FEDERATED NATIONAL HOLDING CO
Form 10-K
March 16, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED December 31, 2016

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 000-25001

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. 14th Street, Suite 180, Sunrise, FL	33323

(Address of principal executive offices) (Zip Code)

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

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.01 per share	NASDAQ Global Market

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

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

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

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

Indicate by check mark whether the registrant has 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 No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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. (Check one):

Large accelerated filer	Accelerated filer	Non accelerated filer (Do not check if a smaller reporting company)	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

The aggregate market value of the Registrant's common stock held by non-affiliates was $246,945,830 on June 30, 2016, computed on the basis of the closing sale price of the Registrant's common stock on that date.

As of March 13, 2017, the total number of common shares outstanding of Registrant's common stock was 13,853,574.

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FEDERATED NATIONAL HOLDING COMPANY

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PART I

CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements are therefore entitled to the protection of the safe harbor provisions of these laws. These statements may be identified by the use of forward-looking terminology such as "anticipate," "believe," "budget," "contemplate," "continue," "could," "envision," "estimate," "expect," "forecast," "guidance," "indicate," "might," "outlook," "plan," "possibly," "potential," "predict," "probably," "pro-forma," "project," "seek," "should," "target," be," "will continue" or the negative thereof or other variations thereon or comparable terminology. We have based these forward-looking statements on our current expectations, assumptions, estimates and projections. While we believe these expectations, assumptions, estimates and projections are reasonable, such forward-looking statements are only predictions and involve a number of risks and uncertainties, many of which are beyond our control. These and other important factors may cause our actual results, performance or achievements to differ materially from any future results, performance or achievements expressed or implied by these forward-looking statements. Management cautions that the forward-looking statements contained in this Annual Report on Form 10-K are not guarantees of future performance, and we cannot assume that such statements will be realized or the forward-looking events and circumstances will occur. Factors that might cause such a difference include, without limitation, the risks and uncertainties discussed under "Risk Factors" in this Annual Form 10 K, and discussed from time to time in our reports filed with the SEC.

Given these risks and uncertainties, you are cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements included or incorporated by reference into this Annual Form 10-K are made only as of the date hereof. We do not undertake and specifically decline any obligation to update any such statements or to publicly announce the results of any revisions to any such statements to reflect future events or developments.

ITEM 1. BUSINESS

GENERAL

Federated National Holding Company ("FNHC", "Company", "we", "us") 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 other lines of insurance in Florida and other states. We market, distribute and service 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"), which is licensed as an admitted carrier in Florida, Alabama, Louisiana, Georgia, Texas and South Carolina. We also serve as managing general agent for Monarch National Insurance Company ("MNIC"), which was founded in 2015 through the joint venture, described below, and 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.

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	Year Ended December 31,		
	2016	2015	2014
Gross premiums written	(in thousands)		
Homeowners:			
Florida	$ 477,489	$ 427,428	$ 335,338
Louisiana	25,385	18,540	9,288
South Carolina	6,531	1,518	—
Alabama	3,332	2,280	312
Total homeowners	512,737	449,766	344,938
Personal automobile:			
Texas	34,239	17,916	10,805
Georgia	31,831	2,762	197
Florida	1,745	1,200	1,374
Alabama	1,664	34	—
Total personal automobile	69,479	21,912	12,376
Commercial general liability	13,256	13,928	12,432
Federal flood	10,013	8,164	7,410
Gross premiums written total	$ 605,485	$ 493,770	$ 377,156

Monarch National Insurance Company Joint Venture

On March 19, 2015, the Company entered into a joint venture to organize MNIC, 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"). The Company's joint venture partners are a majority-owned limited partnership of Crosswinds Holdings Inc., a publicly traded Canadian private equity firm and asset manager ("Crosswinds"); and Transatlantic Reinsurance Company ("TransRe").

The Company and Crosswinds each invested $14.0 million in Monarch Delaware Holdings, LLC ("Monarch Delaware"), the indirect parent company of MNIC, for a 42.4% interest in Monarch Delaware (each holding 50% of the voting interests in Monarch Delaware). TransRe invested $5.0 million for a 15.2% non-voting interest in Monarch Delaware and 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 ("MNHC"), a wholly owned subsidiary of Monarch Delaware and the direct parent company of MNIC.

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

- MNIC entered into a Managing General Agent and Claims Administration Agreement (the "Monarch MGA Agreement") with FedNat Underwriters, Inc. ("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.

- MNIC, MNHC 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.

- MNIC 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 agreements that Monarch Insurance deems necessary in its sole discretion for so long as TransRe remains a member of Monarch Delaware or the MNHC 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 MNIC in any individual reinsurance contract.

- The Company's CEO and Interim CFO hold their respective positions with Monarch Entities while they remain employed by the Company.

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MNIC expands our ability to provide insurance policies in Florida. Additionally, it strengthens our relationships with our partner agents. Monarch Entities are consolidated as a variable interest entity ("VIE") in the accompanying consolidated financial statements included in Part II, Item 8 of this Report. Refer to notes 1 and 14 set forth in Part II, Item 8 "Financial Statements and Supplemental Data" of this Form 10-K for additional information regarding the accounting and consolidation of the joint venture.

Executive Offices

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

Available Information

Our internet web site is www.FedNat.com for policy holders, agents and investors. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports are available, free of charge, through our website as soon as reasonably practicable after we electronically file or furnish such material to the Securities and Exchange Commission ("SEC"). The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding our filings at www.sec.gov.

INSURANCE OPERATIONS AND RELATED SERVICES

Business Strategy

We expect that in 2017 we will capitalize on our operational efficiencies and business practices through:

· improved property analytical qualities such as a broader geographical dispersion of risks throughout the southeast United States and avoiding risks that do not yield an underwriting profit;

- continued expansion of our homeowners' and private passenger automobile insurance products into additional states;
- employing our business practices developed and used in Florida in our expansion to other states;
- maintaining a commitment to provide high quality customer service to our agents and insureds;
- expansion of our marketing efforts by retaining key personnel and implementing direct marketing technologies;
- offering attractive incentives to our agents to place a high volume of quality business with our companies;
- cede our insurance risk through reinsurance treaties; and
- additional strategies that may include possible mergers, acquisitions and joint ventures or dispositions of assets (such as the MNIC joint venture).

Overview of Insurance Lines of Business

Homeowners Property and Casualty Insurance

FNIC and MNIC underwrite homeowners insurance in Florida and FNIC also underwrites homeowners insurance in Alabama, Louisiana, Texas and South Carolina. Homeowners insurance generally protects an owner of real and personal property against covered causes of loss to that property. The homeowners' policies in-force totaled 279,109 and 254,105 at December 31, 2016 and 2015, respectively.

