

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**FOR THE QUARTERLY PERIOD ENDED March 31, 2015  
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 0-2500111

Federated National Holding Company  
(Exact name of registrant as specified in its charter)

**Florida**

(State or Other Jurisdiction of  
Incorporation or Organization)

**65-0248866**

(IRS Employer  
Identification Number)

14050 N.W. 14<sup>th</sup> Street, Suite 180, Sunrise, Florida 33323  
(Address of principal executive offices) (Zip Code)

800-293-2532  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant has electronically submitted and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted 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 and post such files).

Yes [X] No [ ]

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

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ] Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$.01 par value -14,172,923 outstanding as of May 3, 2015

**FEDERATED NATIONAL HOLDING COMPANY**

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**PART I: FINANCIAL INFORMATION**  
**Item 1 Financial Statements**

FEDERATED NATIONAL HOLDING COMPANY  
CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)

	<u>Period Ending</u>	
	<u>March 31, 2015</u>	<u>December 31, 2014</u>
ASSETS	(Dollars in Thousands)	
Investments		
Debt maturities, available for sale, at fair value	\$ 288,193	\$ 284,099
Debt maturities, held to maturity, at amortized cost	7,462	7,417
Equity securities, available for sale, at fair value	<u>40,726</u>	<u>39,247</u>
Total investments	336,381	330,763
Cash and short term investments	88,163	40,157
Prepaid reinsurance premiums	46,039	54,502
Premiums receivable, net of allowance for credit losses of \$148 and \$148, respectively	29,809	27,275
Reinsurance recoverable, net	13,034	12,534
Deferred policy acquisition costs	15,765	13,610
Income taxes receivable	2,090	1,810
Property, plant and equipment, net	1,720	1,749
Other assets	8,265	7,231
Contingent quota-share profit sharing	<u>14,000</u>	<u>14,000</u>
Total assets	<u>\$ 555,266</u>	<u>\$ 503,631</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Unpaid losses and LAE	\$ 84,475	\$ 78,330
Unearned premiums	203,433	192,424
Debt	5,000	-
Premiums deposits and customer credit balances	11,291	7,381
Deferred income taxes, net	1,897	1,341
Claims payments outstanding	9,653	10,152
Accounts payable and accrued expenses	8,967	10,924
Deferred quota-share profit sharing	<u>8,750</u>	<u>10,500</u>
Total liabilities	<u>333,466</u>	<u>311,052</u>
Shareholders' equity:		
Common stock, \$0.01 par value. Authorized 25,000,000 shares; issued and outstanding 13,701,122 and 13,632,414, respectively	137	136
Preferred stock, \$0.01 par value. Authorized 1,000,000 shares; none issued or outstanding	-	-
Additional paid-in capital	128,611	127,302
Accumulated other comprehensive income		
Unrealized net gains on investments, available for sale	8,925	7,718
Total accumulated other comprehensive income	<u>8,925</u>	<u>7,718</u>
Retained earnings	<u>66,140</u>	<u>57,423</u>
Total Federated National Holding Company equity	203,813	192,579
Non-controlling interest	<u>17,987</u>	<u>-</u>
Total shareholders' equity	<u>221,800</u>	<u>192,579</u>
Total liabilities and shareholders' equity	<u>\$ 555,266</u>	<u>\$ 503,631</u>

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FEDERATED NATIONAL HOLDING COMPANY  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

	<u>Three Months Ended March 31,</u>	
	<u>2015</u>	<u>2014</u>
	(Dollars in Thousands)	
Revenue:		
Gross premiums written	\$ 106,702	\$ 81,102
Gross premiums ceded	<u>(25,958)</u>	<u>(3,306)</u>
Net premiums written	<u>80,744</u>	<u>77,796</u>
Decrease in prepaid reinsurance premiums	(24,949)	(16,795)
Increase in unearned premiums	<u>(11,009)</u>	<u>(16,997)</u>
Net change in prepaid reinsurance premiums and unearned premiums	<u>(35,958)</u>	<u>(33,792)</u>
Net premiums earned	44,786	44,004
Commission income	1,126	954
Finance revenue	427	311
Direct written policy fees	2,492	1,827
Net investment income	1,546	1,007
Net realized investment gains	1,704	1,331
Other income	1,378	281
Quota-share profit sharing, net	<u>1,477</u>	<u>-</u>
Total revenue	<u>54,936</u>	<u>49,715</u>
Expenses:		
Losses and LAE	23,949	20,828
Operating and underwriting expenses	6,322	3,667
Salaries and wages	5,137	3,050
Amortization of deferred policy acquisition costs	<u>5,044</u>	<u>8,442</u>
Total expenses	40,452	35,987
Income before provision for income tax expense	14,484	13,728
Provision for income tax expense	<u>5,711</u>	<u>5,305</u>
Income before non-controlling interest	8,773	8,423
Non-controlling interest	(511)	-
Net income attributable to Federated National Holding Company common stockholders	<u>\$ 9,284</u>	<u>\$ 8,423</u>
Net income per share - basic	<u>\$ 0.68</u>	<u>\$ 0.77</u>
Net income per share - diluted	<u>\$ 0.66</u>	<u>\$ 0.74</u>
Weighted average number of common shares outstanding - basic	<u>13,656,190</u>	<u>10,948,646</u>
Weighted average number of common shares outstanding - diluted	<u>13,976,131</u>	<u>11,317,458</u>
Dividends paid per share	<u>\$ 0.04</u>	<u>\$ 0.03</u>

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FEDERATED NATIONAL HOLDING COMPANY  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(UNAUDITED)

Three Months Ended March 31,

2015                      2014

(Dollars in Thousands)

Net income	\$	9,284	\$	8,423
Change in net unrealized gains on investments available for sale		<u>1,965</u>		<u>880</u>
Comprehensive income before tax		11,249		9,303
Income tax expense related to items of other comprehensive income		<u>(758)</u>		<u>(430)</u>
Comprehensive income	\$	<u>10,491</u>	\$	<u>8,873</u>

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FEDERATED NATIONAL HOLDING COMPANY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	<u>Three Months Ended March 31,</u>	
	<u>2015</u>	<u>2014</u>
	(Dollars in Thousands)	
Cash flow from operating activities:		
Net income	\$ 9,284	\$ 8,423
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premium or discount, net	1,253	844
Depreciation and amortization of property plant and equipment, net	152	76
Net realized investment gains	(1,704)	(1,331)
Non-cash compensation	999	134
Changes in operating assets and liabilities:		
Premiums receivable	(2,535)	(1,537)
Prepaid reinsurance premiums	8,463	6,755
Reinsurance recoverable, net	(500)	33
Income taxes recoverable	(280)	-
Deferred income tax expense, net of other comprehensive income	(202)	(574)
Policy acquisition costs, net of amortization	(2,156)	(1,757)
Other assets	(1,034)	(970)
Contingent quota-share profit sharing	(1,750)	-
Unpaid losses and LAE	6,145	1,538
Unearned premiums	11,009	16,997
Debt	5,000	-
Premium deposits and customer credit balances	3,911	3,383
Income taxes payable	-	1,978
Claims payments outstanding	(499)	(991)
Accounts payable and accrued expenses	(1,957)	(383)
Net cash provided by operating activities	<u>33,599</u>	<u>32,618</u>
Cash flow used by investing activities:		
Proceeds from sale of investment securities	56,264	20,946
Purchases of investment securities available for sale	(59,466)	(44,387)
Purchases of property and equipment	(122)	(218)
Net cash used by investing activities	<u>(3,324)</u>	<u>(23,659)</u>
Cash flow provided by financing activities:		
Exercised stock options	\$ 27	\$ 353
Dividends paid	(566)	(341)
Non-controlling interest	17,987	-
Tax benefit related to non-cash compensation	283	72
Net cash provided by financing activities	<u>17,731</u>	<u>84</u>
Net increase in cash and short term investments	48,006	9,043
Cash and short term investments at beginning of period	40,157	41,446
Cash and short term investments at end of period	<u>\$ 88,163</u>	<u>\$ 50,489</u>

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FEDERATED NATIONAL HOLDING COMPANY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

(continued)

Three Months Ended March 31,

2015                      2014

(Dollars in Thousands)

Supplemental disclosure of cash flow information:

Cash paid during the period for:

Income taxes

\$ 5,662                      \$ 3,885

Non-cash investing and finance activities:

Accrued dividends payable

\$ 567                              \$ 336

**SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Federated National Holding Company**  
**Notes to Condensed Consolidated Financial Statements**

**(1) Organization and Business**

In this Quarterly Report on Form 10-Q, “FNHC” and the terms “Company”, “we”, “us” and “our” refer to Federated National Holding Company and its subsidiaries, unless the context indicates otherwise. We changed our name on September 11, 2012, pursuant to approval received at our annual shareholders’ meeting, from 21st Century Holding Company so that our parent company and other subsidiary companies’ names are consistent with our primary insurance subsidiary and the name under which we have been writing insurance for more than 23 years.

FNHC is an insurance holding company that controls substantially all steps in the insurance underwriting, distribution and claims processes through our subsidiaries and our contractual relationships with our independent agents and general agents.

We are authorized to underwrite, and/or place through our wholly owned subsidiaries, homeowners’ multi-peril (“homeowners”), commercial general liability, federal flood, personal auto and various other lines of insurance in Florida and various other states. We market and distribute our own and third-party insurers’ products and our other services through a network of independent agents.

Our wholly owned insurance subsidiary is Federated National Insurance Company (“FNIC”). FNIC is licensed as an admitted carrier in Florida. An admitted carrier is an insurance company that has received a license from the state department of insurance giving the company the authority to write specific lines of insurance in that state. These companies are also bound by rate and form regulations, and are strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud. Admitted carriers are also required to financially contribute to the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders. Through contractual relationships with a network of approximately 3,800 independent agents, of which approximately 2,300 actively sell and service our products, FNIC is authorized to underwrite homeowners’, commercial general liability, fire, allied lines, and personal automobile insurance in Florida. FNIC is licensed as an admitted carrier in Alabama, Louisiana, Georgia, and Texas and underwrites commercial general liability insurance in those states. FNIC also underwrites homeowners’ insurance in Alabama and Louisiana and just became admitted in South Carolina to underwrite homeowners insurance. Additionally, we underwrite personal automobile insurance in Georgia and Texas.

FNIC is licensed as a non-admitted carrier in Missouri and Nevada and can underwrite commercial general liability insurance in these states. Currently, we do not have any operations in these states. A non-admitted carrier, sometimes referred to as an “excess and surplus lines” carrier, is permitted to do business in a state and, although it is strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud, non-admitted carriers are subject to considerably less regulation with respect to policy rates and forms. Non-admitted carriers are not required to financially contribute to and benefit from the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders.

The Company has entered into a joint venture to organize Monarch National Insurance Company, which received its certificate of authority to write homeowners’ property and casualty insurance in Florida from the Florida Office of Insurance Regulation (the “Florida OIR”) on March 19, 2015. The Company’s joint venture partners are a majority-owned limited partnership of Crosswinds Holdings Inc., f/k/a C.A. Bancorp Inc., a publicly traded Canadian private equity firm and asset manager; and Transatlantic Reinsurance Company. For more information regarding the organization of Monarch National Insurance Company, please see Note 11, Subsequent Events.

We previously entered into a Coexistence Agreement effective August 30, 2013 (the “Coexistence Agreement”) with Federated Mutual Insurance Company (“Federated Mutual”) pursuant to which, among other things, we may continue to use “Federated” until at least August 30, 2020, after which time we have agreed to either cease using “Federated” in commerce or otherwise adopt and use trade names that are not confusingly similar to Federated Mutual’s trademarks. We continue to develop our brand under the “FedNat” name, which is the name by which agents generally know us.

As of September 30, 2014, we had satisfied all applicable conditions of the Consent Order we entered into in January 2011 (the “Consent Order”) with the Florida Office of Insurance Regulation (“Florida OIR”). We entered into the Consent Order in connection with the merger of our one of our wholly owned insurance



**Federated National Holding Company**  
**Notes to Condensed Consolidated Financial Statements**

subsidiaries, American Vehicle Insurance Company (“American Vehicle”), into FNIC, with FNIC continuing the operations of both entities. As of the date of this Report, the only operational restriction that remains in effect is a requirement to obtain OIR approval prior to writing commercial multi-peril business or any new commercial property business, including condo associations, under any other line of business for which FNIC is authorized. FNIC currently has no commercial multi-peril policy premium in-force and the current commercial habitation book of business is fully earned. The Consent Order required us to, among other things, limit the number of policies that we write in the Tri-County area and imposed certain other operational requirements on us, all of which we have complied with.

During the three months ended March 31, 2015, 91.7%, 3.7%, 1.4% and 3.2% of the premiums we underwrote were for homeowners’, commercial general liability, federal flood, and automobile insurance, respectively. During the three months ended March 31, 2015, \$19.7 million or 20.1% of the \$97.8 million of the homeowners’ premiums we underwrote were produced under an agency agreement with Ivantage Select Agency, Inc. (“ISA”), an affiliate of Allstate Insurance Company, that grants Allstate agents the authority to offer certain FNIC products. The \$19.7 million of homeowners’ premiums produced under this agreement with ISA represents 82.6% of the total increase in the sale of homeowners’ policies during the three months ended March 31, 2015. During the three months ended March 31, 2014, \$11.6 million or 15.7% of the \$74.0 million of the homeowners’ premiums we underwrote were produced under an agency agreement with ISA. This network of agents began writing for FNIC in March 2013. During the three months ended March 31, 2014, 91.2%, 3.9%, 1.9% and 3.0% of the premiums we underwrote were for homeowners’, commercial general liability, federal flood, and automobile insurance, respectively.

Our business, results of operations and financial condition are subject to fluctuations due to a variety of factors. Abnormally high severity or frequency of claims in any period could have a material adverse effect on us. When our estimated liabilities for unpaid losses and loss adjustment expenses (“LAE”) are less than the actuarially determined amounts, we increase the expense in the current period. Conversely, when our estimated liabilities for unpaid losses and LAE are greater than the actuarially determined amounts, we decrease the expense in the current period.

We are focusing our marketing efforts on continuing to expand our distribution network while maintaining our commitment to long-term relationships. We market our products and services throughout Florida and in other states by establishing relationships with additional independent agents and general agents. There can be no assurance, however, that we will be able to obtain the required regulatory approvals to offer additional insurance products or expand into other states.

FedNat Underwriters, Inc. (“FNU”), formerly known as Assurance Managing General Agents, Inc., a wholly owned subsidiary of the Company, acts as FNIC’s exclusive managing general agent in Florida and is also licensed as a managing general agent in the States of Alabama, Georgia, Louisiana, Mississippi, Nevada, South Carolina and Texas. FNU has contracted with other unaffiliated insurance companies to sell personal umbrella through FNU’s existing network of agents.

FNU earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. FNU earns a per policy fee which ranges from \$25 to \$55 and a commission fee from its affiliate, FNIC, which totaled 4% during the three months ended March 31, 2015. The Florida OIR periodically reviews our managing general agent’s fee structure to ensure that it is neither excessive nor inadequate to operate.

We internally process claims made by our insureds through our wholly owned claims adjusting company, Federated National Adjusting, Inc. (“FNA”), formerly known as Superior Adjusting, Inc. Our agents have no authority to settle claims or otherwise exercise control over the claims process. Furthermore, we believe that the retention of independent adjusters, in addition to the employment of salaried claims personnel, results in reduced ultimate loss payments, lower LAE and improved customer service for our claimants and policyholders. We also employ an in-house litigation management team to cost effectively manage claims-related litigation and to monitor our claims handling practices for efficiency and regulatory compliance.

**Federated National Holding Company**  
**Notes to Condensed Consolidated Financial Statements**

During 2014, the Florida OIR approved an application to allow the claims administration operations of FNA to be assumed by FNU. Under the amended managing general agency agreement between FNU and FNIC, FNU will provide the same claims administration services under the same fee structure. The combination of these services in FNU had no effect on consolidated net income.

Insure-Link, Inc. (“Insure-Link”) is our independent insurance agency. The insurance agency markets direct to the public to provide a variety of insurance products and services to individual clients, as well as business clients, by offering a full line of insurance products including, but not limited to, homeowners’, flood, personal and commercial automobile, commercial general liability and workers’ compensation insurance through their agency appointments with over forty different carriers.

**(2) Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements for the Company and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America referred to as Generally Accepted Accounting Principles (“GAAP”) for interim financial information, and the Securities and Exchange Commission (“SEC”) rules for interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of management, the accompanying financial statements reflect all normal recurring adjustments necessary to present fairly the Company’s financial position as of March 31, 2015 and the results of operations and cash flows for the periods presented.

The results of operations for the interim periods presented are not necessarily indicative of the results of operations to be expected for any subsequent interim period or for the fiscal year ending December 31, 2015. The accompanying unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2014 included in the Company’s Form 10-K, which was filed with the SEC on March 16, 2015.

In preparing the interim unaudited condensed consolidated financial statements, management was required to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the financial reporting date and throughout the periods being reported upon. Certain of the estimates result from judgments that can be subjective and complex and consequently actual results may differ from these estimates.

Material estimates that are particularly susceptible to significant changes in the near-term relate to the determination of loss and LAE, ceded reinsurance balances payable, the recoverability of Deferred Policy Acquisition Costs (“DPAC”), the determination of federal income taxes, and the net realizable value of reinsurance recoverables. Although considerable variability is inherent in these estimates, management believes that the amounts provided are reasonable. These estimates are continually reviewed and adjusted as necessary. Such adjustments are reflected in current operations.

All significant intercompany balances and transactions have been eliminated. No material reclassifications have been made to the prior-period balances to conform to the current-period presentation.

**(3) Summary of Significant Accounting Policies and Practices**

**(A) Critical Accounting Policies**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

**Federated National Holding Company**  
**Notes to Condensed Consolidated Financial Statements**

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with management's evaluation of the determination of (i) liability for unpaid losses and LAE, (ii) the amount and recoverability of amortization of DPAC, and (iii) estimates for our reserves with respect to finance contracts, premiums receivable and deferred income taxes. Various assumptions and other factors underlie the determination of these significant estimates, which are described in greater detail in Footnote 2 of the Company's audited consolidated financial statements for the fiscal year ended December 31, 2014, which we included in the Company's Annual Report on Form 10-K which was filed with the SEC on March 16, 2015.

