No ☒

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.

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**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	
	<i>(amounts in thousands, except percentages)</i>					
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.



## 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.



### *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](http://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](http://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.



***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 cyclicity 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	
<b>Selected Income Statement Data<sup>(1)</sup></b>	<i>(amounts in thousands, except percentages and per share data)</i>					
Gross premium written	\$ 5,416,839	\$ 4,755,985	\$ 3,500,898	\$ 2,590,044	\$ 2,135,107	
Ceded premiums <sup>(2)</sup>	(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 <sup>(3)</sup>	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 <sup>(4)</sup>	735,266	672,429	497,007	406,662	315,089	
General and administrative expenses <sup>(5)</sup>	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	
<b>Per common share data:</b>						
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	
<b>Insurance Ratios</b>						
Net loss ratio <sup>(6)</sup>	71.3	% 71.9	% 69.9	% 69.7	% 68.9	%
Net operating expense ratio (non-GAAP) <sup>(7)(8)</sup>	23.5	% 26.4	% 26.0	% 24.2	% 25.6	%
Net combined ratio (non-GAAP) <sup>(7)(8)(9)</sup>	94.8	% 98.3	% 95.9	% 93.9	% 94.5	%
<b>Insurance Ratios Before Amortization and Impairment (non-GAAP)</b>						

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Net operating expense ratio before amortization and impairment (non-GAAP) <sup>(10)</sup>	22.7	%	24.7	%	23.6	%	22.4	%	23.7	%
Net combined ratio before amortization and impairment (non-GAAP) <sup>(10)(11)</sup>	94.0	%	96.6	%	93.5	%	92.1	%	92.6	%

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	As of December 31,				
	2018	2017	2016	2015	2014
<b>Selected Balance Sheet Data</b>	<i>(amounts in thousands)</i>				
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.  
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.  
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.
- (5) Net loss ratio is calculated by dividing the loss and loss adjustment expense by net earned premiums.  
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."
- (7) 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
<i>(amounts in thousands)</i>								
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

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	Year Ended December 31,					
	2018			2017		
	Reciprocal NGHC Exchanges	Eliminations	Total	Reciprocal NGHC Exchanges	Eliminations	Total
<i>Underwriting ratios:</i>	<i>(amounts in thousands, except percentages)</i>					
Net loss ratio	<del>70.3</del> 71.1	—%	<del>71.3</del> 71.3	<del>71.9</del> 71.5	—%	<del>71.9</del> 71.9
Net operating expense ratio (non-GAAP)	<del>23.9</del> 23.9	—%	<del>23.5</del> 23.5	<del>25.9</del> 25.4	—%	<del>26.4</del> 26.4
Net combined ratio (non-GAAP)	<del>93.1</del> 95.0	—%	<del>94.8</del> 94.8	97.8		