Our homeowners insurance products provide maximum dwelling coverage in the amount of approximately \$3.8 million, with the aggregate maximum policy limit being approximately \$6.5 million. We currently offer dwelling coverage "A" up to \$4.0 million with an aggregate total insured value of \$6.5 million. We continually subject these limits to review; during 2015, coverage "A" was increased by \$1.0 million and total insured value increased by \$1.5 million. The approximate average premium on the policies currently in-force is \$1,837, as compared with \$1,758 for 2015. The typical deductible is either \$2,500 or \$1,000 for non-hurricane-related claims and generally 2% of the coverage amount for the structure for hurricane-related claims.

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Premium rates charged to our homeowners' insurance policyholders are continually evaluated to assure that they meet the expectation that they are actuarially sound and produce a reasonable level of profit (neither excessive, inadequate or discriminatory). Premium rates in Florida and other states are regulated and approved by the respective states' office of insurance regulation. In 2016, FNIC applied for and was approved by the Florida OIR for a rate increase of 5.6% for Florida homeowners multiple-peril insurance policies, which became effective for new and renewals on August 1, 2016. MNIC applied for and was approved by the Florida OIR for a rate decrease of 11.9% for Florida homeowners multiple-peril insurance policies, which became effective for new and renewals on April 15, 2016. In 2015, there were no rate increases or decreases in our voluntary property book of homeowners business in FNIC or MNIC. As of the date of this Report, the Company has applied with the Florida OIR for a 2017 rate increase of 6.5% for FNIC for Florida homeowners' insurance policies only. These rate changes are currently awaiting approval from the Florida OIR. We continue to monitor and seek appropriate adjustment to our rates in order to remain competitive and profitable.

Other Lines of Business

Personal Automobile: Nonstandard personal automobile insurance is principally provided to insureds that are unable to obtain standard insurance coverage because of their driving record, age, vehicle type or other factors, including market conditions. We market this through licensed general agents in their respective territories. Currently, FNIC offers this line of business as an admitted carrier in Texas, Florida, Georgia, and Alabama.

Commercial General Liability: We underwrite for approximately 380 classes of skilled craft workers (excluding home-builders and developers) and mercantile trades (such as owners, landlords and tenants). The limits of liability range from $100,000 per occurrence with a $200,000 policy aggregate to $1.0 million per occurrence with a $2.0 million policy aggregate. We market the commercial general liability insurance products through independent agents and a limited number of general agencies unaffiliated with the Company.

Flood: FNIC writes flood insurance through the National Flood Insurance Program ("NFIP"). We write the policy for the NFIP, which assumes 100% of the flood risk while we retain a commission for our service. Currently, FNIC offers this line of business in Florida, Alabama, Louisiana, South Carolina, and Texas.

MARKETING AND DISTRIBUTION

Our independent agents and general agents have the authority to sell and bind insurance coverage in accordance with procedures established by FNU. FNU reviews all coverage bound by the agents promptly and generally accepts all coverage that falls within stated underwriting criteria. For all policies issued, FNU also has the right, within a period that varies by state between 60 days and 120 days from a policy's inception, to cancel any policy, upon an advanced notice provided in accordance with statutory specific guidelines, even if the risk falls within our underwriting criteria. 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.

We believe that our integrated computer systems, which allow for rapid automated premium quotation and policy issuance by our agents, are key elements in providing quality service to both our agents and insureds for various lines of our business.

LIABILITY FOR LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

We are directly liable for loss and loss adjustment expense reserves ("LAE") payments under the terms of the insurance policies that are underwritten by our insurance companies. In many cases, there may be a time lag between the occurrence and reporting of an insured loss and our payment of that loss. As required by insurance regulations and accounting rules, we reflect the liability for the ultimate payment of all incurred losses and LAE's by establishing a liability for those unpaid losses and LAE's for both reported and unreported claims, which represent estimates of future amounts needed to pay claims and related expenses.

When a claim involving a probable loss is reported, we establish a liability for the estimated amount of our ultimate losses and LAE payments. The estimate of the amount of the ultimate loss is based upon such factors as the type of loss, jurisdiction of the occurrence, knowledge of the circumstances surrounding the claim, severity of injury or damage, potential for ultimate exposure, estimate of liability on the part of the insured, past experience with similar claims and the applicable policy provisions.

In addition, management provides for a liability on an aggregate basis to provide for incurred but not yet reported ("IBNR").   The estimates of the liability for loss and LAE reserves are subject to the effect of trends in claims severity and frequency and are continually reviewed. As part of this process, we review historical data and consider various factors, including known and anticipated legal developments, inflation and economic conditions. As experience develops and other data become available, these estimates are revised, as required, resulting in increases or decreases to the existing liability for loss and LAE reserves. Adjustments are reflected in results of operations in the period in which they are made and the liabilities may deviate substantially from prior estimates.

Among our classes of insurance, the automobile and homeowners' liability claims historically tend to have longer time lapses between the occurrence of the event, the reporting of the claim and the final settlement, than do automobile physical damage and homeowners' property claims. These liability claims often involve parties filing suit and therefore may result in litigation. By comparison, property damage claims tend to be reported in a relatively shorter period of time and settled in a shorter time frame with less occurrence of litigation.

REINSURANCE AGREEMENTS

Reinsurance is used primarily to manage overall capital adequacy and mitigate the insurance loss exposure related to certain events such as natural and man-made catastrophes.

FNIC and MNIC operate primarily by underwriting and accepting risks for their direct account on a gross basis and reinsuring a portion of the exposure on either an individual risk or an aggregate basis to the extent those exceed the desired retention level. We continually evaluate the relative attractiveness of different forms of reinsurance contracts and different markets that may be used to achieve our risk and profitability objectives.

Reinsurance markets include:

- Traditional local and global reinsurance markets including those in the United States, Bermuda, London and Europe, accessed directly and through reinsurance intermediaries;
- Capital markets through insurance-linked securities and collateralized reinsurance transactions, such as catastrophe bonds, sidecars and similar vehicles; and
- Other insurers that engage in both direct and assumed reinsurance

The form of reinsurance that we may choose from time to time will generally depend on whether we are seeking:

- Proportional reinsurance, whereby we cede a specified percentage of premium and losses to reinsurers;

·

Non-proportional or excess of loss reinsurance, whereby we cede all or a specified portion of losses in excess of a specified amount on a per risk, per occurrence (including catastrophe reinsurance) or aggregate basis; or

· Facultative contracts that reinsure individual policies

All of our reinsurance contracts do not relieve FNIC or MNIC from their direct obligations to insured. While it is not always possible to reinsure every known and unknown risk to the company, an effective reinsurance program substantially mitigates our exposure to potentially significant losses. There is a credit risk exposure 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. The availability and amount of ceded premiums and losses associated with the acquisition of reinsurance will vary year to year. Our reinsurance program is subject to approval primarily by the Florida OIR and other regulators in states where we do business, and is subject to review by Demotech, Inc. ("Demotech"), in connection with Demotech's rating of FNIC or MNIC. Demotech provides financial stability ratings for property and casualty insurance companies.