We believe that there were no significant changes in those critical accounting policies and estimates during the first three months of fiscal 2015. Senior management has reviewed the development and selection of our critical accounting policies and estimates and their disclosure in this Form 10-Q with the Audit Committee of our Board of Directors.

The process of determining significant estimates is fact-specific and takes into account factors such as historical experience, current and expected economic conditions, and in the case of unpaid losses and LAE, an actuarial valuation. Management regularly reevaluates these significant factors and makes adjustments where facts and circumstances dictate. In selecting the best estimate, we utilize various actuarial methodologies. Each of these methodologies is designed to forecast the number of claims we will be called upon to pay and the amounts we will pay on average to settle those claims. In arriving at our best estimate, our actuaries consider the likely predictive value of the various loss development methodologies employed in light of underwriting practices, premium rate changes and claim settlement practices that may have occurred, and weight the credibility of each methodology. Our actuarial methodologies take into account various factors, including, but not limited to, paid losses, liability estimates for reported losses, paid allocated LAE, salvage and other recoveries received, reported claim counts, open claim counts and counts for claims closed with and without payment for loss.

Accounting for loss contingencies pursuant to Financial Accounting Standards Board ("FASB") issued guidance involves the existence of a condition, situation or set of circumstances involving uncertainty as to possible loss that will ultimately be resolved when one or more future event(s) occur or fail to occur. Additionally, accounting for a loss contingency requires management to assess each event as probable, reasonably possible or remote. Probable is defined as the future event or events are likely to occur. Reasonably possible is defined as the chance of the future event or events occurring is more than remote but less than probable, while remote is defined as the chance of the future event or events occurring is slight. An estimated loss in connection with a loss contingency shall be recorded by a charge to current operations if both of the following conditions are met: First, the amount can be reasonably estimated, and second, the information available prior to issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability.

We are required to review the contractual terms of all our reinsurance purchases to ensure compliance with FASB issued guidance. The guidance establishes the conditions required for a contract with a reinsurer to be accounted for as reinsurance and prescribes accounting and reporting standards for those contracts. Contracts that do not result in the reasonable possibility that the reinsurer may realize a significant loss from the insurance risk assumed generally do not meet the conditions for reinsurance accounting and must be accounted for as deposits. The guidance also requires us to disclose the nature, purpose and effect of reinsurance transactions, including the premium amounts associated with reinsurance assumed and ceded. It also requires disclosure of concentrations of credit risk associated with reinsurance receivables and prepaid reinsurance premiums.

FASB issued guidance addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. We account for our investment securities consistent with FASB issued guidance that requires our securities to be classified into one of three categories: (i) held-to-maturity, (ii) trading securities or (iii) available-for-sale.

Investments classified as held-to-maturity include debt securities wherein the Company's intent and ability are to hold the investment until maturity and are carried at amortized cost without consideration to unrealized gains or losses. Investments classified as trading securities include debt and equity securities bought and held primarily for sale in the near term and are carried at fair value with unrealized holding gains and losses included in current period

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**Notes to Condensed Consolidated Financial Statements**

operations. Investments classified as available-for-sale include debt and equity securities that are not classified as held-to-maturity or as trading security investments and are carried at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income."

A decline in the fair value of an available-for-sale security below cost that is deemed other-than-temporary results in a charge to income, resulting in the establishment of a new cost basis for the security. Premiums and discounts are amortized or accreted, respectively, over the life of the related debt security as an adjustment to yield using a method that approximates the effective interest method. Dividends and interest income are recognized when earned. Realized gains and losses are included in earnings and are derived using the specific-identification method for determining the cost of securities sold.

Financial instruments, which potentially expose us to concentrations of credit risk, consist primarily of investments, premiums receivable, amounts due from reinsurers on paid and unpaid losses and finance contracts. We have not experienced significant losses related to premiums receivable from individual policyholders or groups of policyholders in a particular industry or geographic area. We believe no credit risk beyond the amounts provided for collection losses is inherent in our premiums receivable or finance contracts. In order to reduce credit risk for amounts due from reinsurers, we seek to do business with financially sound reinsurance companies and regularly review the financial strength of all reinsurers used. Additionally, our credit risk in connection with our reinsurers is frequently mitigated by the establishment of irrevocable clean letters of credit in favor of FNIC.

The fair value of our investments is estimated based on prices published by financial services or quotations received from securities dealers and is reflective of the interest rate environment that existed as of the close of business on March 31, 2015 and December 31, 2014. Changes in interest rates subsequent to March 31, 2015 and December 31, 2014 may affect the fair value of our investments.

The carrying amounts for the following financial instrument categories approximate their fair values at March 31, 2015 and December 31, 2014 because of their short-term nature: cash and short-term investments, premiums receivable, finance contracts, due from reinsurers, revolving credit outstanding, claims payments outstanding, accounts payable and accrued expenses.

**(B) Impact of New Accounting Pronouncements**

In April 2015, the FASB issued Accounting Standard Update ("ASU") 2015-05, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement ("ASU 2015-05"). ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015, and, earlier adoption is permitted. The adoption of the amendments in this ASU will not have a material impact on our financial position, results of operations or cash flows.

In February 2015, the FASB issued Accounting Standard Update ("ASU") 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis ("ASU 2015-02"). ASU 2015-02 amends the consolidation requirements and significantly changes the consolidation analysis required. The amendments in this ASU affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments: (i) modify the evaluation of whether limited partnership and similar legal entities are VIEs, (ii) eliminate the presumption that a general partner should consolidate a limited partnership, (iii) affect the consolidation analysis of reporting entities that are involved with VIEs particularly those that have fee arrangements and related party relationships, and (iv) provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Act of 1940 for registered money market funds. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015, and, earlier adoption is

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permitted. The adoption of the amendments in this ASU will not have a material impact on our financial position, results of operations or cash flows.

In June 2014, the FASB issued Accounting Standard Update (“ASU”) No. 2014-12: *Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*, a consensus of the FASB Emerging Issues Task Force. The amendments in this ASU apply to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. That is the case when an employee is eligible to retire or otherwise terminate employment before the end of the period in which a performance target (for example, an initial public offering or a profitability target) could be achieved and still be eligible to vest in the award if and when the performance target is achieved. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Current U.S. GAAP does not contain explicit guidance on whether to treat a performance target that could be achieved after the requisite service period as a performance condition that affects vesting or as a non-vesting condition that affects the grant-date fair value of an award. The amendments in this ASU provide explicit guidance for those awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015, and, earlier adoption is permitted. The adoption of the amendments in this ASU will not have a material impact on our financial position, results of operations or cash flows.

In July 2013, the FASB issued Accounting Standard Update (“ASU”) No. 2013-11: *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. Topic 740, *Income Taxes*, does not include explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists, and there is diversity in practice in the presentation of unrecognized tax benefit in those instances. The objective of the amendments in this ASU is to eliminate that diversity in practice. The ASU applies to all entities that have unrecognized tax benefits when a net operating loss carry forward, a similar tax loss, or a tax credit carryforward exists at the operating date. The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 and early adoption is permitted. The amendments in this ASU should be applied prospectively to all unrecognized tax benefits that exist at the effective date and retrospective application is permitted. The adoption of the amendments in this ASU did not have a material impact on our financial condition, results of operations or cash flows.

In February 2013, the FASB issued ASU No. 2013-02: *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The objective of this ASU is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments require an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety in net income. For other amounts that are not required to be reclassified to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The amendments in the ASU do not change the current requirements for reporting net income or other comprehensive income in financial statements. The ASU is effective prospectively for reporting periods beginning after December 15, 2012. The adoption of these amendments did not have a material impact on our financial condition, results of operations or cash flows.

In January 2013, the FASB issued ASU No. 2013-01: *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. The objective of this ASU is to clarify the scope of offsetting disclosures and to address implementation issues with ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. The amendments clarify that the scope of ASU 2011-11 applies to derivatives accounted for in accordance with Topic 815, *Derivatives and Hedging*, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions. An entity is required to apply the amendments for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods. The adoption of these amendments did not have a material impact on

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our financial condition, results of operations or cash flows.

In July 2012, the FASB issued ASU No. 2012-02: *Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*. The objective of the amendments in this ASU is to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Upon adoption, these amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012; early adoption is permitted. The adoption of these amendments did not have a material impact on our financial condition, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05: *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. The guidance in this ASU is intended to increase the prominence of items reported in other comprehensive income in the financial statements by presenting the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The guidance in this ASU does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. Upon adoption, this update is to be applied retrospectively and is effective during interim and annual periods beginning after December 15, 2011. Early adoption is permitted. The adoption of this ASU did not have a material impact on our financial condition, results of operations or cash flows.

In December 2011, the FASB issued ASU No. 2011-12: *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. The guidance defers certain provisions contained in ASU No. 2011-05 requiring the requirement to present components of reclassifications of other comprehensive income on the face of the income statement or in the notes to the financial statements. However, this deferral does not impact the other requirements contained in the new standard on comprehensive income as described above. This ASU is effective during interim and annual periods beginning after December 15, 2011. The adoption of this ASU did not have a material impact on our financial condition, results of operations or cash flows.

In September 2011, the FASB issued ASU No. 2011-08: *Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment*, which amends ASC Topic 350, *Intangibles-Goodwill and Other*. The guidance in this ASU permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC Topic 350. Under the amendments in this ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. The adoption of this ASU did not have a material impact on our financial condition, results of operations or cash flows.

In December 2011, the FASB issued ASU No. 2011-11: *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*, which requires new disclosure requirements mandating that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. In addition, the standard requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements. This ASU is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this ASU did not have a material impact on our financial condition, results of operations or cash flows.

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Other recent accounting pronouncements issued by FASB, the American Institute of Certified Public Accountants (“AICPA”), and the SEC did not or are not believed by management to have a material impact on the Company’s present or future financial statements.

**(C) Stock Options**

Pursuant to FASB issued guidance, compensation cost recognized during the three months ended March 31, 2015 includes compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the guidance.

**(D) Earnings per Share**

Basic earnings per share (“Basic EPS”) is computed by dividing net income by the weighted average number of common shares outstanding during the period presented. Diluted earnings per share (“Diluted EPS”) is computed by dividing net income by the weighted average number of shares of common stock and common stock equivalents outstanding during the period presented.

**(E) Reclassifications**

No material reclassification of the 2014 financial statements was necessary to conform to the 2015 presentation.

**(4) Commitments and Contingencies**

Management has a responsibility to continually measure and monitor its commitments and its contingencies. The nature of the Company’s commitments and contingencies can be grouped into three major categories: insured claim activity, assessment related activities and operational matters.

**(A) Insured Claim Activity**

We are involved in claims and legal actions arising in the ordinary course of business. The amount of liability for these claims and lawsuits is uncertain. Revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages; and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors. In the opinion of management, the ultimate disposition of these matters may have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

The Company’s subsidiaries are, from time to time, named as defendants in various lawsuits incidental to their insurance operations. Legal actions relating to claims made in the ordinary course of seeking indemnification for a loss covered by the insurance policy are considered by the Company in establishing loss and LAE reserves.

The Company also faces, in the ordinary course of business, lawsuits that seek damages beyond policy limits. The Company continually evaluates potential liabilities and reserves for litigation of these types using the criteria established by FASB issued guidance. Under this guidance, reserves for a loss are recorded if the likelihood of occurrence is probable and the amount can be reasonably estimated. If a loss, while not probable, is judged to be reasonably possible, management will make an estimate of a possible range of loss or state that an estimate cannot be made. Management considers each legal action using this guidance and records reserves for losses as warranted.

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**(B) Assessment Related Activity**

We operate in a regulatory environment where certain entities and organizations have the authority to require us to participate in assessments. Currently these entities and organizations include, but are not limited to, Florida Insurance Guaranty Association (“FIGA”), Citizens Property Insurance Corporation (“Citizens”), Florida Hurricane Catastrophe Fund (“FHCF”) and Florida Joint Underwriters Insurance Association (“JUA”). As a direct premium writer in the state of Florida, we are required to participate in certain insurer solvency associations under Florida Statutes Section 631.57(3) (a), administered by FIGA.

FNIC is also required to participate in an insurance apportionment plan under Florida Statutes Section 627.351, which is referred to as a JUA Plan. The JUA Plan provides for the equitable apportionment of any profits realized, or losses and expenses incurred, among participating automobile insurers. In the event of an underwriting deficit incurred by the JUA Plan which is not recovered through the policyholders in the JUA Plan, such deficit shall be recovered from the companies participating in the JUA Plan in the proportion that the net direct written premiums of each such member during the preceding calendar year bear to the aggregate net direct premiums written in this state by all members of the JUA Plan. FNIC was not assessed by the JUA Plan during 2015 or 2014. Future assessments by this association are undeterminable at this time.

**(C) Operational Matters**

The Company files federal income tax returns as well as multiple state and local tax returns. The Company’s consolidated federal and state income tax returns for 2011 - 2014 are open for review by the Internal Revenue Service (“IRS”) and the various state taxing authorities. The Company’s 2011 federal tax return was reviewed by the IRS and a “no change” report was issued indicating that the IRS is in agreement with the tax positions presented on the 2011 return. The 2013 federal and state income tax returns were timely filed by the extended filing deadline of September 15, 2014. The Company does not have any known uncertain tax positions and all tax positions are evaluated in accordance with FIN 48. Any change to or resolution of tax reserves could be material to the Company’s results of operations for any period, but is not expected to be material to the Company’s financial position.

The Company has recorded a net deferred tax liability of \$1.9 million as of March 31, 2015 compared with \$1.3 million as of December 31, 2014.

The calculation of current and deferred income taxes presents management’s assessment of the amount of current and future taxes to be paid. The calculation of deferred tax assets and liabilities is in accordance with ASC 740. These assets and liabilities may be impacted if new information not previously available is considered in future analysis and calculations. Because of the unpredictability and complexity of these future uncertainties the ultimate resolution of the tax payment may be an amount that is materially different from the current estimate of the tax liabilities. As of March 31, 2015 the Company has recorded a net deferred tax liability of \$1.9 million. The primary reason for the increase in deferred tax liabilities include the tax impact of the appreciation in the market value of the available-for-sale securities. Any change in circumstances leading to a change in the tax liability would be recorded in the period that the change in circumstances occurs.

Our executive offices are located at 14050 N.W. 14<sup>th</sup> Street, Suite 180, Sunrise, Florida 33323 in an 18,500 square foot office facility. Our original lease for this office space was scheduled to expire in May 2017. During March 2014, we extended our lease term to expire in August 2019 and expanded the leased premises to include an additional 13,642 square feet. All of our operations are consolidated within these facilities. We believe that the facilities are well maintained, in substantial compliance with environmental laws and regulations, and adequately covered by insurance. We also believe that these leased facilities are not unique and could be replaced, if necessary, at the end of the lease term.



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The expected future payments in connection with this lease are as follows.

<u>Fiscal Year</u>	<u>Payments</u>
	(Dollars in Thousands)
2015	545
2016	714
2017	726
2018	740
Thereafter	<u>502</u>
Total	<u>\$ 3,227</u>

The Company is not currently involved in any material legal actions arising from the ordinary course of business that are not related to the insured claims activity.

**(5) Investments**

FASB issued guidance addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. We account for our investment securities consistent with FASB issued guidance that requires our securities to be classified into one of three categories: (i) held-to-maturity, (ii) trading securities or (iii) available-for-sale.

Investments classified as held-to-maturity include debt securities wherein the Company's intent and ability are to hold the investment until maturity and are carried at amortized cost without consideration to unrealized gains or losses. Investments classified as trading securities include debt and equity securities bought and held primarily for sale in the near term and are carried at fair value with unrealized holding gains and losses included in current period operations. Investments classified as available-for-sale include debt and equity securities that are not classified as held-to-maturity or as trading security investments and are carried at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income."

Total investments increased \$5.6 million, or 1.7%, to \$336.4 million as of March 31, 2015, compared with \$330.8 million as of December 31, 2014.

The debt and equity securities that are available-for-sale and carried at fair value represent 98% of total investments as of March 31, 2015 and December 31, 2014.

We did not hold any trading investment securities during the three months ended March 31, 2015.

The FASB issued guidance also addresses the determination as to when an investment is considered impaired, whether that impairment is other-than temporary, and the measurement of an impairment loss. The Company's policy for the valuation of temporarily impaired securities is to determine impairment based on the analysis of the following factors.

- rating downgrade or other credit event (eg., failure to pay interest when due);
- length of time and the extent to which the fair value has been less than amortized cost;
- financial condition and near term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology or discontinuance of a business segment;
- prospects for the issuer's industry segment;

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- intent and ability of the Company to retain the investment for a period of time sufficient to allow for anticipated recovery in market value;
- historical volatility of the fair value of the security.

Pursuant to FASB issued guidance, the Company records the unrealized losses, net of estimated income taxes that are associated with that part of our portfolio classified as available-for-sale through the shareholders' equity account titled "Other Comprehensive Income". Management periodically reviews the individual investments that comprise our portfolio in order to determine whether a decline in fair value below our cost either is other-than-temporarily or permanently impaired. Factors used in such consideration include, but are not limited to, the extent and length of time over which the market value has been less than cost, the financial condition and near-term prospects of the issuer and our ability and intent to keep the investment for a period sufficient to allow for an anticipated recovery in market value.

In reaching a conclusion that a security is either other-than-temporarily or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as Standard and Poor's ("S&P") and Moody's Investors Service, Inc. ("Moody's"), as well as information released via the general media channels. During the three months ended March 31, 2015 and the three months ended March 31, 2014, respectively, in connection with the process, we have not charged operations with investment losses.

As of March 31, 2015 and December 31, 2014, respectively, all of our securities are in good standing and not impaired as defined by FASB issued guidance.

As of March 31, 2015 and December 31, 2014, our investments consisted primarily of corporate bonds held in various industries, municipal bonds and United States government bonds. As of March 31, 2015, 78% of our debt portfolio was in diverse industries and 22% was in United States government bonds. As of March 31, 2015, approximately 88% of our equity holdings were in equities related to diverse industries and 12% were in mutual funds. As of December 31, 2014, 77% of our debt portfolio was in diverse industries and 23% is in United States government bonds. As of December 31, 2014, approximately 88% of our equity holdings were in equities related to diverse industries and 12% were in mutual funds.