FNIC and MNIC operate primarily by underwriting and accepting risks for their direct account on a gross basis and reinsuring a portion of the exposure on either an individual risk or an aggregate basis to the extent those exceed the desired retention level. We continually evaluate the relative attractiveness of different forms of reinsurance contracts and different markets that may be used to achieve our risk and profitability objectives. All of our reinsurance contracts do not relieve FNIC or MNIC from their direct obligations to the insured.

FNIC's 2015-2016 catastrophe reinsurance program, which ran either from June 1 to May 31 or from July 1 to June 30, consists of the Florida Hurricane Catastrophe Fund ("FHCF"), excess of loss treaties placed with the private market and a 40% property quota-share program. The property quota-share reinsurance is a form of proportional reinsurance that provides coverage for the homeowners' property lines for wind related catastrophes in Florida. The FHCF treaty affords coverage for losses sustained in Florida and represents only a portion of the reinsurance coverage in Florida.

The excess of loss and FHCF treaties, which became effective on July 1, 2015 and June 1, 2015, respectively, insure for approximately $1.82 billion of aggregate catastrophic losses and loss adjustment expenses ("LAE") with a maximum single event coverage totaling approximately $1.26 billion, with the Company retaining the first $12.9 million in Florida and $5.0 million in

Louisiana, Alabama and South Carolina for losses and LAE from each event. Ceded premiums in connection with this program totaled approximately $149.7 million.

FNIC’s 2016-2017 reinsurance programs, costing approximately $179.5 million, include approximately $125.7 million for the private reinsurance for Federated National’s Florida exposure, including prepaid automatic premium reinstatement protection on all layers, along with approximately $53.8 million payable to the FHCF. The combination of private and FHCF reinsurance treaties will afford Federated National with approximately $2.22 billion of aggregate coverage with a maximum single event coverage totaling approximately $1.58 billion, exclusive of retentions. FNIC maintained its FHCF participation at 75% for the 2016 hurricane season. FNIC’s single event pre-tax retention for a catastrophic event in Florida is $18.45 million. In addition, FNIC purchases separate underlying reinsurance layers in Louisiana, Alabama, and South Carolina to cover losses and LAE outside of Florida for each catastrophic event from $8.0 million to $18.45 million. Depending on the characteristics of the catastrophic event, and the states involved, FNIC’s single event pre-tax retention could be as low as $8.0 million. The maximum pre-tax retention of $18.45 million for Florida represents 7.76% of the Company’s shareholders’ equity as of December 31, 2016.

Additionally, the Company’s private market excess of loss treaties became effective July 1, 2016 and all private layers have prepaid automatic reinstatement protection, which affords us additional coverage against multiple catastrophic events in the same hurricane season. The Company obtained multiple year protection for a portion of its program; as a result, some of the coverage will expire on June 30, 2017, and a portion of the coverage will remain in-force one additional treaty year until June 30, 2018. These private market excess of loss treaties structure coverage into layers, with a cascading feature such that substantially all private layers attach after $18.45 million in losses for FNIC’s Florida exposure. If the aggregate limit of the preceding layer is exhausted, the next layer drops down (cascades) in its place. Additionally, any unused layer protection drops down for subsequent events until exhausted.

MNIC’s 2016-2017 catastrophe reinsurance program, which runs from either June 1 to May 31 or June 1 to June 30 (13 month period), consists of the FHCF and private market excess of loss treaties. All private layers have prepaid automatic reinstatement protection, which affords MNIC additional coverage, and have a cascading feature such that substantially all layers attach at $3.4 million for MNIC's Florida exposure.

The Company’s property quota share treaties, which are included in the reinsurance program, run for a two-year period from July 1 to July 1 of the following year. The property quota-share treaties consist of two different treaties, one for 30% which became effective July 1, 2014, and the other for 10% which became effective July 1, 2015. The combined treaties provided up to a 40% quota-share reinsurance on the first $100 million of covered losses for the homeowners’ property insurance program in Florida. The treaties are accounted for as retrospectively rated contracts whereby the estimated ultimate premium or commission is recognized over the period of the contracts.

On July 1, 2016, the 30% property quota-share treaty expired on a cut-off basis, which means as of that date the Company will retain 30% of its unearned premiums and losses. The reinsurers will remain liable for 30% of the paid losses occurring during the term of the treaty, until the treaty is commuted.

The Company's private passenger automobile quota share treaties are typically one-year programs which become effective at different points in the year and cover auto policies across several states. These automobile quota share treaties cede 75% to 90% of all written premiums entered into by the Company.

We are selective in choosing reinsurers and consider numerous factors, the most important of which are the financial stability of the reinsurer or capital specifically pledged to uphold the contract, 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. As of December 31, 2016, we have over 65 reinsurance companies in our program that are required to have at least an "A-" or better rating by A.M. Best Company ("A.M. Best") or the agreement would need to be fully collateralized.

EMPLOYEES

As of December 31, 2016, we had 381 employees, including two executive officers. The 381 employees are made up of 187 from our claims department (of which 58 handle automobile claims), 81 from our underwriting department, 16 from our insurance agency, and 97 perform our back office functions. The back office functions include but are not limited to accounting, information technology, risk management and human resources. We are not a party to any collective bargaining agreement and we have not experienced work stoppages or strikes as a result of labor disputes. We consider relations with our employees to be satisfactory.

COMPETITION

We operate in highly competitive markets and face competition from national, regional and residual market insurance companies in the homeowners', commercial general liability, automobile and flood 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 50 companies compete with us in the homeowners' insurance market. Three of our larger competitors are Citizens Property Insurance Corporation ("Citizens"), Universal Property and Casualty Insurance Company and Security First Insurance Company. In Florida, more than a dozen companies compete with us in the commercial general liability insurance market.

Significant competition also emerged because of fundamental changes made to the property and casualty insurance business in Florida in recent years which resulted in a multi-pronged approach to address the cost of residential property insurance in Florida. First, the law increased the capacity of reinsurance that stabilized the reinsurance market to the benefit of the insurance companies writing properties lines in Florida. Secondly, the law provided for rate relief to all policyholders. The law also authorized the state-owned insurance company, Citizens, which is free of many of the restraints on private carriers such as surplus, ratios, income taxes and reinsurance expense, to reduce its premium rates and begin competing against private insurers in the residential property insurance market and expands the authority of Citizens to write commercial insurance.

REGULATION

Overview

Our insurance operations are subject to the laws and regulations of Alabama, Florida, Georgia, Louisiana, Nevada, South Carolina and Texas. We are also subject to employment regulations in Florida as well as California, North Carolina and Nevada, and regulations of any other states in which we seek to conduct business in the future. The regulations cover all aspects of our business and are generally designed to protect the interests of insurance policyholders, as opposed to the interests of shareholders. Such regulations relate to authorized lines of business, capital and surplus requirements, allowable rates and forms, investment parameters, underwriting limitations, transactions with affiliates, dividend limitations, changes in control, market conduct, maximum amount allowable for premium financing service charges and a variety of other financial and non-financial components of our business. Our failure to comply with certain provisions of applicable insurance laws and regulations could have a material adverse effect on our business, results of operations or financial condition. In addition, any changes in such laws and regulations, including the adoption of consumer initiatives regarding rates charged for coverage, could materially and adversely affect our operations or our ability to expand.