As of March 31, 2015 and December 31, 2014, we have classified \$7.5 million and \$7.4 million, respectively, of our bond portfolio as held-to-maturity. We classify bonds as held-to-maturity to support securitization of credit requirements.

During the three months ended March 31, 2015 and 2014, we did not re-classify any of our bond portfolio between available-for-sale and held-to-maturity.

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**(A) Debt and Equity Securities**

The following table summarizes, by type, our investments as of March 31, 2015 and December 31, 2014.

	<u>March 31, 2015</u>		<u>December 31, 2014</u>	
	<u>Carrying Amount</u>	<u>Percent of Total</u>	<u>Carrying Amount</u>	<u>Percent of Total</u>
	(Dollars in Thousands)			
Debt securities, at market:				
United States government obligations and authorities	\$ 59,549	17.70%	\$ 62,323	18.84%
Obligations of states and political subdivisions	92,172	27.40%	91,614	27.70%
Corporate	125,021	37.18%	119,024	35.99%
International	<u>11,451</u>	<u>3.40%</u>	<u>11,138</u>	<u>3.37%</u>
	<u>288,193</u>	<u>85.68%</u>	<u>284,099</u>	<u>85.90%</u>
Debt securities, at amortized cost:				
United States government obligations and authorities	4,564	1.36%	4,490	1.36%
Corporate	2,701	0.80%	2,681	0.81%
International	<u>197</u>	<u>0.06%</u>	<u>246</u>	<u>0.07%</u>
	<u>7,462</u>	<u>2.22%</u>	<u>7,417</u>	<u>2.24%</u>
Total debt securities	295,655	87.90%	291,516	88.14%
Equity securities, at market:	<u>40,726</u>	<u>12.10%</u>	<u>39,247</u>	<u>11.86%</u>
Total investments	<u>\$ 336,381</u>	<u>100.00%</u>	<u>\$ 330,763</u>	<u>100.00%</u>

The following table shows the realized gains (losses) for debt and equity securities for the three months ended March 31, 2015 and 2014.

	<u>Three Months Ended March 31,</u>			
	<u>2015</u>	<u>2014</u>	<u>2015</u>	<u>2014</u>
	<u>Gains (Losses)</u>	<u>Fair Value at Sale</u>	<u>Gains (Losses)</u>	<u>Fair Value at Sale</u>
	(Dollars in Thousands)			
Debt securities	\$ 515	\$ 34,860	\$ 135	\$ 9,668
Equity securities	<u>1,395</u>	<u>3,084</u>	<u>1,610</u>	<u>4,815</u>
Total realized gains	<u>1,910</u>	<u>37,944</u>	<u>1,745</u>	<u>14,483</u>
Debt securities	(103)	15,072	(70)	3,699
Equity securities	<u>(103)</u>	<u>459</u>	<u>(344)</u>	<u>1,338</u>
Total realized losses	<u>(206)</u>	<u>15,531</u>	<u>(414)</u>	<u>5,037</u>
Net realized gains on investments	<u>\$ 1,704</u>	<u>\$ 53,475</u>	<u>\$ 1,331</u>	<u>\$ 19,520</u>

Net realized investment gains totaled \$1.7 million for the three months ended March 31, 2015, compared with \$1.3 million during the three months ended March 31, 2014.

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A summary of the amortized cost, estimated fair value and gross unrealized gains and losses of debt and equity securities at March 31, 2015 and December 31, 2014 is as follows.

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
	(Dollars in Thousands)			
March 31, 2015				
Debt Securities - Available-For-Sale:				
United States government obligations and authorities	\$ 58,136	\$ 1,466	\$ 53	\$ 59,549
Obligations of states and political subdivisions	91,125	1,102	55	92,172
Corporate	122,736	2,396	111	125,021
International	<u>11,340</u>	<u>118</u>	<u>7</u>	<u>11,451</u>
	<u>\$ 283,337</u>	<u>\$ 5,082</u>	<u>\$ 226</u>	<u>\$ 288,193</u>
Debt Securities - Held-To-Maturity:				
United States government obligations and authorities	\$ 4,564	\$ 54	\$ 131	\$ 4,487
Corporate	2,701	52	1	2,752
International	<u>197</u>	<u>3</u>	<u>-</u>	<u>200</u>
	<u>\$ 7,462</u>	<u>\$ 109</u>	<u>\$ 132</u>	<u>\$ 7,439</u>
Equity securities - common stocks	<u>\$ 31,200</u>	<u>\$ 10,231</u>	<u>\$ 705</u>	<u>\$ 40,726</u>
December 31, 2014				
Debt Securities - Available-For-Sale:				
United States government obligations and authorities	\$ 61,376	\$ 1,022	\$ 75	\$ 62,323
Obligations of states and political subdivisions	90,728	956	70	91,614
Corporate	117,778	1,578	332	119,024
International	<u>11,139</u>	<u>53</u>	<u>54</u>	<u>11,138</u>
	<u>\$ 281,021</u>	<u>\$ 3,609</u>	<u>\$ 531</u>	<u>\$ 284,099</u>
Debt Securities - Held-To-Maturity:				
United States government obligations and authorities	\$ 4,490	\$ 41	\$ 225	\$ 4,306
Corporate	2,681	31	5	2,707
International	<u>246</u>	<u>1</u>	<u>1</u>	<u>246</u>
	<u>\$ 7,417</u>	<u>\$ 73</u>	<u>\$ 231</u>	<u>\$ 7,259</u>
Equity securities - common stocks	<u>\$ 29,908</u>	<u>\$ 9,836</u>	<u>\$ 497</u>	<u>\$ 39,247</u>

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The table below reflects our unrealized investment losses by investment class, aged for length of time in a continuous unrealized loss position as of March 31, 2015.

	<u>Unrealized Losses</u>	<u>Less than 12 months</u>	<u>12 months or longer</u>
	(Dollars in Thousands)		
Debt securities:			
United States government obligations and authorities	\$ 54	\$ 49	\$ 5
Obligations of states and political subdivisions	55	55	-
Corporate	111	68	43
International	5	5	-
	<u>225</u>	<u>177</u>	<u>48</u>
Equity securities:			
Common stocks	<u>706</u>	<u>672</u>	<u>34</u>
Total debt and equity securities	<u>\$ 931</u>	<u>\$ 849</u>	<u>\$ 82</u>

The table below reflects our unrealized investment losses by investment class, aged for length of time in a continuous unrealized loss position as of December 31, 2014.

	<u>Unrealized Losses</u>	<u>Less than 12 months</u>	<u>12 months or longer</u>
	(Dollars in Thousands)		
Debt securities:			
United States government obligations and authorities	\$ 75	\$ 22	\$ 53
Obligations of states and political subdivisions	70	66	4
Corporate	332	260	72
International	54	54	-
	<u>531</u>	<u>402</u>	<u>129</u>
Equity securities:			
Common stocks	<u>497</u>	<u>461</u>	<u>36</u>
Total debt and equity securities	<u>\$ 1,028</u>	<u>\$ 863</u>	<u>\$ 165</u>

Below is a summary of debt securities at March 31, 2015 and December 31, 2014, by contractual or expected maturity periods. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>March 31, 2015</u>		<u>December 31, 2014</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
	(Dollars in Thousands)			
Due in one year or less	\$ 17,357	\$ 17,355	\$ 16,777	\$ 16,797
Due after one through five years	169,008	170,974	173,236	174,273
Due after five through ten years	104,439	107,274	98,404	100,259
Due after ten years	<u>26</u>	<u>33</u>	<u>26</u>	<u>33</u>
Total	<u>\$ 290,830</u>	<u>\$ 295,636</u>	<u>\$ 288,443</u>	<u>\$ 291,362</u>

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United States Treasury notes with a book value of \$64,639 and \$2,055,445, maturing in 2016 and 2022, and a certificate of deposit with a book value of \$0.3 million, were on deposit with the Florida OIR as of March 31, 2015, as required by law for FNIC and Monarch Insurance, respectively, and are included with other investments held until maturity.

United States Treasury notes with a book value of \$61,465 and \$2,208,588, maturing in 2016 and 2022, respectively, were on deposit with the Florida OIR as of December 31, 2014, as required by law for FNIC, and are included with other investments held until maturity.

The table below sets forth investment results for the three months ended March 31, 2015 and 2014.

	<u>Three Months Ended March 31,</u>	
	<u>2015</u>	<u>2014</u>
	(Dollars in Thousands)	
Interest on debt securities	\$ 1,342	\$ 895
Dividends on equity securities	106	111
Interest on cash and cash equivalents	<u>98</u>	<u>1</u>
 Total investment income	 <u>\$ 1,546</u>	 <u>\$ 1,007</u>
 Net realized gains	 <u>\$ 1,704</u>	 <u>\$ 1,331</u>

Proceeds from sales, pay downs and maturities of debt securities and proceeds from sales of equity securities during the three months ended March 31, 2015 and 2014, were approximately \$56.3 million and \$20.9 million, respectively.

The table below sets forth a summary of net realized investment gains during the three months ended March 31, 2015 and 2014.

	<u>Three Months Ended March 31,</u>	
	<u>2015</u>	<u>2014</u>
	(Dollars in Thousands)	
Net realized gains		
Debt securities	\$ 412	\$ 65
Equity securities	<u>1,292</u>	<u>1,266</u>
 Total	 <u>\$ 1,704</u>	 <u>\$ 1,331</u>

The table below sets forth a summary of net unrealized investment gains as of March 31, 2015 and December 31, 2014.

	<u>Unrealized Gains</u>	
	<u>March 31, 2015</u>	<u>December 31, 2014</u>
	(Dollars in Thousands)	
Net unrealized gains		
Debt securities	\$ 4,856	\$ 3,078
Equity securities	<u>9,526</u>	<u>9,339</u>
 Total	 <u>\$ 14,382</u>	 <u>\$ 12,417</u>

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**(6) Fair Value Disclosure**

In April 2009, the FASB issued accounting guidance that if an entity determines that either the volume and/or level of activity for an investment security has significantly decreased (from normal conditions for that investment security) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. This guidance was effective for interim and annual periods ending after June 15, 2009, with early adoption permitted. This guidance was applied prospectively. The adoption of this guidance did not have an impact on our financial condition, results of operations or cash flows.

In October 2008, the FASB issued accounting guidance to clarify the application of GAAP in determining fair value of financial instruments in a market that is not active. The guidance was effective upon issuance, including prior periods for which financial statements had not been issued. Our adoption of this guidance did not have a material effect on our financial position, results of operations or cash flows.

In September 2006, FASB issued accounting guidance that defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants on the measurement date. This guidance also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance also categorizes assets and liabilities at fair value into one of three different levels depending on the observation of the inputs employed in the measurement, as follows.

Level 1 — inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.

Level 2 — inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs are observable for an asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 — inputs to the valuation methodology are unobservable and significant to the fair value measurement.

**Securities available-for-sale:** The fair value of securities available-for-sale is determined by obtaining quoted prices on nationally recognized security exchanges.

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Assets measured at fair value on a recurring basis as of March 31, 2015, presented in accordance with this guidance, are as follows.

	<u>Level 1</u>	<u>As of March 31, 2015</u>		<u>Total</u>
		<u>Level 2</u>	<u>Level 3</u>	
		(Dollars in Thousands)		
Debt securities:				
United States government obligations and authorities	\$ 39,419	\$ 20,130	\$ -	\$ 59,549
Obligations of states and political subdivisions	-	92,172	-	92,172
Corporate	-	125,021	-	125,021
International	-	11,451	-	11,451
	<u>39,419</u>	<u>248,774</u>	<u>-</u>	<u>288,193</u>
Equity securities:				
Common stocks	<u>40,726</u>	-	-	<u>40,726</u>
	<u>40,726</u>	-	-	<u>40,726</u>
Total debt and equity securities	<u>\$ 80,145</u>	<u>\$ 248,774</u>	<u>\$ -</u>	<u>\$ 328,919</u>

Assets measured at fair value on a recurring basis as of December 31, 2014, presented in accordance with this guidance, are as follows.

	<u>Level 1</u>	<u>As of December 31, 2014</u>		<u>Total</u>
		<u>Level 2</u>	<u>Level 3</u>	
		(Dollars in Thousands)		
Debt securities:				
United States government obligations and authorities	\$ 46,002	\$ 16,321	\$ -	\$ 62,323
Obligations of states and political subdivisions	-	91,614	-	91,614
Corporate	-	119,024	-	119,024
International	-	11,138	-	11,138
	<u>46,002</u>	<u>238,097</u>	<u>-</u>	<u>284,099</u>
Equity securities:				
Common stocks	<u>39,247</u>	-	-	<u>39,247</u>
	<u>39,247</u>	-	-	<u>39,247</u>
Total debt and equity securities	<u>\$ 85,249</u>	<u>\$ 238,097</u>	<u>\$ -</u>	<u>\$ 323,346</u>

**(7) Reinsurance Agreements**

Financing risk generally involves a combination of risk retention and risk transfer techniques. "Retention", similar to a deductible, involves financing losses by funds internally generated. "Transfer" involves the existence of a contractual arrangement designed to shift financial responsibility to another party in exchange for premium. Secondary to the primary risk-transfer agreements, we use reinsurance agreements to transfer a portion of the risks insured under our policies to other companies through the purchase of reinsurance. We utilize reinsurance to reduce exposure to catastrophic and non-catastrophic risks and to help manage the cost of capital. Reinsurance techniques are designed to lessen earnings volatility, improve shareholder return, and to support the required statutory surplus



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requirements. We also use reinsurance to realize an arbitrage of premium rates, benefit from the availability of our reinsurers' expertise, and benefit from the management of a profitable portfolio of insureds by way of enhanced analytical capacities. Our primary property line that is subject to catastrophic reinsurance is Homeowners' Multiple Peril. FNIC cedes these risks to domestic and foreign reinsurance participants from Bermuda and Europe as well as to the FHCF.

Quota share reinsurance is a pro rata agreement among the primary insurer and one or more reinsurers where each party shares a fixed and predetermined percentage of the program's premiums and losses. Excess of loss risk transfer agreements involve the transfer of premium in exchange for reimbursement for claims, if they occur, as a result of specific events such as severe catastrophic weather. For quota share and excess of loss reinsurance, coverage is generally afforded based on meeting predetermined risk characteristics. In contrast, facultative reinsurance is negotiated between the primary insurer and the reinsurer(s) on a case-by-case basis with no obligation on either part to cede or assume share of the risk.

Generally, there are three separate kinds of reinsurance structures – quota share, excess of loss, and facultative, each considered either proportional or non-proportional. Our reinsurance structures are maintained to protect our insurance subsidiary against the severity of losses on individual claims or unusually serious occurrences in which the frequency and or the severity of claims produce an aggregate extraordinary loss from catastrophic events. In addition to reinsurance agreements, we also from time to time enter into retro-cessionary reinsurance agreements; each designed to shift financial responsibility based on predefined conditions.

Although reinsurance does not discharge us from our primary obligation to pay for losses insured under the policies we issue, reinsurance does make the assuming reinsurer liable to the insurance subsidiary for the reinsured portion of the risk. A credit risk exposure exists with respect to ceded losses to the extent that any reinsurer is unable or unwilling to meet the obligations assumed under the reinsurance contracts. The collectability of reinsurance is subject to the solvency of the reinsurers, interpretation of contract language and other factors. A reinsurer's insolvency or inability to make payments under the terms of a reinsurance contract could have a material adverse effect on our results of operations and financial condition. Our reinsurance structure has significant risks, including the fact that the FHCF may not be able to raise sufficient money to pay its claims or impair its ability to pay its claims in a timely manner. This could result in significant financial, legal and operational challenges to all property and casualty companies associated with FHCF, including our company.

The availability and costs associated with the acquisition of reinsurance will vary year to year. These fluctuations, which can be significant, are not subject to our control and may limit our ability to purchase adequate coverage. For example, FHCF continues to restrict its reinsurance capacity and is expected to continue constricting capacity for future seasons. This gradual restriction is requiring us to replace that capacity with private market reinsurance. Our reinsurance program is subject to approval by the Florida OIR and review by Demotech, Inc. ("Demotech"). The recovery of increased reinsurance costs through rate action is not immediate and cannot be presumed and is subject to Florida OIR approval.

For the 2014–2015 hurricane season, the excess of loss and FHCF treaties insured the property lines for approximately \$1.49 billion of aggregate catastrophic losses and LAE with a maximum single event coverage totaling approximately \$1.01 billion, with the Company retaining the first \$11.20 million in Florida and \$3.0 million in Louisiana for losses and LAE from each event. Florida risks represent 98.5%, or \$1.46 billion of the \$1.49 billion of total aggregate catastrophic losses and LAE. The reinsurance program includes coverage purchased from the private market, which affords optional reinstatement premium protection that provides coverage beyond the first event, along with any remaining coverage from the FHCF. The FHCF only affords coverage for losses sustained in Florida. Coverage afforded by the FHCF totals approximately \$546.3 million, or 37.4% of Florida's \$1.46 billion of aggregate catastrophic losses and LAE. The FHCF affords coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event.

The estimated cost to the Company for the excess of loss reinsurance products for the 2014–2015 hurricane season, inclusive of approximately \$40.20 million payable to the FHCF and the prepaid automatic premium reinstatement protection, is approximately \$117.0 million.

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Included in this year's program is a 30% quota share reinsurance treaty for the Company's in-force new and renewal homeowners' insurance program in the State of Florida. This two-year quota share reinsurance treaty provides 30% of \$200 million of aggregate catastrophe coverage per year with maximum single event coverage of 30% of \$100 million per year. The approximate cost of this quota share is projected to be \$6.7 million per year, net of ceding commissions, and it is included in the \$117.0 million amount referenced above. The quota share treaty contains commutation provisions for the Company to share profits based on loss experience during the term of the treaty.

The 30% quota share reinsurance treaty described above contains profit sharing provisions that will adjust over its two-year term depending on the Company's loss experience from catastrophic and non-catastrophic events during the term. The frequency and severity of catastrophic events, coupled with non-catastrophic loss experience, will determine the ultimate profit share, if any. In accordance with GAAP, the Company will initially recognize an asset and liability and the resultant net income or loss. For example, deferred quota-share profit sharing totaled \$8.8 million and \$10.5 million as of March 31, 2015 and December 31, 2014, respectively. The deferred quota-share profit sharing was originally recorded at \$14.0 million at the program's July 1, 2014 inception and will continue to amortize over the life of the program. Subsequently, the Company will adjust the value of the asset and liability based on information available at the time of valuation. Upward and downward adjustments to the asset's value will affect the Company's results of operations by increasing or decreasing net income in the period of the adjustment.

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The 2014-2015 private reinsurance companies and their respective A.M. Best Company (“A.M. Best”) and S&P ratings are listed in the table as follows.

<u>Reinsurer</u>	<u>A.M. Best Rating</u>	<u>S&amp;P Rating</u>
<b>UNITED STATES</b>		
American Agricultural Insurance Company	A-	NR
American Standard Insurance Company of Wisconsin	A	NR
AIG (National Union Fire Insurance Company of Pittsburgh, PA)	A	A+
Everest Reinsurance Company	A+	A+
Odyssey Reinsurance Company	A	A-
QBE Reinsurance Corporation	A	A+
RLI Insurance Company	A+	A+
Transatlantic Reinsurance Company	A	A+
<b>BERMUDA</b>		
ACE Tempest Reinsurance Limited	A++	AA-
Allied World Assurance Company, Limited	A	A
Arch Reinsurance Limited	A+	A+
Argo Reinsurance Limited	A	NR
Ariel Reinsurance Bermuda Ltd for and on Behalf of Ariel Syndicate 1910 (ARE)	A-	A+
Aspen Bermuda Limited	A	A
AXIS Specialty Limited	A+	A+
BGS Services (Bermuda) Limited/Lloyds Syndicate 2987	A	A+
DaVinci Reinsurance Ltd	A	AA-
Endurance Specialty Insurance Limited	A	A
Hamilton Re, Limited	A-	NR
Hiscox Insurance Company (Bermuda) Limited	A	NR
Partner Reinsurance Company Limited	A+	A+
Platinum Underwriters Bermuda Limited	A	A-
Renaissance Reinsurance, Limited	A+	AA-
Securis Re III Limited Bermuda	NR	* ** NR
Securis Re IV Limited Bermuda	NR	* ** NR
Tokio Millennium Re AG, Bermuda Branch	A++	AA-
XL RE Limited	A	A+
<b>UNITED KINGDOM</b>		
A.F. Beazley Syndicate No. 623 (AFB)	A	A+
A.F. Beazley Syndicate No. 2623 (AFB)	A	A+
Amlin Syndicate No. 2001 (AML)	A	A+
Antares Syndicate No. 1274 (AUL)	A	A+
Ariel Syndicate No. 1910 (ARE)	A	A+
ARK Syndicate No. 4020 (ARK)	A	A+
Ascot Syndicate No. 1414 (ASC)	A	A+
Barbican Syndication No. 1955 (BAR)	A	A+
Canopus Syndicate No. 958 (CNP)	A	A+
Canopus Syndicate No. 4444 (CNP)	A	A+
Cathederal Syndicate No. 2010 (MMX)	A	A+
Chaucer Syndicate No. 1084 (CSL)	A	A+
Dale Underwriting Syndicate No. 1729 (DUW)	A	A+
Faraday Syndicate No. 435 (FDY)	A	A+
Hiscox Syndicate No. 0033 (HIS)	A	A+
Kiln Syndicate No. 510 (KLN)	A	A+
Liberty Syndicates Services Limited, Paris for and on behalf of Lloyd's Syndicate No. 4472 (LIB)	A	A+
MAP Underwriting Syndicate No. 2791 (MAP)	A	A+
MAP Underwriting Syndicate No. 2791 (Parallel) (MAP)	A	A+
Novae Syndicate No. 2007 (NVA)	A	A+
S.J.O, Catlin & Others No. 2003 (SJC)	A	A+
<b>EUROPE</b>		
Amlin AG, Switzerland, Bermuda Branch	A	A
Hannover Rueck SE (obo Pillar Capital Management)	NR	* ** NR
Lansforsakringar Sak Forsakringsaktiebolag (publ)	NR	A
SCOR Global P&C SE, Paris, Zurich Branch	A	A
<b>ASIA</b>		
China Reinsurance (Group) Corporation	A	NR
Qatar Reinsurance Company LLC	A	A
* Reinstatement Premium Protection Program Participants		
** Participant will fund a trust agreement for their exposure with cash and U.S. Government obligations of American institutions at fair market value.		

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For the 2013–2014 hurricane season, the excess of loss and FHCF treaties insured the property lines for approximately \$562.7 million of aggregate catastrophic losses and LAE with a maximum single event coverage totaling approximately \$420.4 million, with the Company retaining the first \$7.0 million of losses and LAE for each event. The reinsurance program includes coverage purchased from the private market, which affords optional reinstatement premium protection that provides coverage beyond the first event, along with any remaining coverage from the FHCF. Coverage afforded by the FHCF totals approximately \$278.1 million, or 49.4% of the \$562.7 million of aggregate catastrophic losses and LAE. The FHCF affords coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event.

The estimated cost to the Company for the excess of loss reinsurance products for the 2013-2014 hurricane season, inclusive of approximately \$21.7 million payable to the FHCF and the prepaid automatic premium reinstatement protection, is approximately \$67.9 million.

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The 2013-2014 private reinsurance companies and their respective A.M. Best and S&P ratings are listed in the table as follows.

<u>Reinsurer</u>	<u>A.M. Best Rating</u>	<u>S&amp;P Rating</u>
<b>UNITED STATES</b>		
American Agricultural Insurance Company	A-	NR
Everest Reinsurance Company	A+	A+
Houston Casualty Company, UK Branch	A	A+
Odyssey Reinsurance Company	A	A-
<b>BERMUDA</b>		
ACE Tempest Reinsurance Limited	A+	AA-
Allied World Assurance Company Limited, Bermuda	A	A
Arch Reinsurance Limited	A+	A+
Argo Reinsurance Limited	A	NR
Ariel Reinsurance Bermuda Ltd for and on Behalf of Ariel Syndicate 1910 (ARE)	A-	NR
DaVinci Reinsurance Ltd	A	A+
Endurance Specialty Insurance Limited	A	A
JC Re Ltd. (aka Pillar Capital and fka Juniperus & Actua Re Ltd.)	NR	* ** NR
Partner Reinsurance Company Limited	A+	A+
Platinum Underwriters Bermuda Limited	A	A-
Renaissance Reinsurance Ltd	A+	AA-
S.A.C. Re, Ltd.	A-	NR
XL Re Limited	A	A
<b>UNITED KINGDOM</b>		
A.F. Beazley Syndicate No. 623 (AFB)	A	A+
A.F. Beazley Syndicate No. 2623 (AFB)	A	A+
Amlin Syndicate No. 2001 (AML)	A	A+
Ariel Syndicate No. 1910 (ARE)	A	A+
ARK Syndicate No. 3902 (NOA)	A	A+
Ascot Syndicate No. 1414 (ASC)	A	A+
Barbican Syndication No. 1955 (BAR)	A	A+
Canopus Syndicate No. 958 (CNP)	A	A+
Canopus Syndicate No. 4444 (CNP)	A	A+
Cathederal Syndicate No. 2010 (MMX)	A	A+
Kiln Syndicate No. 510 (KLN)	A	A+
Liberty Syndicates Services Limited, Paris for and on behalf of Lloyd's Syndicate No. 4472 (LIB)	NR	A+
MAP Underwriting Syndicate No. 2791 (MAP)	A	A+
MAP Underwriting Syndicate No. 2791 (Parallel) (MAP)	A	A+
Novae Syndicate No. 2007 (NVA)	A	A+
Pembroke Syndicate No. 4000 (PEM)	A	A+
Tokio Marine Kiln Syndicate No. 1880 (TMK)	A	A+
<b>EUROPE</b>		
Amlin Bermuda (Branch of Amlin AG)	A	A
SCOR Global P&C SE	A	A
* Reinstatement Premium Protection Program Participants		
** Participant will fund a trust agreement for their exposure with cash and U.S. Government obligations of American institutions at fair market value.		

Annually, the cost and amounts of reinsurance are based on management's analysis of FNIC's exposure to catastrophic risk as of June 30 and estimated to September 30. Our data is then subjected to actual exposure level analysis as of September 30. This analysis of our exposure level in relation to the total exposures to the FHCF and excess of loss treaties may produce changes in limits and reinsurance premiums as a result of the reconciliation of estimated to actual exposure level. The September 30, 2014 change to total insured value was an increase of \$5.4 billion or 8.2% and the change to reinsurance premiums was an increase of \$0.4 million. The September 30, 2013 change to total insured value was an increase of \$8.7 billion or 25.3% and the change to reinsurance premiums was an increase of \$8.3 million or 13.3%. These adjustments are amortized over the remaining underlying policy term.

To date, we have made no claims asserted against our reinsurers in connection with the 2014–2015 and 2013–2014 excess of loss and FHCF treaties.

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The quota share retrocessionaire reinsurance agreements require FNIC to securitize credit, regulatory and business risk. Fully funded trust agreements totaled \$4.9 million as of March 31, 2015 and December 31, 2014.

We are selective in choosing reinsurers and consider numerous factors, the most important of which are the financial stability of the reinsurer, its history of responding to claims and its overall reputation. In an effort to minimize our exposure to the insolvency of a reinsurer, we evaluate the acceptability and review the financial condition of the reinsurer at least annually.

**(8) Unpaid losses and LAE**

The liability for unpaid losses and LAE is determined on an individual-case basis for all incidents reported. The liability also includes amounts for unallocated expenses, anticipated future claim development and Incurred but Not Yet Reported (“IBNR”).

Activity in the liability for unpaid losses and LAE is summarized as follows.

	<u>Period Ending</u>	
	<u>March 31, 2015</u>	<u>December 31, 2014</u>
	(Dollars in Thousands)	
Balance at January 1	\$ 78,330	\$ 61,016
Less reinsurance recoverables	<u>(12,534)</u>	<u>(2,742)</u>
Net balance at January 1	<u>\$ 65,796</u>	<u>\$ 58,274</u>
Incurred related to		
Current year	\$ 28,180	\$ 79,932
Prior years	<u>(4,231)</u>	<u>1,104</u>
Total incurred	<u>\$ 23,949</u>	<u>\$ 81,036</u>
Paid related to		
Current year	\$ 6,908	\$ 42,391
Prior years	<u>11,396</u>	<u>31,123</u>
Total paid	<u>\$ 18,304</u>	<u>\$ 73,514</u>
Net balance at period end	\$ 71,441	\$ 65,796
Plus reinsurance recoverables	<u>13,034</u>	<u>12,534</u>
Balance as of period end	<u>\$ 84,475</u>	<u>\$ 78,330</u>

Based upon consultations with our independent actuarial consultants, we believe that the liability for unpaid losses and LAE is adequate to cover all claims and related expenses that may arise from incidents reported.

Our review of the liability for losses and LAE includes a re-evaluation of the adequacy of reserve levels for prior year’s claims. We decreased the liability for losses and LAE for claims occurring in prior years by \$4.2 million during the three months ended March 31, 2015. We increased the liability for losses and LAE for claims occurring in prior years by \$1.1 million during the year ended December 31, 2014.

We continue to revise our estimates of the ultimate financial impact of claims made resulting from past storms. The revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) Company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and (iv) trends in general economic conditions, including the effects of inflation.

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**(9) Stock Compensation Plans**

We implemented a stock option plan in 2002 (the “2002 Plan”), which expired in April 2012. Under this plan, we were authorized to grant options to purchase up to 1,800,000 common shares, and as of March 31, 2015 and December 31, 2014, we had outstanding exercisable options to purchase 210,284 and 219,285 shares, respectively.

In April 2012, our Board of Directors adopted, and in September 2012 our shareholders approved, the Company’s 2012 Stock Incentive Plan (the “2012 Plan”). The 2012 Plan permits the issuance of up to 1,000,000 shares of our common stock, subject to adjustment as provided for in the 2012 Plan, in connection with the grant of a variety of equity incentive awards, such as incentive stock options, non-qualified stock options, stock appreciation rights, dividend equivalent rights, restricted stock, restricted stock units, and performance shares. Officers, directors and executive, managerial, administrative and professional employees of the Company and its subsidiaries are eligible to participate in the 2012 Plan. Awards may be granted singly, in combination, or in tandem. The 2012 Plan was amended and restated in March 2013 to clarify the plan administrator’s authority to permit the vesting of unvested restricted shares in the event of the death of the grantee. The 2012 Plan will expire on April 5, 2022.

On March 4, 2013, a total of 100,000 restricted shares from the 2012 Plan were granted pursuant to the vesting requirements and other terms and conditions set forth in restricted stock agreements. Of the total, 25,000 shares were granted to the Company’s Chief Executive Officer and President and 15,000 shares were granted to the Company’s Chief Financial Officer. An aggregate of 20,000 shares were granted to the Company’s directors and the remaining 40,000 shares were granted to other employees of the Company.

On August 5, 2013, a total of 150,000 restricted shares from the 2012 Plan were granted pursuant to the vesting requirements and other terms and conditions set forth in restricted stock agreements. Of the total, 100,000 shares were granted to the Company’s Chief Executive Officer and President and 50,000 shares were granted to the Company’s Chief Financial Officer.

On March 4, 2014, a total of 88,648 restricted shares from the 2012 Plan were granted pursuant to the vesting requirements and other terms and conditions set forth in restricted stock agreements. Of the total, 43,997 shares were granted to the Company’s Chief Executive Officer and President and 16,341 shares were granted to the Company’s Chief Financial Officer. An aggregate of 15,710 shares were granted to the Company’s directors and the remaining 12,600 shares were granted to other employees of the Company.

On September 9, 2014, a total of 130,000 restricted shares from the 2012 Plan were granted pursuant to the vesting requirements and other terms and conditions set forth in restricted stock agreements. Of the total, 45,000 shares were granted to the Company’s Chief Executive Officer and President and 15,000 shares were granted to the Company’s Chief Financial Officer. An aggregate of 50,000 shares were granted to the Company’s directors and the remaining 20,000 shares were granted to other employees of the Company.

On December 9, 2014, a total of 50,000 restricted shares from the 2012 Plan were granted to the Company’s Chief Executive Officer and President pursuant to the vesting requirements and other terms and conditions set forth in the restricted stock agreement.

On March 10, 2015, a total of 66,140 restricted shares from the 2012 Plan were granted pursuant to the vesting requirements and other terms and conditions set forth in restricted stock agreements. Of the total, 32,997 shares were granted to the Company’s Chief Executive Officer and President and 9,551 shares were granted to the Company’s Chief Financial Officer. An aggregate of 6,252 shares were granted to the Company’s directors and the remaining 17,340 shares were granted to other employees of the Company.

FASB issued guidance requires that when valuing an employee stock option under the Black-Scholes option pricing model, the fair value be based on the option’s expected term and expected volatility rather than the contractual term. The estimate of the fair value on the grant date should reflect the assumptions marketplace participants now use on the date of the measurement (i.e. grant date). During 2011, management changed the expected term in the Black –Scholes option pricing model from four years to two years for new options granted.

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Management believes that share price volatility over the last two years is more indicative of future share price volatility. The change has had an immaterial impact on the financial statements.

Activity in our stock option and incentive plans for the period from January 1, 2013 to March 31, 2015 is as follows.

	1998 Plan		2002 Plan		2012 Plan	
	Number of Shares	Weighted Average Option Exercise Price	Number of Shares	Weighted Average Option Exercise Price	Number of Shares	Fair Market Value at Grant
Outstanding at January 1, 2013	78,500	\$ 12.73	702,597	\$ 5.17	-	\$ -
Granted	-	\$ -	-	\$ -	250,000	\$ 5.54
Exercised	(500)	\$ 8.67	(165,577)	\$ 7.15	-	\$ -
Cancelled	(75,000)	\$ 12.92	(13,499)	\$ 5.41	(500)	\$ 5.54
Outstanding at January 1, 2014	3,000	\$ 8.67	523,521	\$ 4.54	249,500	\$ 5.54
Granted	-	\$ -	-	\$ -	268,648	\$ 5.54
Exercised	(3,000)	\$ 8.67	(299,735)	\$ 5.10	(68,988)	\$ -
Cancelled	-	\$ -	(4,501)	\$ 3.49	(1,359)	\$ 5.54
Outstanding at January 1, 2015	-	\$ 8.67	219,285	\$ 3.79	447,801	\$ 5.54
Granted	-	\$ -	-	\$ -	66,140	\$ 28.79
Exercised	-	\$ -	(9,001)	\$ 2.98	(59,707)	\$ 10.47
Cancelled	-	\$ -	-	\$ -	-	\$ -
Outstanding at March 31, 2015	-	\$ -	210,284	\$ 3.83	454,234	\$ 19.41

Options outstanding as of March 31, 2015 are exercisable as follows.

Options Exercisable at:	2002 Plan	
	Number of Shares	Weighted Average Option Exercise Price
March 31, 2015	153,584	\$ 3.83
December 31, 2015	56,700	\$ 3.83
December 31, 2016	-	\$ 3.83
December 31, 2017	-	\$ 3.83
December 31, 2018	-	\$ 3.83
December 31, 2019	-	\$ 3.83
Thereafter	-	\$ 3.83
Total options exercisable	210,284	

Upon the exercise of options, the Company issues authorized shares.

Prior to January 1, 2006, we accounted for the plans under the recognition and measurement provisions of stock-based compensation using the intrinsic value method prescribed by the APB and related Interpretation, as permitted by FASB issued guidance. Under these provisions, no stock-based employee compensation cost was recognized in the Statement of Operations as all options granted under those plans had an exercise price equal to or less than the market value of the underlying common stock on the date of grant.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB issued guidance using the modified-prospective-transition method. Under that transition method, compensation costs



**Federated National Holding Company**  
**Notes to Condensed Consolidated Financial Statements**

recognized during 2015 and 2014 include the following.

- Compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FASB issued guidance, and
- Compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair-value estimated in accordance with the provisions of FASB issued guidance. Results for prior periods have not been restated, as they are not required to be by the pronouncement.

As a result of adopting FASB issued guidance on January 1, 2006, the Company's income from continuing operations before provision for income tax expense and net income for the three months ended March 31, 2015 are lower by approximately \$752,000 and \$469,000, respectively, than if it had continued to account for share-based compensation under APB guidance. The Company's income from continuing operations before provision for income tax expense and net income for the three months ended March 31, 2014 are lower by approximately \$192,000 and \$119,000, respectively, than if it had continued to account for share-based compensation under APB guidance.