Most states' laws restrict an insurer's underwriting discretion, such as the ability to terminate policies, terminate agents or reject insurance coverage applications, and many state regulators have the power to reduce, or to disallow, increases in premium rates. In addition, state laws generally require that rate schedules and other information be filed with the state's insurance regulatory authority, either directly or through a rating organization with which the insurer is affiliated. The regulatory authority may disapprove a rate filing if it finds that the rates are inadequate, excessive or unfairly discriminatory. Rates, which are not necessarily uniform for all insurers, vary by class of business, hazard covered, and size of risk. Certain states, including Florida, as discussed above, have adopted laws or are considering proposed legislation which, among other things, limit the ability of insurance companies to effect rate increases or to cancel, reduce or non-renew insurance coverage with respect to existing policies, particularly personal automobile insurance.

Most states require licensure or regulatory approval prior to the marketing of new insurance products. Typically, licensure review is comprehensive and includes a review of a company's business plan, solvency, reinsurance, character of its officers and directors, rates, forms and other financial and non-financial aspects of a company. The regulatory authorities may prohibit entry into a new market by not granting a license or by withholding approval.

All insurance companies must file quarterly and annual statements with certain regulatory agencies and are subject to regular and special examinations by those agencies. We may be the subject of additional special examinations or analysis. These examinations or analysis may result in one or more corrective orders being issued by the Florida OIR. The Florida OIR is currently performing a regularly scheduled statutory examination of FNIC for the five years ended December 31, 2015. Prior to this, the most recent balance sheet audit of FNIC by the Florida OIR occurred as of December 31, 2010. There were no material findings by the Florida OIR in connection with this examination. FNIC also experienced a regularly scheduled statutory examination by the Florida OIR which occurred during 2010 for the five years ended December 31, 2010. There were no material findings in connection with this examination.

In some instances, various states routinely require deposits of assets for the protection of policyholders either in those states or for all policyholders. As of December 31, 2016, FNIC and MNIC held investment securities with a fair value of approximately $7.9 million, as deposits with the state of Florida, North Carolina, Alabama, and Georgia.

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Consent Order

On October 21, 2015, the Florida OIR approved the filing made by FNIC to comply with their cease and desist order dated May 19, 2015 which enabled them to review and approve FNIC's underwriting analytic models. Upon its approval of the filing, the Florida OIR rescinded the cease and desist order. FNIC was required to pay a nominal administration fee.

Insurance Holding Company Regulation

We, the parent company, are subject to laws governing insurance holding companies in Florida where FNIC and MNIC are domiciled. These laws, among other things, (i) require us to file periodic information with the Florida OIR, including information concerning our capital structure, ownership, financial condition and general business operations, (ii) regulate certain transactions between us and our affiliates, including the amount of dividends and other distributions, the terms of surplus notes and amounts that our affiliates can charge the holding company for services such as management fees or commissions, (iii) restrict the ability of any one person to acquire certain levels of our voting securities without prior regulatory approval. Any purchaser of 10% or more of the outstanding shares of our Common Stock will be presumed to have acquired control of FNIC unless the Florida OIR, upon application, determines otherwise.

Restrictions in Payments of Dividends by Domestic Insurance Companies

Under Florida law, a domestic insurer may not pay any dividend or distribute cash or other property to its shareholders except out of that part of its available and accumulated capital surplus funds which is derived from realized net operating profits on its business and net realized capital gains. A Florida domestic insurer may not make dividend payments or distributions to shareholders without prior approval of the Florida OIR if the dividend or distribution would exceed the larger of (i) the lesser of (a) 10.0% of its capital surplus or (b) net income, not including realized capital gains, plus a two-year carryforward, (ii) 10.0% of capital surplus with dividends payable constrained to unassigned funds minus 25.0% of unrealized capital gains or (iii) the lesser of (a) 10.0% of capital surplus or (b) net investment income plus a three-year carryforward with dividends payable constrained to unassigned funds minus 25.0% of unrealized capital gains.

Alternatively, a Florida domestic insurer may pay a dividend or distribution without the prior written approval of the Florida OIR (i) if the dividend is equal to or less than the greater of (a) 10.0% of the insurer's capital surplus as regards policyholders derived from realized net operating profits on its business and net realized capital gains or (b) the insurer's entire net operating profits and realized net capital gains derived during the immediately preceding calendar year, (ii) the insurer will have policy holder capital surplus equal to or exceeding 115.0% of the minimum required statutory capital surplus after the dividend or distribution, (iii) the insurer files a notice of the dividend or distribution with the Florida OIR at least ten business days prior to the dividend payment or distribution and (iv) the notice includes a certification by an officer of the insurer attesting that, after the payment of the dividend or distribution, the insurer will have at least 115.0% of required statutory capital surplus as to policyholders. Except as provided above, a Florida domiciled insurer may only pay a dividend or make a distribution (i) subject to prior approval by the Florida OIR or (ii) 30 days after the Florida OIR has received notice of such dividend or distribution and has not disapproved it within such time.

No dividends were paid by FNIC in 2016, 2015 and 2014, and none are anticipated in 2017. Also, no dividends were paid by MNIC since inception in 2015 and none are anticipated in 2017. Although we believe that amounts required to meet our financial and operating obligations will be available from sources other than dividends from our insurance subsidiaries, there can be no assurance in this regard. Further, there can be no assurance that, if requested, the Florida OIR will allow any dividends to be paid by FNIC or MNIC to us, the parent company, in the future. The maximum dividends permitted by state law are not necessarily indicative of an insurer's actual ability to pay dividends or other distributions to a parent company, which also may be constrained by business and regulatory considerations, such as the impact of dividends on capital surplus, which could affect an insurer's competitive position, the amount of premiums that can be written and the ability to pay future dividends. Further, state insurance laws and regulations require that the statutory capital surplus of an insurance company following any dividend or distribution by it be reasonable in relation to its outstanding liabilities and adequate for its financial needs.

While the non-insurance company subsidiaries (FNU and any other affiliate) are not subject directly to the dividend and other distribution limitations, insurance holding company regulations govern the amount that any affiliate within the holding company structure may charge any of the insurance companies for service (e.g., management fees and commissions).

Underwriting and Marketing Restrictions

During the past several years, various regulatory and legislative bodies have adopted or proposed new laws or regulations to address the cyclical nature of the insurance industry, catastrophic events and insurance capacity and pricing. These regulations include (i) the creation of "market assistance plans" under which insurers are induced to provide certain coverages, (ii) restrictions on the ability of insurers to rescind or otherwise cancel certain policies in mid-term, (iii) advance notice requirements or limitations imposed for certain policy non-renewals and (iv) limitations upon or decreases in rates permitted to be charged.

National Association of Insurance Commissioners (“NAIC”) Risk-Based Capital Requirements

In order to enhance the regulation of insurer solvency, NAIC established risk-based capital requirements for insurance companies that are designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policy holders. These requirements measure three major areas of risk facing property and casualty insurers: (i) underwriting risks, which encompass the risk of adverse loss developments and inadequate pricing; (ii) declines in asset values arising from credit risk; and (iii) other business risks from investments. Insurers having less statutory surplus than required will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. The Florida OIR, which follows these requirements, could require FNIC or MNIC to cease operations in the event they fail to maintain the required statutory capital.

Based upon the 2016 and 2015 statutory financial statements for FNIC and MNIC, statutory surplus exceeded the regulatory action levels established by the NAIC’s risk-based capital requirements.

Based on risk-based capital requirements, the extent of regulatory intervention and action increases as the ratio of an insurer’s statutory surplus to its Authorized Control Level (“ACL”), as calculated under the NAIC’s requirements, decreases. The first action level, the Company Action Level, requires an insurer to submit a plan of corrective actions to the insurance regulators if statutory surplus falls below 200.0% of the ACL amount. The second action level, the Regulatory Action Level, requires an insurer to submit a plan containing corrective actions and permits the insurance regulators to perform an examination or other analysis and issue a corrective order if statutory surplus falls below 150.0% of the ACL amount. The third action level, ACL, allows the regulators to rehabilitate or liquidate an insurer in addition to the aforementioned actions if statutory surplus falls below the ACL amount. The fourth action level is the Mandatory Control Level, which requires the regulators to rehabilitate or liquidate the insurer if statutory surplus falls below 70.0% of the ACL amount. FNIC’s ratio of statutory surplus to its ACL was 307.5%, 439.3% and 534.0% at December 31, 2016, 2015 and 2014, respectively. MNIC’s ratio of statutory surplus to its ACL was 2,419.8% and 7,260.0% at December 31, 2016 and 2015, respectively.

Industry Ratings Services

Third-party rating agencies assess and rate the ability of insurers to pay their claims. These financial strength ratings are used by the insurance industry to assess the financial strength and quality of insurers. These ratings are based on criteria established by the rating agencies and reflect evaluations of each insurer’s profitability, debt and cash levels, customer base, adequacy and soundness of reinsurance, quality and estimated market value of assets, adequacy of reserves and management. Ratings are based upon factors of concern to agents, reinsurers and policyholders and are not directed toward the protection of investors, such as purchasers of our common stock.

As of December 31, 2016, FNIC and MNIC are rated by 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. On November 16, 2016, Demotech reaffirmed FNIC’s FSR of “A” (“Exceptional”) and on November 30, 2016 Demotech reaffirmed MNIC’s FSR of “A” (“Exceptional”).

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ITEM 1A. RISK FACTORS

We are subject to certain risks in our business operations which are described below. Careful consideration of these risks should be made before making an investment decision. The risks and uncertainties described below are not the only ones facing FNHC. Additional risks and uncertainties not presently known or currently deemed immaterial may also impair our business operations.

Risks Related to Our Business

Our financial condition could be adversely affected by the occurrence of natural and man-made disasters.

We write insurance policies that cover homeowners, business owners and automobile owners for losses that result from, among other things, catastrophes and sinkholes. Catastrophic losses can be caused by natural events such as hurricanes, tropical storms, tornadoes, wind, hail, fires, explosions and other events, and their incidence and severity are inherently unpredictable. They can also be caused by terrorist attacks, war, riots, political instability and other man-made events. The extent of losses from a catastrophe is a function of two factors: the total amount of the insurance company’s exposure in the area affected by the event and the severity of the event. Although our homeowners’ policyholders are disbursed throughout the Southeast, the majority of which are located in Florida, which is especially subject to adverse weather conditions such as hurricanes and tropical storms, and a substantial portion are located in southeastern Florida.

The occurrence of claims from catastrophic events could result in substantial volatility in our results of operations or financial condition for any fiscal quarter or year. Increases in the values and concentrations of insured property may also increase the severity of these occurrences in the future. Although we attempt to manage our exposure to such events through the use of underwriting controls and the purchase of third-party reinsurance, catastrophic events are inherently unpredictable and the actual nature of such events when they occur could be more frequent or severe than contemplated in our pricing and risk management expectations. As a result, the occurrence of one or more catastrophic events could have a material adverse effect on our results of operations or financial condition.

Florida experienced two significant hurricanes in 2016, which some weather analysts believe is consistent with a period of greater hurricane activity. We are exploring alternatives to reduce our exposure to these types of storms, which may increase operating expenses and may not be successful in protecting long-term profitability. If our loss experience is more adverse than is contemplated by our loss reserves, the related increase in our loss reserves may have a material adverse effect on our results of operations in the period in which the increase occurs.

Although we follow the industry practice of reinsuring a portion of our risks, our costs of obtaining reinsurance fluctuates and we may not be able to successfully alleviate risk through reinsurance arrangements.

We have a reinsurance structure that is a combination of private reinsurance and the FHCF. Our reinsurance structure is composed of several reinsurance companies with varying levels of participation providing coverage for loss and LAE's at pre-established minimum and maximum amounts. Losses incurred in connection with a catastrophic event below the minimum and above the maximum are the responsibility of FNIC and MNIC.

The availability and costs associated with the acquisition of reinsurance will vary year to year. We are not able to control these fluctuations which may be significant and may limit our ability to purchase adequate coverage. The recovery of increased reinsurance costs through rate action is not immediate and cannot be presumed, as it is subject to approval of the Florida OIR.

We face a risk of non-collectability of reinsurance, which could materially and adversely affect our business, results of operations and financial condition.

As is common practice within the insurance industry, we transfer a portion of the risks insured under our policies to other companies through the purchase of reinsurance. This reinsurance is maintained to protect our insurance subsidiary against the severity of losses on individual claims, unusually serious occurrences in which a number of claims produce an aggregate extraordinary loss and other catastrophic events. Although reinsurance does not discharge our insurance subsidiary from its primary obligation to pay for losses insured under the policies it issues, reinsurance does make the assuming reinsurer liable to the insurance subsidiary for the reinsured portion of the risk. A credit 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 business, results of operations and financial condition.

Our reinsurance structure has significant risks, including the fact that the FHCF or our other reinsurers may not have available capital resources to pay their claims or that their ability to pay their claims in a timely manner may be impaired. This could result in significant financial, legal and operational challenges to our company. Therefore, in the event of a catastrophic loss, we may become

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dependent upon the FHCF’s ability to pay, which may, in turn, be dependent upon the SBA’s ability to issue bonds in amounts that would be required to meet its reinsurance obligations in the event of such a catastrophic loss.

If we are unable to continue our growth because our capital must be used to pay greater than anticipated claims, our financial results may suffer.