Basic and diluted earnings per share for the three months ended March 31, 2015 would have been \$0.71 and \$0.69, respectively, if the Company had not adopted FASB issued guidance, compared with reported basic and diluted earnings per share of \$0.68 and \$0.66, respectively. Basic and diluted earnings per share for the three months ended March 31, 2014 would have been \$0.78 and \$0.75, respectively, if the Company had not adopted FASB issued guidance, compared with reported basic and diluted earnings per share of \$0.77 and \$0.74, respectively.

Because the change in income taxes payable includes the effect of excess tax benefits, those excess tax benefits also must be shown as a separate operating cash outflow so that operating cash flows exclude the effect of excess tax benefits. FASB issued guidance requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows.

Summary information about the Company's stock option plans at March 31, 2015 is as follows.

	Range of <u>Exercise Price</u>	Outstanding at <u>March 31, 2015</u>	Weighted Average Contractual <u>Periods in Years</u>	Weighted Average <u>Exercise Price</u>	Exercisable at <u>March 31, 2015</u>
2002 Plan	\$2.45 - \$4.40	210,284	6.41	\$3.83	153,584

**(10) Stockholders' Equity**

**Capital Stock**

The Company's authorized capital consists of 1,000,000 shares of preferred stock, par value \$0.01 per share, and 25,000,000 shares of common stock, par value \$0.01 per share. As of March 31, 2015, there were no preferred shares issued or outstanding and there were 13,701,122 shares of common stock outstanding.

**(11) Subsequent Events**

The Company has entered into a joint venture to organize Monarch National Insurance Company ("Monarch Insurance"), which received its certificate of authority to write homeowners' property and casualty insurance in Florida from the Florida Office of Insurance Regulation (the "Florida OIR") on March 19, 2015. The Company's joint venture partners are a majority-owned limited partnership of Crosswinds Holdings Inc., f/k/a C.A. Bancorp Inc., a publicly traded Canadian private equity firm and asset manager ("Crosswinds"); and Transatlantic Reinsurance Company ("TransRe").

**Federated National Holding Company**  
**Notes to Condensed Consolidated Financial Statements**

The Company and Crosswinds have each invested \$14.0 million in Monarch Delaware Holdings LLC, the indirect parent company of Monarch Insurance (“Monarch Delaware”), for a 42.4% interest in Monarch Delaware (each holding 50% of the voting interests in Monarch Delaware). TransRe has invested \$5.0 million for a 15.2% non-voting interest in Monarch Delaware and has advanced an additional \$5.0 million in debt evidenced by a six-year promissory note bearing 6% annual interest payable by Monarch National Holding Company (“Monarch Holding”), a wholly owned subsidiary of Monarch Delaware and the direct parent company of Monarch Insurance.

In connection with the organization of Monarch Insurance, the parties entered into the following agreements dated as of March 17, 2015:

- Monarch Insurance entered into a Managing General Agent and Claims Administration Agreement (the “Monarch MGA Agreement”) with FNU, a wholly owned subsidiary of the Company, pursuant to which FNU provides underwriting, accounting, reinsurance placement and claims administration services to Monarch. For its services under the Monarch MGA Agreement, FNU will receive 4% of Monarch’s total written annual premium, excluding acquisition expenses payable to agents, for FNU’s managing general agent services; 3.6% of Monarch’s total earned annual premium for FNU’s claims administration services; and a per-policy administrative fee of \$25 for each policy underwritten for Monarch. The Company will also receive an annual expense reimbursement for accounting and related services.
- Monarch Insurance, Monarch Holding and Monarch Delaware (collectively, the “Monarch Entities”) entered into an Investment Management Agreement (the “Monarch Investment Agreement”) with Crosswinds AUM LLC, a wholly owned subsidiary of Crosswinds (“Crosswinds AUM”), pursuant to which Crosswinds AUM will manage the investment portfolios of the Monarch Entities. The management fee, on an annual basis, is 0.75% of assets under management up to \$100 million; 0.50% of assets under management of more than \$100 million but less than \$200 million; and 0.30% of assets under management of more than \$200 million.
- Monarch Insurance also entered into a Reinsurance Capacity Right of First Refusal Agreement with TransRe, pursuant to which TransRe has a right of first refusal for all quota share and excess of loss reinsurance that Monarch Insurance deems necessary in its sole discretion for so long as TransRe remains a member of Monarch Delaware or the Monarch Holding debt remains outstanding. Pursuant to this agreement, TransRe has the right to provide, at market rates and terms, a maximum of 15% of any reinsurance coverage obtained by Monarch Delaware in any individual reinsurance contract.
- The Limited Liability Company Agreement of Monarch Delaware Holdings LLC dated as of March 17, 2015 (the “Monarch LLC Agreement”) provides that Monarch Delaware is managed by a seven-member Board of Managers, three of whom have been designated by the Company, three of whom have been designated by Crosswinds, and one who will be jointly selected by the Company and Crosswinds. The Company’s designees are Michael H. Braun, the Company’s President and Chief Executive Officer and a director of the Company; Peter J. Prygelski, III, the Company’s Chief Financial Officer and a director of the Company; and Jenifer G. Kimbrough, a director of the Company. Crosswinds’ designees are Colin King, Robert Wolf, and Charles S. Duncker. The Company and Crosswinds have agreed to identify the seventh member of the Board of Managers within six months.
- The LLC Agreement provides that certain material transactions must be approved by a supermajority of the managers, including a termination, amendment or non-renewal of the Monarch MGA Agreement or the Monarch Investment Agreement. The Company will be entitled to receive a termination fee equal to the aggregate fees paid under the Monarch MGA Agreement for the 12 calendar months prior to the date of termination, if the Monarch MGA Agreement is terminated other than for cause. The Monarch LLC Agreement also provides the members with certain redemption, tag-along, drag-along and buy-sell rights. In addition, the Monarch LLC Agreement provides the Company and Crosswinds with the right, for 24 months from the closing date, to participate in certain other transactions relating to the formation or acquisition of homeowners’ property and casualty insurers undertaken by the other.

**Federated National Holding Company**  
**Notes to Condensed Consolidated Financial Statements**

In connection with the organization of Monarch Insurance, the Company's Board of Directors approved amendments dated March 17, 2015 to the Amended and Restated Non-Competition, Non-Disclosure and Non-Solicitation Agreements dated as of August 5, 2013 with each of Mr. Braun and Mr. Prygelski (each, a "Restrictive Covenant Agreement") to permit each of them to hold their respective positions with the Monarch Entities while remaining employed by the Company. Mr. Braun's Restrictive Covenant Agreement was further amended to permit him to continue to hold his positions with the Monarch Entities if he is terminated without cause by the Company. In addition, Mr. Braun's Second Amended and Restated Employment Agreement dated as of January 18, 2012 (the "Employment Agreement") was amended to extend the term of his Employment Agreement to four years from the date of the amendment (the "Term") with automatic extensions so that at all times the balance of the Term is not less than two years unless sooner terminated as provided in the Employment Agreement.

## Federated National Holding Company

*General information about Federated National Holding Company can be found at [www.FedNat.com](http://www.FedNat.com); however, the information that can be accessed through our web site is not part of our report. We make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports filed or furnished pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934 available free of charge on our web site, as soon as reasonably practicable after they are electronically filed with the SEC.*

### Item 2

#### Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion in conjunction with our condensed consolidated financial statements and related notes and information included under this Item 2 and elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on March 16, 2015 ("Form 10-K"). Unless the context requires otherwise, as used in this Form 10-Q, the terms "FNHC" "Company," "we," "us" and "our," refers to Federated National Holding Company and its subsidiaries. We changed our name on September 11, 2012, pursuant to approval received at our annual shareholders' meeting, from 21st Century Holding Company so that our parent company and other subsidiary companies' names are consistent with our primary insurance subsidiary and the name under which we have been writing insurance for more than 23 years.

#### Forward-Looking Statements

Statements in this Quarterly Report on Form 10-Q for the three months ended March 31, 2015 ("Form 10-Q") or in documents that are incorporated by reference that are not historical fact are forward-looking statements that are subject to certain risks and uncertainties that could cause actual events and results to differ materially from those discussed herein. Without limiting the generality of the foregoing, words such as "may," "will," "expect," "believe," "anticipate," "intend," "could," "would," "estimate," or "continue" or the negative other variations thereof or comparable terminology are intended to identify forward-looking statements. The risks and uncertainties include, without limitation, uncertainties related to estimates, assumptions and projections relating to unpaid losses and loss adjustment expenses ("LAE") and other accounting policies, losses from the nine hurricanes that occurred in fiscal years 2005 and 2004 and in other estimates, assumptions and projections contained in this Form 10-Q; inflation and other changes in economic conditions (including changes in interest rates and financial markets); the impact of new regulations adopted in Florida which affect the property and casualty insurance market; the costs of reinsurance, assessments charged by various governmental agencies; pricing competition and other initiatives by competitors; our ability to obtain regulatory approval for requested rate changes and the timing thereof; legislative and regulatory developments; the outcome of various litigation matters pending against us, including the terms of any settlements; risks related to the nature of our business; dependence on investment income and the composition of our investment portfolio; the adequacy of our liability for loss and loss adjustment expense; insurance agents; claims experience; ratings by industry services; catastrophe losses; reliance on key personnel; weather conditions (including the severity and frequency of storms, hurricanes, tornadoes and hail); changes in driving patterns and loss trends; acts of war and terrorist activities; court decisions and trends in litigation and health care and auto repair costs; and other matters described from time to time by us in this report, and in our other filings with the SEC, including the Company's Form 10-K.

You are cautioned not to place reliance on these forward-looking statements, which are valid only as of the date they were made. The Company undertakes no obligation to update or revise any forward-looking statements to reflect new information or the occurrence of unanticipated events or otherwise. In addition, readers should be aware that Generally Accepted Accounting Principles ("GAAP") prescribes when a company may reserve for particular risks, including litigation exposures. Accordingly, results for a given reporting period could be significantly affected when a reserve is established for a major contingency. Reported results may therefore appear to be volatile in certain accounting periods.

## Federated National Holding Company

### Overview

FNHC is an insurance holding company that controls substantially all steps in the insurance underwriting, distribution and claims processes through our subsidiaries and our contractual relationships with our independent agents and general agents.

We are authorized to underwrite, and/or place through our wholly owned subsidiaries, homeowners' multi-peril ("homeowners"), commercial general liability, federal flood, personal auto and various other lines of insurance in Florida and various other states. We market and distribute our own and third-party insurers' products and our other services through a network of independent agents.

Our wholly owned insurance subsidiary is Federated National Insurance Company ("FNIC"). FNIC is licensed as an admitted carrier in Florida. An admitted carrier is an insurance company that has received a license from the state department of insurance giving the company the authority to write specific lines of insurance in that state. These companies are also bound by rate and form regulations, and are strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud. Admitted carriers are also required to financially contribute to the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders. Through contractual relationships with a network of approximately 3,800 independent agents, of which approximately 2,300 actively sell and service our products, FNIC is authorized to underwrite homeowners', commercial general liability, fire, allied lines, and personal automobile insurance in Florida. FNIC is licensed as an admitted carrier in Alabama, Louisiana, Georgia, and Texas and underwrites commercial general liability insurance in those states. FNIC also underwrites homeowners' insurance in Alabama and Louisiana and just became admitted in South Carolina to underwrite homeowners insurance. Additionally, we underwrite personal automobile insurance in Georgia and Texas.

FNIC is licensed as a non-admitted carrier in Missouri and Nevada and can underwrite commercial general liability insurance in these states. Currently, we do not have any operations in these states. A non-admitted carrier, sometimes referred to as an "excess and surplus lines" carrier, is permitted to do business in a state and, although it is strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud, non-admitted carriers are subject to considerably less regulation with respect to policy rates and forms. Non-admitted carriers are not required to financially contribute to and benefit from the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders.

We previously entered into a Coexistence Agreement effective August 30, 2013 (the "Coexistence Agreement") with Federated Mutual Insurance Company ("Federated Mutual") pursuant to which, among other things, we may continue to use "Federated" until at least August 30, 2020, after which time we have agreed to either cease using "Federated" in commerce or otherwise adopt and use trade names that are not confusingly similar to Federated Mutual's trademarks. We continue to develop our brand under the "FedNat" name, which is the name by which agents generally know us.

### Organization of Monarch National Insurance Company

The Company has entered into a joint venture to organize Monarch National Insurance Company ("Monarch Insurance"), which received its certificate of authority to write homeowners' property and casualty insurance in Florida from the Florida Office of Insurance Regulation (the "Florida OIR") on March 19, 2015. The Company's joint venture partners are a majority-owned limited partnership of Crosswinds Holdings Inc., f/k/a C.A. Bancorp Inc., a publicly traded Canadian private equity firm and asset manager ("Crosswinds"); and Transatlantic Reinsurance Company ("TransRe").

The Company and Crosswinds have each invested \$14.0 million in Monarch Delaware Holdings LLC, the indirect parent company of Monarch Insurance ("Monarch Delaware"), for a 42.4% interest in Monarch Delaware (each holding 50% of the voting interests in Monarch Delaware). TransRe has invested \$5.0 million for a 15.2% non-voting interest in Monarch Delaware and has advanced an additional \$5.0 million in debt evidenced by a six-year promissory note bearing 6% annual interest payable by Monarch National Holding Company ("Monarch Holding"), a wholly owned subsidiary of Monarch Delaware and the direct parent company of Monarch Insurance.

## Federated National Holding Company

In connection with the organization of Monarch Insurance, the parties entered into the following agreements dated as of March 17, 2015:

- Monarch Insurance entered into a Managing General Agent and Claims Administration Agreement (the “Monarch MGA Agreement”) with FNU, a wholly owned subsidiary of the Company, pursuant to which FNU provides underwriting, accounting, reinsurance placement and claims administration services to Monarch. For its services under the Monarch MGA Agreement, FNU will receive 4% of Monarch’s total written annual premium, excluding acquisition expenses payable to agents, for FNU’s managing general agent services; 3.6% of Monarch’s total earned annual premium for FNU’s claims administration services; and a per-policy administrative fee of \$25 for each policy underwritten for Monarch. The Company will also receive an annual expense reimbursement for accounting and related services.
- Monarch Insurance, Monarch Holding and Monarch Delaware (collectively, the “Monarch Entities”) entered into an Investment Management Agreement (the “Monarch Investment Agreement”) with Crosswinds AUM LLC, a wholly owned subsidiary of Crosswinds (“Crosswinds AUM”), pursuant to which Crosswinds AUM will manage the investment portfolios of the Monarch Entities. The management fee, on an annual basis, is 0.75% of assets under management up to \$100 million; 0.50% of assets under management of more than \$100 million but less than \$200 million; and 0.30% of assets under management of more than \$200 million.
- Monarch Insurance also entered into a Reinsurance Capacity Right of First Refusal Agreement with TransRe, pursuant to which TransRe has a right of first refusal for all quota share and excess of loss reinsurance that Monarch Insurance deems necessary in its sole discretion for so long as TransRe remains a member of Monarch Delaware or the Monarch Holding debt remains outstanding. Pursuant to this agreement, TransRe has the right to provide, at market rates and terms, a maximum of 15% of any reinsurance coverage obtained by Monarch Delaware in any individual reinsurance contract.
- The Limited Liability Company Agreement of Monarch Delaware Holdings LLC dated as of March 17, 2015 (the “Monarch LLC Agreement”) provides that Monarch Delaware is managed by a seven-member Board of Managers, three of whom have been designated by the Company, three of whom have been designated by Crosswinds, and one who will be jointly selected by the Company and Crosswinds. The Company’s designees are Michael H. Braun, the Company’s President and Chief Executive Officer and a director of the Company; Peter J. Prygelski, III, the Company’s Chief Financial Officer and a director of the Company; and Jenifer G. Kimbrough, a director of the Company. Crosswinds’ designees are Colin King, Robert Wolf, and Charles S. Duncker. The Company and Crosswinds have agreed to identify the seventh member of the Board of Managers within six months.
- The LLC Agreement provides that certain material transactions must be approved by a supermajority of the managers, including a termination, amendment or non-renewal of the Monarch MGA Agreement or the Monarch Investment Agreement. The Company will be entitled to receive a termination fee equal to the aggregate fees paid under the Monarch MGA Agreement for the 12 calendar months prior to the date of termination, if the Monarch MGA Agreement is terminated other than for cause. The Monarch LLC Agreement also provides the members with certain redemption, tag-along, drag-along and buy-sell rights. In addition, the Monarch LLC Agreement provides the Company and Crosswinds with the right, for 24 months from the closing date, to participate in certain other transactions relating to the formation or acquisition of homeowners’ property and casualty insurers undertaken by the other.

Our executive offices are located at 14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323 and our telephone number is (800) 293-2532.

## Federated National Holding Company

### Our Subsidiaries

During the three months ended March 31, 2015, 91.7%, 3.7%, 1.4% and 3.2% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and automobile insurance, respectively. During the three months ended March 31, 2015, \$19.7 million or 20.1% of the \$97.8 million of the homeowners' premiums we underwrote were produced under an agency agreement with Ivantage Select Agency, Inc. ("ISA"), an affiliate of Allstate Insurance Company, that grants Allstate agents the authority to offer certain FNIC products. The \$19.7 million of homeowners' premiums produced under this agreement with ISA represents 82.6% of the total increase in the sale of homeowners' policies during the three months ended March 31, 2015. During the three months ended March 31, 2014, \$11.6 million or 15.7% of the \$74.0 million of the homeowners' premiums we underwrote were produced under an agency agreement with ISA. This network of agents began writing for FNIC in March 2013. During the three months ended March 31, 2014, 91.2%, 3.9%, 1.9% and 3.0% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and automobile insurance, respectively.

Our business, results of operations and financial condition are subject to fluctuations due to a variety of factors. Abnormally high severity or frequency of claims in any period could have a material adverse effect on us. When our estimated liabilities for unpaid losses and LAE are less than the actuarially determined amounts, we increase the expense in the current period. Conversely, when our estimated liabilities for unpaid losses and LAE are greater than the actuarially determined amounts, we decrease the expense in the current period.

We are focusing our marketing efforts on continuing to expand our distribution network while maintaining our commitment to long-term relationships. We market our products and services throughout Florida and in other states by establishing relationships with additional independent agents and general agents. There can be no assurance, however, that we will be able to obtain the required regulatory approvals to offer additional insurance products or expand into other states.