Our future growth will depend on our ability to expand the types of insurance products we offer and the geographic markets in which we do business, both balanced by the business risks we choose to assume and cede. We believe that our Company is sufficiently capitalized to operate our business as it now exists and as we currently plan to expand it. Our existing sources of funds include possible sales of our investment securities and our earnings from operations and investments. Unexpected catastrophic events in our market areas, such as the hurricanes experienced in Florida and South Carolina in 2016, have resulted and may result in greater claims losses than anticipated, which could require us to limit or halt our growth while we redeploy our capital to pay these unanticipated claims.

We may require additional capital in the future which may not be available or only available on unfavorable terms.

Our future capital requirements depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. To the extent that our capital may be insufficient to meet future operating requirements and/or cover losses, we may need to raise additional funds through financings or curtail our growth. Many factors will affect the amount and timing of our capital needs, including our growth and profitability, our claims experience, and the availability of reinsurance, as well as possible acquisition opportunities, market disruptions and other unforeseeable developments.

If we were required to raise additional capital, equity or debt financing may not be available at all or may be available only on terms that are not favorable to us. In the case of equity financings, dilution to our shareholders’ ownership could result, and in any case such securities may have rights, preferences and privileges that are senior to those of existing shareholders. If we raise additional funds by incurring debt financing, the terms of the debt may involve significant cash payment obligations as well as covenants and specific financial ratios that may restrict our ability to operate our business or pay dividends. If we cannot obtain adequate capital on favorable terms or at all, our business, financial condition or results of operations could be materially adversely affected.

Our business is heavily regulated, and changes in regulation may reduce our profitability and limit our growth.

We are subject to extensive regulation in the states in which we conduct business. This regulation is generally designed to protect the interests of policyholders, as opposed to shareholders and other investors, and relates to authorization for lines of business, capital and surplus requirements, investment limitations, underwriting limitations, transactions with affiliates, dividend limitations, changes in control, premium rates and a variety of other financial and non-financial components of an insurance company's business. These regulatory requirements may adversely affect or inhibit our ability to achieve some or all of our business objectives. State regulatory authorities also conduct periodic examinations into insurers' business practices. These reviews may reveal deficiencies in our insurance operations or differences between our interpretations of regulatory requirements and those of the regulators.

The NAIC and state insurance regulators are constantly reexamining existing laws and regulations, generally focusing on modifications to holding company regulations, interpretations of existing laws and the development of new laws.

From time to time, some states in which we conduct business have considered or enacted laws that may alter or increase state authority to regulate insurance companies and insurance holding companies. In other situations, states in which we conduct business have considered or enacted laws that impact the competitive environment and marketplace for property and casualty insurance. In addition, in recent years the state insurance regulatory framework has come under increased federal scrutiny. Changes in federal legislation and administrative policies in several areas, including changes in financial services regulation and federal taxation, can significantly impact the insurance industry and us.

We cannot predict with certainty the effect any enacted, proposed or future state or federal legislation or NAIC initiatives may have on the conduct of our business. Furthermore, there can be no assurance that the regulatory requirements applicable to our business will not become more stringent in the future or result in materially higher costs than current requirements. Changes in the regulation of our business may reduce our profitability, limit our growth or otherwise adversely affect our operations.

We may experience financial exposure from climate change.

A body of scientific evidence indicates that climate change may be occurring. Climate change, to the extent that it may affect weather patterns, may cause an increase in the frequency and/or the severity of catastrophic events or severe weather conditions. Our financial exposure from climate change is most notably associated with losses in connection with the occurrence of hurricanes striking Florida. We mitigate the risk of financial exposure from climate change by restrictive underwriting criteria, sensitivity to geographic concentrations, and reinsurance.

Restrictive underwriting criteria can include, but are not limited to, higher premiums and deductibles and more specifically excluded policy risks such as fences and screened-in enclosures. New technological advances in computer generated geographical mapping afford us an enhanced perspective as to geographic concentrations of policyholders and proximity to flood prone areas. Our amount of maximum reinsurance coverage is determined by subjecting our homeowner exposures to statistical forecasting models that are designed to quantify a catastrophic event in terms of the frequency of a storm occurring once in every “n” years. Additionally, if the statistical forecasting models fail to contemplate an emerging claim trend, such as the assignment of insurance benefits in Florida then there is the risk the Company may not purchase adequate catastrophic wind coverage. Our reinsurance coverage contemplates the effects of a catastrophic event that occurs only once every 100 years. Our amount of losses retained (our deductible) in connection with a catastrophic event is determined by market capacity, pricing conditions and surplus preservation. There can be no assurance that our reinsurance coverage and other measures taken will be sufficient to mitigate losses resulting from one or more catastrophic events.

Our loss reserves are estimates and may be inadequate to cover our actual liability for losses, causing our results of operations to be adversely affected.

We maintain reserves to cover our estimated ultimate liabilities for losses and LAE. These reserves are estimates based on historical data and statistical projections of what we believe the settlement and administration of claims will cost based on facts and circumstances then known to us. Actual loss and LAE reserves, however, may vary significantly from our estimates.

Factors that affect loss and LAE reserves include the estimates made on a claim-by-claim basis known as “case reserves” coupled with bulk estimates known as 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, including the impact of trends such as the assignment of benefits by insureds; (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 past 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 the uncertainties that surround estimated loss reserves, we cannot be certain that our reserves will be adequate to cover our actual losses. If our loss and LAE reserves are less than actual losses and LAE’s, we will be required to increase our reserves with a corresponding reduction in our net income in the period in which the deficiency is identified. Future loss experience, substantially in excess of our loss and LAE reserves, could substantially harm our results of operations and financial condition.

Our revenues and operating performance will fluctuate due to statutorily approved assessments that support property and casualty insurance pools and associations.

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, the Florida Joint Underwriters Association ("JUA"), the Florida Insurance Guaranty Association ("FIGA"), Citizens and the FHCF.

The insurance companies currently pass the assessments on to holders or insurance policies, in the form of a policy surcharge, and reflect the collection of these assessments as fully earned credits to operations in the period collected. The collection of these fees may adversely affect our overall marketing strategy due to the competitive landscape in Florida.

In addition, the impact of future assessments on our balance sheet, results of operations or cash flow are undeterminable at this time.

Our investment portfolio may suffer reduced returns or losses, which would significantly reduce our earnings.

Like other insurance companies, we depend on income from our investment portfolio for a substantial portion of our earnings. During the time that normally elapses between the receipt of insurance premiums and any payment of insurance claims, we invest the premiums received, together with our other available capital, primarily in debt securities and to a lesser extent in equity securities, in order to generate investment income.

Our investment portfolio contains interest rate sensitive instruments, such as bonds, which may be adversely affected by changes in interest rates. A significant increase in interest rates or decrease in credit worthiness could have a material adverse effect on our financial condition or results of operations. Generally, bond prices decrease as interest rates rise. Changes in interest rates could also have an adverse effect on our investment income and results of operations. For example, if interest rates decline, investment of new premiums received and funds reinvested will earn less than expected.