FedNat Underwriters, Inc. ("FNU"), formerly known as Assurance Managing General Agents, Inc., a wholly owned subsidiary of the Company, acts as FNIC's exclusive managing general agent in Florida and is also licensed as a managing general agent in the States of Alabama, Georgia, Louisiana, Mississippi, Nevada, South Carolina and Texas. FNU has contracted with other unaffiliated insurance companies to sell personal umbrella through FNU's existing network of agents.

FNU earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. FNU earns a per policy fee which ranges from \$25 to \$55 and a commission fee from its affiliate, FNIC, which totaled 4% during the three months ended March 31, 2015. The Florida OIR periodically reviews our managing general agent's fee structure to ensure that it is neither excessive nor inadequate to operate.

We internally process claims made by our insureds through our wholly owned claims adjusting company, Federated National Adjusting, Inc. ("FNA"), formerly known as Superior Adjusting, Inc. Our agents have no authority to settle claims or otherwise exercise control over the claims process. Furthermore, we believe that the retention of independent adjusters, in addition to the employment of salaried claims personnel, results in reduced ultimate loss payments, lower LAE and improved customer service for our claimants and policyholders. We also employ an in-house litigation management team to cost effectively manage claims-related litigation and to monitor our claims handling practices for efficiency and regulatory compliance.

During 2014, the Florida OIR approved an application to allow the claims administration operations of FNA to be assumed by FNU. Under the amended managing general agency agreement between FNU and FNIC, FNU will provide the same claims administration services under the same fee structure. The combination of these services in FNU had no effect on consolidated net income.

Insure-Link, Inc. ("Insure-Link") is our independent insurance agency. The insurance agency markets direct to the public to provide a variety of insurance products and services to individual clients, as well as business clients, by offering a full line of insurance products including, but not limited to, homeowners', flood, personal and commercial automobile, commercial general liability and workers' compensation insurance through their agency appointments with over forty different carriers.

## **Federated National Holding Company**

### **Insurance Markets in Which We Operate**

We operate in highly competitive markets and face competition from national, regional and residual market insurance companies in the homeowners', commercial general liability, and automobile markets. Our competitors include companies that market their products through agents, as well as companies that sell insurance directly to their customers. Large national writers may have certain competitive advantages over agency writers, including increased name recognition, increased loyalty of their customer base and reduced policy acquisition costs. We compete based on underwriting criteria, our distribution network and superior service to our agents and insureds. Although our pricing is inevitably influenced to some degree by that of our competitors, we believe that it is generally not in our best interest to compete solely on price.

In Florida, more than 100 companies compete with us in the homeowners' insurance market. Several of our larger competitors are Citizens Property Insurance Corporation ("Citizens"), Universal Property and Casualty Insurance Company and St. Johns Insurance Company. In Florida, more than one dozen companies compete with us in the commercial general liability insurance market.

In May 2013, SB 1770 was signed by the Governor of Florida and passed during the 2013 legislative session. This bill is intended to reform Citizens by reducing its insurance policy count and establishing the Property Insurance Clearinghouse ("Clearinghouse"). The Clearinghouse launched in January 2014, for new business ineligible for Citizens if a participating insurance company is willing to afford similar coverage at a price that is no more than 15% above the price of a policy with Citizens. Similarly, existing Citizens policies will not be eligible for renewal with Citizens if a participating insurance company is willing to afford similar coverage at no additional cost over the price for a Citizens policy. This will allow potentially new and renewal policies of Citizens to be comparatively shopped by participating private market insurers before becoming, or remaining, policies of Citizens. Effective March 30, 2014 FNIC joined as a participating insurance company in the Clearinghouse.

### **Critical Accounting Policies**

See Note 3, "Summary of Significant Accounting Policies" in the Notes to the Company's condensed consolidated financial statements for the quarter ended March 31, 2015 included in Item 1 of this Quarterly Report on Form 10-Q for a discussion of the Company's critical accounting policies.

### **New Accounting Pronouncements**

See Note 3, "Summary of Significant Accounting Policies" in the Notes to the Company's condensed consolidated financial statements for the quarter ended March 31, 2015 included in Item 1 of this Quarterly Report on Form 10-Q for a discussion of recent accounting pronouncements and their effect, if any, on the Company.

### **Analysis of Financial Condition As of March 31, 2015 Compared with December 31, 2014**

Our recent investment in Monarch National Holding Company ("MNHC") has impacted our consolidated balance sheet at March 31, 2015 by inclusion of MNHC's asset and liability line items and recognition of the non-controlling interest within shareholders' equity.

### **Total Investments**

FASB issued guidance addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. We account for our investment securities consistent with FASB issued guidance that requires our securities to be classified into one of three categories: (i) held-to-maturity, (ii) trading securities or (iii) available-for-sale.

Investments classified as held-to-maturity include debt securities wherein the Company's intent and ability are to hold the investment until maturity and are carried at amortized cost without consideration to unrealized gains or losses. Investments classified as trading securities include debt and equity securities bought and held primarily for sale in the near term and are carried at fair value with unrealized holding gains and losses included in current period operations. Investments classified as available-for-sale include debt and equity securities that are not classified as held-to-maturity or as trading security investments and are carried at fair value with unrealized holding gains and



## Federated National Holding Company

losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income."

Total investments increased \$5.6 million, or 1.7%, to \$336.4 million as of March 31, 2015, compared with \$330.8 million as of December 31, 2014.

The debt and equity securities that are available-for-sale and carried at fair value represent 98% of total investments as of March 31, 2015 and December 31, 2014.

We did not hold any trading investment securities during the three months ended March 31, 2015.

The FASB issued guidance also addresses the determination as to when an investment is considered impaired, whether that impairment is other-than temporary, and the measurement of an impairment loss. The Company's policy for the valuation of temporarily impaired securities is to determine impairment based on the analysis of the following factors.

- rating downgrade or other credit event (eg., failure to pay interest when due);
- length of time and the extent to which the fair value has been less than amortized cost;
- financial condition and near term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology or discontinuance of a business segment;
- prospects for the issuer's industry segment;
- intent and ability of the Company to retain the investment for a period of time sufficient to allow for anticipated recovery in market value;
- historical volatility of the fair value of the security.

Pursuant to FASB issued guidance, the Company records the unrealized losses, net of estimated income taxes that are associated with that part of our portfolio classified as available-for-sale through the shareholders' equity account titled "Other Comprehensive Income". Management periodically reviews the individual investments that comprise our portfolio in order to determine whether a decline in fair value below our cost either is other-than temporarily or permanently impaired. Factors used in such consideration include, but are not limited to, the extent and length of time over which the market value has been less than cost, the financial condition and near-term prospects of the issuer and our ability and intent to keep the investment for a period sufficient to allow for an anticipated recovery in market value.

In reaching a conclusion that a security is either other-than-temporarily or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as Standard and Poor's ("S&P") and Moody's Investors Service, Inc. ("Moody's"), as well as information released via the general media channels. During the three months ended March 31, 2015 and the three months ended March 31, 2014, respectively, in connection with the process, we have not charged operations with investment losses.

As of March 31, 2015 and December 31, 2014, respectively, all of our securities are in good standing and not impaired as defined by FASB issued guidance.

As of March 31, 2015 and December 31, 2014, our investments consisted primarily of corporate bonds held in various industries, municipal bonds and United States government bonds. As of March 31, 2015, 78% of our debt portfolio was in diverse industries and 22% was in United States government bonds. As of March 31, 2015, approximately 88% of our equity holdings were in equities related to diverse industries and 12% were in mutual funds. As of December 31, 2014, 77% of our debt portfolio was in diverse industries and 23% is in United States government bonds. As of December 31, 2014, approximately 88% of our equity holdings were in equities related to diverse industries and 12% were in mutual funds.

## Federated National Holding Company

As of March 31, 2015 and December 31, 2014, we have classified \$7.5 million and \$7.4 million, respectively, of our bond portfolio as held-to-maturity. We classify bonds as held-to-maturity to support securitization of credit requirements.

During the three months ended March 31, 2015 and 2014, we did not re-classify any of our bond portfolio between available-for-sale and held-to-maturity.

Below is a summary of net unrealized gains (losses) as of March 31, 2015 and December 31, 2014, by category.

	<u>Unrealized Gains (Losses)</u>	
	<u>March 31, 2015</u>	<u>December 31, 2014</u>
	(Dollars in Thousands)	
Debt securities:		
United States government obligations and authorities	\$ 1,413	\$ 945
Obligations of states and political subdivisions	1,047	886
Corporate	2,284	1,249
International	111	(1)
	<u>4,855</u>	<u>3,079</u>
Equity securities:		
Common stocks	<u>9,527</u>	<u>9,338</u>
Total debt and equity securities	<u>\$ 14,382</u>	<u>\$ 12,417</u>

The net unrealized gain of \$14.4 million is inclusive of \$0.9 million of unrealized losses; \$0.2 million of unrealized losses are from debt securities and \$0.7 million of unrealized losses are from equity securities.

The \$0.2 million of unrealized losses from debt securities are made up mainly of losses from corporate securities. The Company does not expect to settle at prices less than the amortized cost basis. The Company does not consider these investments to be other-than-temporarily impaired at March 31, 2015 because we neither currently intend to sell these investments nor consider it likely that we will be required to sell these investments before recovery of the amortized cost basis.

The \$0.7 million of unrealized losses from equity securities are from common stocks and mutual funds held in diverse industries as of March 31, 2015. The Company evaluated the near-term prospects in relation to the severity and duration of the impairment. Based on this evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2015.

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The following table summarizes, by type, our investments as of March 31, 2015 and December 31, 2014.

	<u>March 31, 2015</u>		<u>December 31, 2014</u>	
	<u>Carrying Amount</u>	<u>Percent of Total</u>	<u>Carrying Amount</u>	<u>Percent of Total</u>
	(Dollars in Thousands)			
Debt securities, at market:				
United States government obligations and authorities	\$ 59,549	17.70%	\$ 62,323	18.84%
Obligations of states and political subdivisions	92,172	27.40%	91,614	27.70%
Corporate	125,021	37.18%	119,024	35.99%
International	<u>11,451</u>	<u>3.40%</u>	<u>11,138</u>	<u>3.37%</u>
	<u>288,193</u>	<u>85.68%</u>	<u>284,099</u>	<u>85.90%</u>
Debt securities, at amortized cost:				
United States government obligations and authorities	4,564	1.36%	4,490	1.36%
Corporate	2,701	0.80%	2,681	0.81%
International	<u>197</u>	<u>0.06%</u>	<u>246</u>	<u>0.07%</u>
	<u>7,462</u>	<u>2.22%</u>	<u>7,417</u>	<u>2.24%</u>
Total debt securities	295,655	87.90%	291,516	88.14%
Equity securities, at market:	<u>40,726</u>	<u>12.10%</u>	<u>39,247</u>	<u>11.86%</u>
Total investments	<u>\$ 336,381</u>	<u>100.00%</u>	<u>\$ 330,763</u>	<u>100.00%</u>

### Cash and Short-Term Investments

Cash and short-term investments, which include cash, certificates of deposits, and money market accounts, increased \$48.0 million, or 119.5%, to \$88.2 million as of March 31, 2015, compared with \$40.2 million as of December 31, 2014. The increase in cash and short-term investments is due to our \$25.6 million increase in gross premiums written during the same period, the investment of \$18.9 million from the joint venture partners Monarch Delaware Holdings LLC, the parent of Monarch National Holding Company (“Monarch Holding”) and a \$5.0 million loan to Monarch Holding from Transatlantic Reinsurance Company, reduced by \$0.8 million disbursed to our joint venture partners to reimburse start-up costs incurred.

### Prepaid Reinsurance Premiums

Prepaid reinsurance premiums decreased \$8.5 million, or 15.5%, to \$46.0 million as of March 31, 2015, compared with the \$54.5 million as of December 31, 2014 as the result of the amortization of our payment patterns, in addition to a decrease in ceded unearned premiums on the Property 30% Quota Share reinsurance agreement effective July 1, 2014. We believe concentrations of credit risk associated with our prepaid reinsurance premiums are not significant.

### Premiums Receivable, Net of Allowance for Credit Losses

Premiums receivable, net of allowance for credit losses, increased \$2.5 million, or 9.3%, to \$29.8 million as of March 31, 2015, compared with \$27.3 million as of December 31, 2014.

Our homeowners’ insurance premiums receivable increased \$2.3 million, or 10.5%, to \$24.7 million as of March 31, 2015, compared with \$22.4 million as of December 31, 2014. Our commercial general liability insurance premiums receivable increased \$0.3 million, or 133.9%, to \$0.5 million as of March 31, 2015, compared with \$0.2 million as of December 31, 2014. Our automobile insurance premiums receivable decreased \$0.1 million, or 2.5%, to \$4.7 million as of March 31, 2015, compared with \$4.8 million as of December 31, 2014. Our allowance for credit losses remained unchanged at \$0.1 million as of March 31, 2015, compared with December 31, 2014.

### Reinsurance Recoverable, Net

Reinsurance recoverable, net, increased \$0.5 million, or 4.0%, to \$13.0 million as of March 31, 2015, compared with \$12.5 million as of December 31, 2014. The change is due to the payment patterns by our reinsurers, as influenced by the diminishing catastrophe related claims and to the Property 30% Quota Share agreement

## Federated National Holding Company

effective July 1, 2014. All amounts are current and deemed collectable. We believe concentrations of credit risk associated with our reinsurance recoverables, net, are not significant.

### Deferred Policy Acquisition Costs (“DPAC”)

DPAC increased \$2.2 million, or 15.8%, to \$15.8 million as of March 31, 2015, compared with \$13.6 million as of December 31, 2014. The change reflects in part the deferral of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned associated with our increased unearned premium, which during the three months ended March 31, 2015 total approximately \$2.4 million. The \$2.4 million increase was offset by a \$0.2 million reduction associated with our Property 30% Quota Share agreement effective July 1, 2014.

### Income Taxes Receivable

Income taxes receivable totaled \$2.1 million as of March 31, 2015, compared with \$1.8 million as of December 31, 2014. The change is due to estimated tax payments made in excess of the related accrued liability.

### Property, Plant and Equipment, Net

Property, plant and equipment, net remained unchanged at \$1.7 million as of March 31, 2015, compared with December 31, 2014.

### Other Assets

Other assets increased \$1.1 million, or 14.3%, to \$8.3 million as of March 31, 2015, compared with \$7.2 million as of December 31, 2014. Major components of other assets are shown in the following table. The accrued interest income receivable is primarily investment related and the commission income receivable is primarily related to the commission income sharing with our reinsurance intermediary.

	<u>March 31, 2015</u>	<u>December 31, 2014</u>
	(Dollars in Thousands)	
Accrued interest income receivable	\$ 2,559	\$ 2,600
Commission receivable	3,454	2,077
Deposits	308	281
Prepaid expenses	1,318	1,496
Receivable for investments sold	-	31
Other	626	746
Total	<u>\$ 8,265</u>	<u>\$ 7,231</u>

### Contingent Quota-Share Profit Sharing

Contingent quota-share profit sharing totaled \$14.0 million as of March 31, 2015 and December 31, 2014. The \$14.0 million is our current estimated profit-sharing benefit associated with our Property 30% Quota Share agreement effective July 1, 2014. The provisions of this program allow for profit-sharing up to approximately \$32.0 million at the end of the two-year contract term. The ultimate benefit is based upon the occurrence of future catastrophic events and predefined non-catastrophic loss ratios.

### Unpaid Losses and LAE

Unpaid losses and LAE increased \$6.2 million, or 7.8%, to \$84.5 million as of March 31, 2015, compared with \$78.3 million as of December 31, 2014 in conjunction with the increase to net premiums earned during the three months ended March 31, 2015 as compared with the three months ended March 31, 2014. The \$6.2 million increase was net of a \$6.7 million reduction associated with our Property 30% Quota Share agreement effective July 1, 2014.

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The composition of unpaid losses and LAE by product line is as follows.

	<u>March 31, 2015</u>			<u>December 31, 2014</u>		
	<u>Case</u>	<u>Bulk</u>	<u>Total</u>	<u>Case</u>	<u>Bulk</u>	<u>Total</u>
	(Dollars in Thousands)			(Dollars in Thousands)		
Homeowners'	\$ 15,416	\$ 38,604	\$ 54,020	\$ 14,223	\$ 35,192	\$ 49,415
Commercial General Liability	5,803	12,487	18,290	5,646	12,505	18,151
Automobile	4,147	8,018	12,165	3,672	7,092	10,764
Total	<u>\$ 25,366</u>	<u>\$ 59,109</u>	<u>\$ 84,475</u>	<u>\$ 23,541</u>	<u>\$ 54,789</u>	<u>\$ 78,330</u>

Please see "Results of Operations - Three Months Ended March 31, 2015 Compared with Three Months Ended March 31, 2014 - Losses and LAE" for a description of the factors that affect unpaid losses and LAE.

### Unearned Premium

Unearned premiums increased \$11.0 million, or 5.7%, to \$203.4 million as of March 31, 2015, compared with \$192.4 million as of December 31, 2014. The change was due to a \$10.1 million increase in unearned homeowners' insurance premiums, a \$0.3 million decrease in unearned flood insurance premiums, a \$0.8 million increase in unearned commercial general liability premiums and a \$0.4 million increase in unearned automobile insurance premiums. Generally, as is in this case, an increase in unearned premium directly relates to an increase in written premium on a rolling twelve-month basis. The \$11.0 million total increase and the \$10.1 million homeowners' increase were net of a \$1.9 million reduction associated with our Property 30% Quota Share agreement effective July 1, 2014.

### Debt

Debt totaled \$5.0 million as of March 31, 2015, compared with nothing as of December 31, 2014, reflecting the \$5.0 million loan to Monarch Holding from Transatlantic Reinsurance Company.

### Premium Deposits and Customer Credit Balances

Premium deposits and customer credit balances increased \$3.9 million, or 53.0%, to \$11.3 million as of March 31, 2015, compared with \$7.4 million as of December 31, 2014. Premium deposits are monies received on policies not yet in-force, the change of which is due to the increase in gross written premiums during this same period.

### Deferred Income Taxes, Net

Deferred income taxes, net, increased \$0.6 million to a net liability balance of \$1.9 million as of March 31, 2015, compared with \$1.3 million as of December 31, 2014. Deferred income taxes, net, is comprised of approximately \$10.1 million and \$9.7 million of deferred tax assets, net of approximately \$12.0 million and \$11.0 million of deferred tax liabilities as of March 31, 2015 and December 31, 2014.

### Claims Payments Outstanding

Claims payments outstanding decreased \$0.5 million, or 4.9%, to \$9.7 million as of March 31, 2015, compared with \$10.2 million as of December 31, 2014. The claims payments outstanding relate primarily to losses and LAE disbursements paid but not presented for payment by the policyholder or vendor. The change relates to the timing of presentation of claims checks to the issuing bank.

### Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses decreased \$2.0 million, or 17.9%, to 9.0 million as of March 31, 2015, compared with \$11.0 million as of December 31, 2014. The \$2.0 million change includes decreases of \$1.4 million for premium taxes and \$1.1 million for the remittance of recouped assessments, as well as an increase of \$0.5 million for commissions.

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### Deferred Quota-Share Profit Sharing

Deferred quota-share profit sharing totaled \$8.8 million as of March 31, 2015, compared with \$10.5 million as of December 31, 2014, and relates to the quota-share program. The deferred quota-share profit sharing was originally recorded at \$14.0 million at the program's July 1, 2014 inception and will continue to amortize over the life of the program.

### Results of Operations

#### Three Months Ended March 31, 2015 Compared with Three Months Ended March 31, 2014

Our recent investment in Monarch National Holding Company ("MNHC") has impacted our consolidated statement of operations for the three months ended March 31, 2015 by inclusion of MNHC's revenue and expense line items and recognition of the non-controlling interest when computing net income attributable to FNHC common stockholders.

### Gross Premiums Written

Gross premiums written increased \$25.6 million, or 31.6%, to \$106.7 million for the three months ended March 31, 2015, compared with \$81.1 million for the three months ended March 31, 2014. The following table denotes gross premiums written by major product line. The increase in gross premiums written during the 2015 period is primarily due to the increase in the sale of homeowners' policies. Beginning in 2013, our improved underwriting, risk management and product distribution enabled us to write more policies than in prior years.

	<u>Three Months Ended March 31,</u>			
	<u>2015</u>		<u>2014</u>	
	(Dollars in Thousands)			
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
Homeowners'	\$ 97,778	91.64%	\$ 73,980	91.22%
Commercial General Liability	3,970	3.72%	3,144	3.88%
Federal Flood	1,492	1.40%	1,518	1.87%
Automobile	<u>3,462</u>	<u>3.24%</u>	<u>2,460</u>	<u>3.03%</u>
Gross written premiums	<u>\$ 106,702</u>	<u>100.00%</u>	<u>\$ 81,102</u>	<u>100.00%</u>

The increase in the sale of homeowners' policies by \$23.8 million, or 32.2%, to \$97.8 million for the three months ended March 31, 2015, compared with \$74.0 million for the three months ended March 31, 2014, is gross of reinsurance costs and net of Florida's mandated homeowners' wind mitigation discounts. We offer premium discounts for wind mitigation efforts by policyholders, as required by Florida law. As of March 31, 2015, 75.8% of our in-force homeowners' policyholders were receiving wind mitigation credits totaling approximately \$357.3 million (a 50.0% reduction of in-force premium), while 79.5% of our in-force homeowners' policyholders were receiving wind mitigation credits totaling approximately \$254.3 million, (a 50.4% reduction of in-force premium), as of March 31, 2014.

During the three months ended March 31, 2015, \$19.7 million or 20.1% of the \$97.8 million of the homeowners' premiums we underwrote were produced under an agency agreement with Ivantage Select Agency, Inc. ("ISA"), an affiliate of Allstate Insurance Company, that grants Allstate agents the authority to offer certain FNIC products. The \$19.7 million of homeowners' premiums produced under this agreement with ISA represents 82.6% of the total increase in the sale of homeowners' policies during the three months ended March 31, 2015. During the three months ended March 31, 2014, \$11.6 million or 15.7% of the \$74.0 million of the homeowners' premiums we underwrote were produced under the agreement with ISA. This network of agents began writing for FNIC in March 2013.

During the three months ended March 31, 2015 and 2014, the change to the cumulative wind mitigation credits afforded our policyholders totaled \$20.6 million and \$37.6 million, respectively. These premium discounts have had a significant effect on both written and earned premium. Wind mitigation credits are 50.0% of the pre-credit premium, or \$714.3 million, as of March 31, 2015, as compared with 50.4% of the pre-credit premium, or \$504.5 million, as of March 31, 2014. Our number of in-force homeowners' policies increased by approximately

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14,300 or 7.9%, to approximately 196,900 as of March 31, 2015, compared with approximately 182,600 as of December 31, 2014.

We are required to report write-your-own flood premiums on a direct and 100% ceded basis.

The Company's sale of commercial general liability policies increased \$0.9 million, or 26.3%, to \$4.0 million for the three months ended March 31, 2015, compared with \$3.1 million for the three months ended March 31, 2014.

The following table sets forth the amounts and percentages of our gross premiums written in connection with our commercial general liability program by state.

<u>State</u>	<u>Three Months Ended March 31,</u>			
	<u>2015</u>	<u>Percentage</u>	<u>2014</u>	<u>Percentage</u>
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
	(Dollars in Thousands)			
Alabama	\$ 60	1.51%	\$ 24	0.76%
Florida	3,604	90.78%	2,998	95.36%
Georgia	45	1.14%	-	0.00%
Louisiana	23	0.57%	20	0.64%
Texas	<u>238</u>	<u>6.00%</u>	<u>102</u>	<u>3.24%</u>
Total	<u>\$ 3,970</u>	<u>100.00%</u>	<u>\$ 3,144</u>	<u>100.00%</u>

The Company's sale of auto insurance policies increased \$1.0 million, or 40.7%, to \$3.5 million for the three months ended March 31, 2015, compared with \$2.5 million for the three months ended March 31, 2014.

We are currently rated by Demotech, Inc. ("Demotech") as "A" ("Exceptional"), which is the third of seven ratings, and defined as "Regardless of the severity of a general economic downturn or deterioration in the insurance cycle, insurers earning a Financial Stability Rating ("FSR") of "A" possess "Exceptional" financial stability related to maintaining surplus as regards to policyholders". Demotech's ratings are based upon factors of concern to agents, reinsurers and policyholders and are not primarily directed toward the protection of investors. Our Demotech rating could be jeopardized by factors including adverse development and various surplus related ratio exceptions.

The withdrawal of our ratings could limit or prevent us from writing or renewing desirable insurance policies, from competing with insurers who have higher ratings, from obtaining adequate reinsurance, or from borrowing on a line of credit. The withdrawal of our ratings could have a material adverse effect on the Company's results of operations and financial position because the Company's insurance products might no longer be acceptable to the secondary marketplace and mortgage lenders. Furthermore, a withdrawal of our ratings could prevent independent agents from selling and servicing our insurance products.

### Gross Premiums Ceded

Gross premiums ceded increased \$22.7 million, or 684.9%, to \$26.0 million for the three months ended March 31, 2015, compared with \$3.3 million for the three months ended March 31, 2014. Gross premiums ceded relating to our homeowners', commercial general liability, flood and automobile programs totaled \$21.7 million, \$0.1 million, \$1.5 million and \$2.7 million for 2015. Gross premiums ceded relating to our homeowners' includes \$20.7 million associated with our Property 30% Quota Share agreement effective July 1, 2014.

### Decrease in Prepaid Reinsurance Premiums

The decrease in prepaid reinsurance premiums was \$24.9 million for the three months ended March 31, 2015, compared with \$16.8 million for the three months ended March 31, 2014. The increased charge to written premium is associated with the timing of our reinsurance payments measured against the term of the underlying reinsurance policies.

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### Increase in Unearned Premiums

The increase in unearned premiums was \$11.0 million for the three months ended March 31, 2015, compared with \$17.0 million for the three months ended March 31, 2014. The \$11.0 million charge to written premium was due to a \$10.1 million increase in unearned homeowners' insurance premiums, a \$0.3 million decrease in unearned flood premiums, a \$0.8 million increase in unearned commercial general liability premiums and a \$0.4 million increase in unearned automobile insurance premiums during the three months ended March 31, 2015. These changes are a result of differences in written premium volume during this period as compared with the same period last year. See "Gross Premiums Written" above. The \$11.0 million total increase and the \$10.1 million homeowners' increase were net of a \$1.9 million reduction associated with our Property 30% Quota Share agreement effective July 1, 2014.

### Net Premiums Earned

Net premiums earned increased \$0.8 million, or 1.8%, to \$44.8 million for the three months ended March 31, 2015, compared with \$44.0 million for the three months ended March 31, 2014. The \$0.8 million increase is net of an \$18.8 million decrease due to accounting for our quota-share program. The net impact of the quota-share program was a \$0.8 million charge to pre-tax income. The reduction in net premiums earned and a charge to losses and LAE of \$0.5 million was offset by an estimated \$10.0 million reduction in our reinsurance costs, a reduction in amortization of deferred policy acquisition costs of \$6.8 million, and the recognition of \$1.7 million of the aforementioned accrued income resulting from the quota-share agreement.

The following table denotes net premiums earned by product line.

	<u>Three Months Ended March 31,</u>			
	<u>2015</u>		<u>2014</u>	
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
	(Dollars in Thousands)			
Homeowners'	\$ 41,034	91.62%	\$ 40,926	93.01%
Commercial General Liability	3,001	6.70%	2,453	5.57%
Automobile	751	1.68%	625	1.42%
Net premiums earned	<u>\$ 44,786</u>	<u>100.00%</u>	<u>\$ 44,004</u>	<u>100.00%</u>

The \$0.1 million increase in homeowners' net premiums earned is due to a \$23.8 million increase in gross written premium as discussed, a \$21.8 million increase in gross premiums ceded and a \$1.9 million increase in the net change to prepaid reinsurance premiums and unearned premium.

The \$0.8 million total increase and the \$0.1 million homeowners' increase were net of a \$18.8 million reduction associated with our Property 30% Quota Share agreement effective July 1, 2014.

The \$0.6 million increase in commercial general liability net premiums earned is a result of a \$0.8 million increase in gross written premium, a less than \$0.1 million increase in gross premiums ceded and a \$0.3 million increase in the net change to unearned premium.

The \$0.1 million increase in automobile net premiums earned is a result of a \$1.0 million increase in gross written premium as discussed, a \$0.8 million increase in gross premiums ceded and a \$0.1 million increase in the net change to prepaid reinsurance premiums and unearned premium.

### Commission Income

Commission income increased \$0.1 million, or 18.0%, to \$1.1 million for the three months ended March 31, 2015, compared with \$1.0 million for the three months ended March 31, 2014. The primary sources of our commission income are our managing general agent services, write-your-own flood premiums and our independent insurance agency, Insure-Link.



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### Finance Revenue

Finance revenue increased \$0.1 million, or 37.8%, to \$0.4 million for the three months ended March 31, 2015, compared with \$0.3 million for the three months ended March 31, 2014. The primary source of finance revenue is service fees and interest income from our direct billing program, wherein we accept receivables from our insureds.

### Direct Written Policy Fees

Direct written policy fees increased \$0.7 million, or 36.4%, to \$2.5 million for the three months ended March 31, 2015, compared with \$1.8 million for the three months ended March 31, 2014. The change is due to the increase in gross premiums written during this same period.

### Net Investment Income

Net investment income increased \$0.5 million, or 53.6%, to \$1.5 million for the three months ended March 31, 2015, compared with \$1.0 million for the three months ended March 31, 2014.

Our investment yields, net and gross of investment expenses, excluding equities and including cash, were 2.2% and 2.4% respectively, for the three months ended March 31, 2015. Our investment yields, net and gross of investment expenses, excluding equities and including cash, were 1.8% and 2.1%, respectively, for the three months ended March 31, 2014.

Our investment yield, net and gross of investment expenses measured against debt securities, excluding equities and cash, were 2.3% and 2.5%, respectively, for the three months ended March 31, 2015. Our investment yield, net and gross of investment expenses measured against debt securities, excluding equities and cash, were 1.9% and 2.3%, respectively, for the three months ended March 31, 2014.

See also “Analysis of Financial Condition as of March 31, 2015 Compared with December 31, 2014 – Investments” for a further discussion on our investment portfolio.

### Net Realized Investment Gains

Net realized investment gains totaled \$1.7 million for the three months ended March 31, 2015, compared with \$1.3 million during the three months ended March 31, 2014.

FASB has issued guidance regarding when an investment is considered impaired, whether that impairment is other-than temporary, and the measurement of an impairment loss. Management periodically reviews the individual investments that comprise our portfolio in order to determine whether a decline in fair value below our cost either is other-than temporarily or permanently impaired. During the three months ended March 31, 2015 and the three months ended March 31, 2014, in connection with the process, we have not charged operations with investment losses.

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The table below depicts the net realized investment gains (losses) by investment category during the three months ended March 31, 2015 and 2014.

	<u>Three Months Ended March 31,</u>	
	<u>2015</u>	<u>2014</u>
	(Dollars in Thousands)	
Realized gains:		
Debt securities	\$ 515	\$ 135
Equity securities	<u>1,395</u>	<u>1,610</u>
Total realized gains	<u>1,910</u>	<u>1,745</u>
Realized losses:		
Debt securities	(103)	(70)
Equity securities	<u>(103)</u>	<u>(344)</u>
Total realized losses	<u>(206)</u>	<u>(414)</u>
Net realized gains on investments	<u>\$ 1,704</u>	<u>\$ 1,331</u>

### Other Income

Other income increased to \$1.4 million for the three months ended March 31, 2015, compared with \$0.3 million for the three months ended March 31, 2014. The increase is primarily due to the commission sharing agreement with our reinsurance intermediary.

### Quota-Share Profit Sharing

Quota-share profit sharing totaled \$1.5 million for the three months ended March 31, 2015, compared with nothing for the three months ended March 31, 2014. The deferred quota-share profit sharing was originally estimated and recorded at \$14.0 million at the program's July 1, 2014 inception, based upon the likely occurrence of future catastrophic events and predefined non-catastrophic loss ratios. This estimate, subject to future adjustments, will continue to be amortized over the remaining life of the quota-share program.

The \$1.5 million, net total includes a \$1.8 million benefit associated with our Property 30% Quota Share agreement effective July 1, 2014 and a \$0.3 million charge associated with our profit sharing agreement with SageSure.

Favorable adjustments to the deferred quota-share profit sharing total will increase the amount we recognize over the remaining life of the program. Unfavorable adjustments to the deferred quota-share profit sharing total will decrease the amount we recognize over the remaining life of the program and could result in a current period charge to operations for some or all of the previously recognized profit sharing.

### Losses and LAE

Losses and LAE, our most significant expense, represent actual payments made and changes in estimated future payments to be made to or on behalf of our policyholders, including expenses required to settle claims and losses. We revise our estimates based on the results of analysis of estimated future payments to be made. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events.

Losses and LAE increased \$3.1 million, or 15.0%, to \$23.9 million for the three months ended March 31, 2015, compared with \$20.8 million for the three months ended March 31, 2014. The overall change includes a \$3.0 million increase in our homeowners' program, a \$0.3 million increase in our commercial general liability program and a \$0.2 million decrease in connection with our automobile program.

The change to losses and LAE typically reflects the change to reserves in response to the change in the number of policies we wrote during the same period. Homeowners' losses and LAE for the three months ended March 31, 2015, are net of a \$0.5 million increase relating to the quota-share program for which our actual net premiums earned were reduced by \$18.8 million.

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We continue to revise our estimates of the ultimate financial impact of claims made resulting from past storms. The revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) Company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and (iv) trends in general economic conditions, including the effects of inflation.

The composition of unpaid losses and LAE by product line is as follows.

	<u>March 31, 2015</u>			<u>December 31, 2014</u>		
	<u>Case</u>	<u>Bulk</u>	<u>Total</u>	<u>Case</u>	<u>Bulk</u>	<u>Total</u>
	(Dollars in Thousands)			(Dollars in Thousands)		
Homeowners'	\$ 15,416	\$ 38,604	\$ 54,020	\$ 14,223	\$ 35,192	\$ 49,415
Commercial General Liability	5,803	12,487	18,290	5,646	12,505	18,151
Automobile	4,147	8,018	12,165	3,672	7,092	10,764
Total	<u>\$ 25,366</u>	<u>\$ 59,109</u>	<u>\$ 84,475</u>	<u>\$ 23,541</u>	<u>\$ 54,789</u>	<u>\$ 78,330</u>

Factors that affect unpaid losses and LAE include the estimates made on a claim-by-claim basis known as “case reserves” coupled with bulk estimates known as Incurred but Not Yet Reported (“IBNR”). Periodic estimates by management of the ultimate costs required to settle all claim files are based on the Company’s analysis of historical data and estimations of the impact of numerous factors such as (i) per claim information; (ii) Company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation.

Management revises its estimates based on the results of its analysis. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors. Because of our process, reserves were increased by approximately \$6.1 million during the three months ended March 31, 2015. This overall change includes a \$4.6 million increase in reserves for our homeowners’ program, a \$0.1 million increase in reserves for commercial general liability and a \$1.4 million increase in reserves for our automobile program.

In accordance with GAAP and as discussed above, our loss ratio is computed as losses and LAE divided by net premiums earned. A lower loss ratio generally results in higher operating income. Our loss ratio for the three months ended March 31, 2015 was 53.5% compared with 47.3% for the same period in 2014.

### Operating and Underwriting Expenses

Operating and underwriting expenses increased \$2.6 million, or 72.4%, to \$6.3 million for the three months ended March 31, 2015, compared with \$3.7 million for the three months ended March 31, 2014. The change is primarily due to a \$0.8 million increase in premium tax, a \$0.6 million increase in legal fees, a \$0.4 million increase in credit card fees, a \$0.2 million increase in 401K employer’s fees and a \$0.6 million increase in other general expenses.

### Salaries and Wages

Salaries and wages increased \$2.1 million, or 68.5%, to \$5.1 million for the three months ended March 31, 2015, compared with \$3.0 million for the three months ended March 31, 2014 and is primarily due to an increased number of employees, as well as an increased expense for restricted shares and executive and employee bonuses. The charge to operations for stock-based compensation, in accordance with FASB guidance, was approximately \$752,000 during the three months ended March 31, 2015 compared with approximately \$192,000 for the three months ended March 31, 2014.