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Our determination of the amount of other-than-temporary impairment to record varies by investment type and is based upon our periodic evaluation and assessment of known and inherent risks associated with the respective investment type. We revise our evaluations and assessments as conditions change and new information becomes available, and we reflect changes in other-than- temporary impairments in our consolidated statements of income. We base our assessment of whether other-than-temporary impairments have occurred on our case-by-case evaluation of the underlying reasons for the decline in fair value. We can neither provide assurance that we have accurately assessed whether the impairment of one or more of our investments is temporary or other-than-temporary, nor that we have accurately recorded amounts for other-than-temporary impairments in our financial statements. Furthermore, historical trends may not be indicative of future impairments and additional impairments may need to be recorded in the future.

In addition, volatile and illiquid markets increase the likelihood that investment securities may not behave in historically predictable manners, resulting in fair value estimates that may be overstated compared with actual amounts that could be realized upon disposition or maturity of the security. The effects of market volatility and declining economic conditions may have unforeseen consequences on the credit quality, liquidity and financial stability of the issuers of securities we hold, or reinsurers with which we do business. Such deteriorations in financial condition can occur rapidly, leaving us unable to react to such a scenario in a prudent manner consistent with our historical practices in dealing with more orderly markets. This in turn could adversely and negatively affect our results of operations, liquidity or financial condition.

The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or our results of operations.

Various provisions of our policies, such as limitations or exclusions from coverage which have been negotiated to limit our risks, may not be enforceable in the manner we intend. At the present time we employ a variety of exclusions to our policies that limit exposure to known risks, including, but not limited to, exclusions relating to certain named liabilities, types of vehicles and specific artisan activities.

In addition, the policies we issue contain conditions requiring the prompt reporting of claims to us and our right to decline coverage in the event of a violation of that condition. While we believe our insurance product exclusions and limitations reduce the loss exposure to us and help eliminate known exposures to certain risks, it is possible that a court or regulatory authority could nullify or void an exclusion or that legislation could be enacted modifying or barring the use of such endorsements and limitations in a way that would adversely affect our loss experience, which could have a material adverse effect on our financial condition or results of operations.

The effects of emerging claim and coverage issues on our business are uncertain.

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

Another example of an existing trend, particularly in Florida homeowners insurance, is the assignment of homeowner benefits for a claim where a service provider agrees to make a repair that may be covered by an insurance policy in exchange for the policyholder’s right to sue the insurance carrier directly. The assignment of the insurance benefits has substantially increased, and is likely to continue to increase, the Company’s exposure to inflated claims, attorney fees and costs. Although legislative actions in the State of Florida to limit the effect of assignment of benefits on insurance companies are being contemplated, there can be no assurances that any such legislative actions will become law or, if enacted, that such actions will have the effect of limiting the impact on us of assignments of benefits by insureds.

Our failure to pay claims accurately could adversely affect our business, financial results and capital requirements.

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

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

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Our insurance company is subject to minimum capital and surplus requirements, and our failure to meet these requirements could subject us to regulatory action.

Our insurance company is subject to risk-based capital standards and other minimum capital and surplus requirements imposed under applicable state laws, including the laws of the State of Florida. The risk-based capital (“RBC”) standards, based upon the Risk Based Capital Model Act adopted by the NAIC, require our insurance company to report their results of RBC calculations to state departments of insurance and the NAIC. These RBC standards provide for different levels of regulatory attention depending upon the ratio of an insurance company’s total adjusted capital, as calculated in accordance with NAIC guidelines, to its authorized control level risk-based capital.

If we fail to meet the applicable RBC or minimum statutory capital requirements imposed by the laws of Florida or other states where we do business, we could be subject to further examination or corrective action imposed by state regulators, including limitations on out writing of additional business, state supervision or liquidation, and may be required to raise additional capital. Similarly, an increase in existing RBC requirements or minimum statutory capital requirements may require us to increase our statutory capital levels.

Our revenues and operating performance may fluctuate with business cycles in the property and casualty insurance industry.

Historically, the financial performance of the property and casualty insurance industry has tended to fluctuate in cyclical patterns characterized by periods of significant competition in pricing and underwriting terms and conditions, which is known as a “soft” insurance market, followed by periods of lessened competition and increasing premium rates, which is known as a “hard” insurance market. Although an individual insurance company’s financial performance is dependent on its own specific business characteristics, the profitability of most property and casualty insurance companies tends to follow this cyclical market pattern, with profitability generally increasing in hard markets and decreasing in soft markets. At present, we are experiencing a softening market in the property and casualty market in Florida and in the other states we operate in because of increased competition. We cannot predict, however, how long these market conditions will persist. Although we do not compete entirely on price or targeted market share, negative market conditions may impair our ability to write insurance at rates that we consider appropriate relative to the risk assumed. If we cannot write insurance at appropriate rates, our revenues and operating performance may be adversely affected.

We may not obtain the necessary regulatory approvals to expand the types of insurance products we offer or the states in which we operate.

The insurance industry is highly regulated. Prior to selling a new insurance product in a state, we must obtain approval from the applicable state insurance regulators. The insurance regulators in states to which we might apply may request additional information, add conditions to the license that we find unacceptable, or deny our application. This would delay or prevent us from operating in that state. If we want to operate in any additional states, we must file similar applications for licenses, which we may not be successful in obtaining.

Adverse ratings by insurance rating agencies may adversely impact our ability to write new policies, renew desirable policies or obtain adequate insurance, which could limit or halt our growth and harm our business.

Third-party rating agencies assess and rate the ability of insurers to pay their claims. These financial strength ratings are used by the insurance industry to assess the financial strength and quality of insurers. These ratings are based on criteria established by the rating agencies and reflect evaluations of each insurer's profitability, debt and cash levels, customer base, adequacy and soundness of reinsurance, quality and estimated market value of assets, adequacy of reserves, and management. Ratings are based upon factors of concern to agents, reinsurers and policyholders and are not directed toward the protection of investors, such as purchasers of our common stock.

Our ability to compete successfully in states outside of Florida and to expand our business footprint may also be negatively affected by our lack of an A.M. Best Company rating of our financial strength. Although our insurance subsidiaries have a Demotech rating of "A" (Exceptional), which is generally accepted in Florida and certain other states, a rating by A.M. Best is more widely accepted outside of Florida and may cause customers and agents to prefer a policy written by an A.M. Best-rated company over a policy written by us. In addition, some mortgage companies outside of Florida may require homeowners to obtain property insurance from an insurance company with a minimum A.M. Best rating.

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 or downgrade of our ratings could have a material adverse effect on our results of operations and financial position because our insurance products might no longer be acceptable to the secondary marketplace and mortgage lenders. Furthermore, a withdrawal or downgrade of our ratings could prevent independent agents from selling and servicing our insurance products or could increase the commissions we must pay to these agents.

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We rely on independent and general agents to write our insurance policies, and if we are not able to attract and retain independent and general agents, our revenues would be negatively affected.