## Federated National Holding Company

### Amortization of Deferred Policy Acquisition Costs

Amortization of deferred policy acquisition costs decreased \$3.4 million, or 40.3%, to \$5.0 million for the three months ended March 31, 2015, compared with \$8.4 million for the three months ended March 31, 2014.

The change to amortization of DPAC typically corresponds to the change in net premiums earned during the same period, and consists of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned, which for the three months ended March 31, 2015 totaled approximately \$3.4 million. The \$3.4 million was offset by a \$6.8 million benefit associated with our Property 30% Quota Share agreement effective July 1, 2014.

### Provision for Income Tax Expense

The provision for income tax expense was \$5.7 million for the three months ended March 31, 2015, compared with \$5.3 million for the three months ended March 31, 2014. The effective rate for income taxes was 38.08% for the three months ended March 31, 2015, compared with 38.65% for the three months ended March 31, 2014.

### Non-Controlling Interest

The benefit to the consolidated statement of operations for non-controlling interest was \$0.5 million for the three months ended March 31, 2015, compared with nothing for the three months ended March 31, 2014. MNHC experienced a \$0.9 million loss during the three months ended March 31, 2015, during which time they generated no revenue and incurred expenses by way of reimbursing our joint venture partners for start-up costs incurred. The \$0.9 million is included in our above discussed operating and underwriting expenses which totaled \$6.3 million. Because our interest in MNHC is approximately 42.4%, our consolidated statement of operations is being adjusted for the other 57.6% non-controlling interest held by our joint-venture partners.

### Net Income attributable to FNHC common stockholders

Net income attributable to FNHC common stockholders increased \$0.9 million, or 10.2%, to \$9.3 million for the three months ended March 31, 2015, compared with \$8.4 million for the three months ended March 31, 2014.

### Liquidity and Capital Resources

During the three months ended March 31, 2015, our primary sources of capital included proceeds from the sale of investment securities, recognition of a non-controlling interest, increased unearned premiums, decreased prepaid reinsurance premiums, increased unpaid losses and LAE and increased debt. Additional sources of capital included increased premium deposits and customer credit balances, amortization of investment premium or discount, net, non-cash compensation, a tax benefit related to non-cash compensation, depreciation and amortization and exercised stock options. Because we are a holding company, we are largely dependent upon fees and commissions from our subsidiaries for cash flow.

During the three months ended March 31, 2015 and 2014, operations provided net operating cash flow of \$33.6 million and \$32.6 million, respectively.

During the three months ended March 31, 2015, operations generated \$46.2 million of gross cash flow, due to an \$11.0 million increase in unearned premiums, a \$8.5 million decrease in prepaid reinsurance premiums, a \$6.1 million increase in unpaid losses and LAE and a \$5.0 million increase in debt. Additional sources of cash included a \$3.9 million increase in premium deposits and customer credit balances, \$1.3 million of amortization of investment premium or discount, net, \$1.0 million non-cash compensation and \$0.1 million of depreciation and amortization, all in conjunction with \$9.3 million of net income.

During the three months ended March 31, 2015, operations used \$12.6 million of gross cash flow, due to a \$2.5 million increase in premiums receivable, a \$2.2 million increase in policy acquisition costs, a \$2.0 million decrease in accounts payable and accrued expenses, a \$1.7 million increase in contingent quota-share profit sharing and \$1.7 million in net realized investment gains. Additional uses of cash included a \$1.0 million increase in other assets, a \$0.5 million increase in reinsurance recoverable, net, a \$0.5 million decrease in claims payments outstanding, a \$0.3 million increase in income taxes recoverable and a \$0.2 million increase in deferred income tax

## Federated National Holding Company

expense, net of other comprehensive income.

During the three months ended March 31, 2015 and 2014, net cash used by investing activities was \$3.3 million and \$23.7 million, respectively. Our available-for-sale investment portfolio is highly liquid as it consists entirely of readily marketable securities. During the three months ended March 31, 2015, investing activities generated \$56.3 million and used \$59.6 million.

During the three months ended March 31, 2015 and 2014, net financing activities provided \$17.7 million and \$0.1 million, respectively. In 2015, the sources of cash in connection with financing activities included \$18.0 million from the recognition of a non-controlling interest and \$0.3 million from a tax benefit related to non-cash compensation, while the usage included \$0.6 million for dividends paid.

We offer direct billing in connection with our homeowners' and commercial general liability programs. Direct billing is an agreement in which the insurance company accepts from the insured, as a receivable, a promise to pay the premium, as opposed to requiring the full amount of the policy at policy inception, either directly from the insured or from a premium finance company. The advantage of direct billing a policyholder by the insurance company is that we are not reliant on a credit facility, but remain able to charge and collect interest from the policyholder.

As discussed above, we have experienced significant growth, as evidenced by the 31.6% increase in gross premiums written during the first three months of 2015 as compared with the same period in 2014. We believe that our current capital resources will be sufficient to meet currently anticipated working capital requirements. There can be no assurances, however, that such will be the case. We continue to evaluate our liquidity and the possibility that we may require additional working capital.

As of March 31, 2015, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as "structured finance" or "special purpose" entities, which were established for the purpose of facilitating off-balance-sheet arrangements or other contractually narrow or limited purposes. As such, management believes that we currently are not exposed to any financing, liquidity, market or credit risks that could arise if we had engaged in transactions of that type requiring disclosure herein.

### **Impact of Inflation and Changing Prices**

The consolidated financial statements and related data presented herein have been prepared in accordance with GAAP, which requires the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. Our primary assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the inflationary effect on the cost of paying losses and LAE.

Insurance premiums are established before we know the amount of losses and LAE and the extent to which inflation may affect such expenses. Consequently, we attempt to anticipate the future impact of inflation when establishing rate levels. While we attempt to charge adequate premiums, we may be limited in raising premium levels for competitive and regulatory reasons. Inflation may also affect the market value of our investment portfolio and the investment rate of return. Any future economic changes that result in prolonged and increasing levels of inflation could cause increases in the dollar amount of incurred losses and LAE and thereby materially adversely affect future liability requirements.

### **Item 3**

#### **Quantitative and Qualitative Disclosures about Market Risk**

Our investment objective is to maximize total rate of return after federal income taxes while maintaining liquidity and minimizing risk. Our current investment policy limits investment in non-investment-grade debt securities (including high-yield bonds), and limits total investments in preferred stock, common stock and mortgage notes receivable. We also comply with applicable laws and regulations that further restrict the type, quality and concentration of our investments. In general, these laws and regulations permit investments, within specified limits and subject to certain qualifications, in federal, state and municipal obligations, corporate bonds, preferred and common equity securities and real estate mortgages.

## Federated National Holding Company

Our investment policy is established by the Board of Directors Investment Committee and is reviewed on a regular basis. Pursuant to this investment policy, as of March 31, 2015, approximately 90% of investments were in debt securities and cash and cash equivalents, which are considered to be either held until maturity or available-for-sale, based upon our estimates of required liquidity. Approximately 97% of the debt securities are considered available-for-sale and are marked to market. We may in the future consider additional debt securities to be held-to-maturity and carried at amortized cost. We do not use any swaps, options, futures or forward contracts to hedge or enhance our investment portfolio.

The following table summarizes, by type, our investments as of March 31, 2015 and December 31, 2014.

	<u>March 31, 2015</u>		<u>December 31, 2014</u>	
	<u>Carrying Amount</u>	<u>Percent of Total</u>	<u>Carrying Amount</u>	<u>Percent of Total</u>
	(Dollars in Thousands)			
Debt securities, at market:				
United States government obligations and authorities	\$ 59,549	17.70%	\$ 62,323	18.84%
Obligations of states and political subdivisions	92,172	27.40%	91,614	27.70%
Corporate	125,021	37.18%	119,024	35.99%
International	<u>11,451</u>	<u>3.40%</u>	<u>11,138</u>	<u>3.37%</u>
	<u>288,193</u>	<u>85.68%</u>	<u>284,099</u>	<u>85.90%</u>
Debt securities, at amortized cost:				
United States government obligations and authorities	4,564	1.36%	4,490	1.36%
Corporate	2,701	0.80%	2,681	0.81%
International	<u>197</u>	<u>0.06%</u>	<u>246</u>	<u>0.07%</u>
	<u>7,462</u>	<u>2.22%</u>	<u>7,417</u>	<u>2.24%</u>
Total debt securities	295,655	87.90%	291,516	88.14%
Equity securities, at market:	<u>40,726</u>	<u>12.10%</u>	<u>39,247</u>	<u>11.86%</u>
Total investments	<u>\$ 336,381</u>	<u>100.00%</u>	<u>\$ 330,763</u>	<u>100.00%</u>

Available-for-sale debt securities are carried on the balance sheet at market and held-to-maturity debt securities are carried on the balance sheet at amortized cost. As of March 31, 2015 and December 31, 2014, debt securities has had the following quality ratings by S&P and for securities not assigned a rating by S&P, Moody's or Fitch ratings were used.

	<u>March 31, 2015</u>		<u>December 31, 2014</u>	
	<u>Carrying Amount</u>	<u>Percent of Total</u>	<u>Carrying Amount</u>	<u>Percent of Total</u>
	(Dollars in Thousands)			
AAA	\$ 33,828	11.45%	\$ 40,119	13.76%
AA	123,529	41.78%	125,385	43.01%
A	75,162	25.42%	67,818	23.26%
BBB	62,812	21.24%	58,172	19.96%
Not rated	<u>324</u>	<u>0.11%</u>	<u>22</u>	<u>0.01%</u>
	<u>\$ 295,655</u>	<u>100.00%</u>	<u>\$ 291,516</u>	<u>100.00%</u>

## Federated National Holding Company

The following table summarizes, by maturity, the debt securities as of March 31, 2015 and December 31, 2014.

	<u>March 31, 2015</u>		<u>December 31, 2014</u>	
	<u>Carrying Amount</u>	<u>Percent of Total</u>	<u>Carrying Amount</u>	<u>Percent of Total</u>
	(Dollars in Thousands)			
<b>Matures In:</b>				
One year or less	\$ 17,343	5.87%	\$ 16,796	5.76%
One year to five years	170,942	57.82%	174,260	59.78%
Five years to 10 years	107,337	36.30%	100,427	34.45%
More than 10 years	<u>33</u>	<u>0.01%</u>	<u>33</u>	<u>0.01%</u>
Total debt securities	<u>\$ 295,655</u>	<u>100.00%</u>	<u>\$291,516</u>	<u>100.00%</u>

At March 31, 2015, the duration of the debt portfolio was approximately 3.8 years.

The following table provides information about the financial instruments as of March 31, 2015 that are sensitive to changes in interest rates. The table presents principal cash flows and the related weighted average interest rate by expected maturity date based upon par values.

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>Thereafter</u>	<u>Total</u>	<u>Carrying Amount</u>
<b>Principal amount by expected maturity:</b>								
United States government obligations and authorities	\$ 196	\$ 2,189	\$ 4,033	\$ 4,640	\$ 6,860	\$ 24,324	\$ 42,242	\$ 43,714
Obligations of states and political subdivisions	3,935	9,380	17,730	9,805	13,140	27,895	81,885	92,172
Corporate securities	3,320	16,109	19,889	18,527	14,837	38,050	110,732	118,274
International securities	491	2,087	2,822	1,955	1,315	2,617	11,287	11,648
Collateralized mortgage obligations	1,279	3,696	3,772	2,654	4,396	12,260	28,057	29,847
Equity securities, at market	-	-	-	-	-	-	-	40,726
All investments	<u>\$ 9,221</u>	<u>\$ 33,461</u>	<u>\$48,246</u>	<u>\$ 37,581</u>	<u>\$ 40,548</u>	<u>\$ 105,146</u>	<u>\$274,203</u>	<u>\$336,381</u>
<b>Weighted average interest rate by expected maturity:</b>								
United States government obligations and authorities	0.38%	1.87%	0.70%	1.31%	1.70%	2.31%	1.92%	
Obligations of states and political subdivisions	4.27%	4.72%	4.57%	4.99%	5.04%	4.84%	4.79%	
Corporate securities	4.07%	4.06%	3.53%	4.52%	4.62%	4.18%	4.16%	
International securities	0.74%	2.15%	2.20%	3.15%	2.10%	3.68%	2.62%	
Collateralized mortgage obligations	5.28%	5.56%	3.93%	4.03%	4.02%	3.85%	4.19%	
Equity securities, at market	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
All investments	4.07%	4.15%	3.63%	4.14%	4.12%	3.87%	3.94%	

## Federated National Holding Company

### Item 4

#### Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as of March 31, 2015. Based upon their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures, as of March 31, 2015, were effective to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted by it under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and to provide reasonable assurance that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no changes during the three months ended March 31, 2015 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.



## **Federated National Holding Company**

### **Part II: OTHER INFORMATION**

#### **Item 1**

##### **Legal Proceedings**

See Item 1 of Part I, “Financial Statements – Note 4 – Commitments and Contingencies.”

#### **Item 1A**

##### **Risk Factors**

There have been no material changes from the risk factors previously disclosed in Item 1, Risk Factors, in the Company’s Form 10-K for the fiscal year ended December 31, 2014.

##### **Additional Risk Factors**

The risks described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

#### **Item 2**

##### **Unregistered Sales of Equity Securities and Use of Proceeds**

(a) None

(b) None

(c) None

#### **Item 3**

##### **Defaults upon Senior Securities**

(a) None

(b) None

#### **Item 4**

##### **Mine Safety Disclosures**

Not applicable

## Federated National Holding Company

### Item 5

#### Other Information

(a) On May 6, 2015, the Company entered into a Consulting Agreement with Bruce F. Simberg (the “Agreement”) pursuant to which Mr. Simberg will provide consulting services relating to legal, claims processes and compliance matters when and as requested by the Company's Board or management (including the head of claims administration). Mr. Simberg, who had been a director of the Company until March 2015, is an attorney with significant experience in insurance defense. The Agreement is for an initial one-year term that renews for additional one-year terms unless terminated by either party upon 30 days' notice, and provides for the payment of a consulting fee of \$10,000 per quarter. Under the Agreement, Mr. Simberg is subject to non-disclosure, non-competition and non-solicitation covenants and has agreed to abide by the Company's insider trading policy and remain subject to Section 16 of the Securities Exchange Act of 1934, as amended.

(b) None

## Federated National Holding Company

### Item 6

#### Exhibits

- 10.1 Managing General Agent and Claims Administration Agreement dated as of March 17, 2015 between Monarch National Insurance Company and FedNat Underwriters, Inc.\*
- 10.2 Limited Liability Company Agreement of Monarch Delaware Holdings LLC dated as of March 17, 2015\*
- 10.3 Amendment to Employment Agreement and Restrictive Covenant Agreement effective as of March 17, 2015 between Federated National Holding Company and Michael H. Braun\*
- 10.4 Non-Competition, Non-Disclosure and Non-Solicitation Agreement effective as of March 17, 2015 between Monarch Delaware Holdings LLC and Michael H. Braun\*
- 10.5 Amendment No. 1 to the Amended and Restated Non-Competition, Non-Disclosure and Non-Solicitation Agreement effective as of March 17, 2015 between Federated National Holding Company and Peter J. Prygelski, III\*
- 10.6 Second Amendment to Insurance Agency Master Agreement dated January 1, 2015 between Federated National Underwriters, Inc. and Ivantage Select Agency, Inc.\*
- 10.7 Consulting Agreement dated as of May 6, 2015 between Bruce F. Simberg and Federated National Holding Company\*
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act. \*
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act. \*
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act. \*
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act. \*
- 101.INS-XBRL Instance Document. \*\*
- 101.SCH-XBRL Taxonomy Extension Schema Document. \*\*
- 101.CAL-XBRL Taxonomy Extension Calculation Linkbase Document. \*\*
- 101.LAB-XBRL Taxonomy Extension Label Linkbase Document. \*\*
- 101.PRE-XBRL Taxonomy Extension Presentation Linkbase Document. \*\*

\* filed herewith

\*\* In accordance with Rule 406T of Regulation S-T, these interactive data files are deemed not filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

**Federated National Holding Company**

**Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**FEDERATED NATIONAL HOLDING COMPANY**

By: /s/ Michael H. Braun  
Michael H. Braun, Chief Executive Officer  
(Principal Executive Officer)

/s/ Peter J. Prygelski, III  
Peter J. Prygelski, III, Chief Financial Officer  
(Principal Financial and Accounting Officer)

Date: May 11, 2015

## Federated National Holding Company

### EXHIBIT INDEX

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**Federated National Holding Company**

**EXHIBIT 31.1**

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT**

I, Michael H. Braun, certify that:

1. I have reviewed this Form 10-Q of Federated National Holding Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Michael H. Braun

**Michael H. Braun**

**Chief Executive Officer**

**(Principal Executive Officer)**

Dated: May 11, 2015

## Federated National Holding Company

### EXHIBIT 31.2

#### CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT

I, Peter J. Prygelski, III, certify that:

1. I have reviewed this Form 10-Q of Federated National Holding Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Peter J. Prygelski, III

**Peter J. Prygelski, III**

**Chief Financial Officer**

**(Principal Financial and Accounting Officer)**

Dated: May 11, 2015

**Federated National Holding Company**

**EXHIBIT 32.1**

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-  
OXLEY ACT**

In connection with the Quarterly Report on Form 10-Q of Federated National Holding Company for the quarter ended March 31, 2015 as filed with the Securities and Exchange Commission (the "Report"), I, Michael H. Braun, Chief Executive Officer of Federated National Holding Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Federated National Holding Company.

By: */s/ Michael H. Braun*

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**Michael H. Braun, Chief Executive Officer (Principal Executive Officer)**

**May 11, 2015**



**Federated National Holding Company**

**EXHIBIT 32.2**

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-  
OXLEY ACT**

In connection with the Quarterly Report on Form 10-Q of Federated National Holding Company for the quarter ended March 31, 2015 as filed with the Securities and Exchange Commission (the "Report"), I, Peter J. Prygelski, III, Chief Financial Officer of Federated National Holding Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Federated National Holding Company.

By: */s/ Peter J. Prygelski, III*

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**Peter J. Prygelski, III, Chief Financial Officer (Principal Financial and Accounting Officer)**

**May 11, 2015**