We currently market and distribute our products and services through contractual relationships with a network of independent agents and a selected number of general agents. Our independent agents are our primary source for our property and liability insurance policies. Many of our competitors also rely on independent agents. As a result, we must compete with other insurers for independent agents' business. Our competitors may offer a greater variety of insurance products, lower premiums for insurance coverage, or higher commissions to their agents. If our products, pricing and commissions do not remain competitive, we may find it more difficult to attract business from independent agents to sell our products. A material reduction in the amount of our products that independent agents sell or a material reduction in the number of independent agents with whom we maintain a relationship could negatively affect our results of operations and financial condition.

We are a party to an Insurance Agency Master Agreement with Ivantage Select Agency, Inc. ("ISA") an affiliate of Allstate Insurance Company, or Allstate, pursuant to which we are authorized by ISA to appoint Allstate agents to offer our homeowners' and commercial general liability insurance products to consumers in Florida. Since that time, our homeowners' premiums and the percentage of homeowners' premiums attributable to Allstate agents has increased rapidly. During 2016, 24.1% of the homeowners' premiums we underwrote were from Allstate's network of Florida agents, and this concentration may continue to increase. An interruption or change in our relationship with ISA could have a material adverse effect on the amount of premiums we are able to write, as well as our results of operations.

Our business could be materially and adversely affected by a security breach or other attack involving our computer systems or the systems of one or more of our business partners or vendors.

Our business requires that we build and maintain computer systems to run our operations and to store the significant volume of data that we acquire, including the personal confidential information of our customers, agents and employees and our intellectual property, trade secrets, and other sensitive business and financial information. These systems are subject to attacks by sophisticated third parties with substantial computing resources and capabilities. Such attacks may include, among other things, attempts to gain unauthorized access to this confidential or proprietary data or attempts to disrupt or shut down the system. Additionally, an employee, consultant, vendor representative or other person with legitimate access to our systems may take actions, or be the subject of a security breach or cyber-attack, which could result in improper or unauthorized access to our systems, and in the loss or theft of our intellectual property or the personal information of our customers, agents or employees.

We undertake substantial efforts to protect our systems and sensitive or confidential information. These efforts include internal processes and technological defenses that are preventative or detective, and other controls designed to provide multiple layers of security protection. While we expend significant resources on these defensive measures, there can be no assurance that we will be successful in preventing attacks or detecting and stopping them once they have begun.

We also conduct significant business functions and computer operations using the systems of third-party business partners and vendors, who provide software, hosting, communication, and other computer services to us. These third-party systems may experience cyber-attacks and other security breaches, which could result in the loss, theft or unauthorized publication of our information or the confidential information of our customers, agents or employees.

Our business could be significantly damaged by a security breach, data loss or corruption, or cyber-attack. In addition to the potentially high costs of investigating and stopping such an event and implementing necessary fixes, we could incur substantial liability if confidential customer, agent or employee information is stolen. This could cause a significant disruption of our ability to conduct our insurance operations, adversely affect our competitive position if trade secrets or other proprietary information is stolen, and have severe ramifications on our reputation and brand, resulting in a materially adverse effect on our ability to generate new and renewal business. To mitigate these costs, we carry a cyber-liability insurance policy. Our insurance may not be sufficient to protect against all financial and other loss. Additionally, this policy will not afford us coverage for security breaches, data loss, or cyber-attacks experienced by our third-party business partners who have access to our customer, agent, or employee data.

We rely on our information technology and telecommunications systems, and the failure of these systems could disrupt our operations.

Our business is highly dependent upon the successful and uninterrupted functioning of our current information technology and telecommunications systems. We rely on these systems to process new and renewal business, provide customer service, make claims payments and facilitate collections and cancellations, as well as to perform actuarial and other analytical functions necessary for pricing and product development. As a result, the failure of these systems could interrupt our operations and adversely affect our financial results. We utilize a third-party to provide certain information security related services designed to prevent an information security event or detect one timely. Although we have implemented security measures to protect our systems from computer viruses and intrusions by third parties, there can be no assurances that these measures will be effective.

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Nonstandard automobile insurance historically has a higher frequency of claims than standard automobile insurance, thereby increasing our potential for loss exposure beyond what we would be likely to experience if we offered only standard automobile insurance.

Nonstandard automobile insurance is provided to insureds that are unable to obtain preferred or standard insurance coverage because of their payment histories, driving records, age, vehicle types, or prior claims histories. This type of automobile insurance historically has a higher frequency of claims than does preferred or standard automobile insurance policies, although the average dollar amount of the claim is usually smaller under nonstandard insurance policies. As a result, we are exposed to the possibility of increased loss exposure and higher claims experience than would be the case if we offered only standard automobile insurance.

Our success depends on our ability to accurately price the risks we underwrite.

The results of operations and the financial condition of our insurance company depend on our ability to underwrite and set premium rates accurately for a wide variety of risks. Rate adequacy is necessary to generate sufficient premiums to pay losses, LAE’s and underwriting expenses and to earn a profit. In order to price our products accurately, we must collect and properly analyze a substantial amount of data; develop, test and apply appropriate rating formulas; closely monitor and timely recognize changes in trends; and project both severity and frequency of losses with reasonable accuracy. Our ability to undertake these efforts successfully and price our products accurately is subject to a number of risks and uncertainties, some of which are outside our control, including:

· the availability of sufficient reliable data and our ability to properly analyze available data;

· the uncertainties that inherently characterize estimates and assumptions;

· our selection and application of appropriate rating and pricing techniques;

· changes in legal standards, claim settlement practices, medical care expenses and restoration costs;

· regulatory restrictions; and

· legislatively imposed consumer initiatives.

Consequently, we could underprice risks, which would negatively affect our profit margins, or we could overprice risks, which could reduce our sales volume and competitiveness. In either event, the profitability of our insurance company could be materially and adversely affected.

Current operating resources are necessary to develop future new insurance products.

We currently intend to expand our product offerings by underwriting additional insurance products and programs, and marketing them through our distribution network. Expansion of our product offerings will result in increases in expenses due to additional costs incurred in actuarial rate justifications, software and personnel. Offering additional insurance products may also require regulatory approval, further increasing our costs. There can be no assurance that we will be successful bringing new insurance products to our marketplace in a manner that is profitable.

Increased competition, competitive pressures, industry developments and market conditions could affect the growth of our business and adversely impact our financial results.

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, many of whom are larger, have greater financial and other resources, have higher financial strength ratings and offer more diversified insurance coverage. 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 may be forced to reduce our premiums significantly to compete, which could make us less profitable and have a material adverse effect on our business, results of operations and financial condition. If we do not meet the prices offered by our competitors, we may lose business in the short term, which could also result in a material adverse effect on our business, results of operations and financial condition.

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MNIC has focused on the Florida homeowners' insurance market, which has increased our exposure to the factors that impact the Florida insurance market generally, such as the occurrence of hurricanes, trends in claims experience, and the impact of changes in Florida insurance law and regulations.

MNIC is organized as a Florida property and casualty insurer and has initially focused primarily on the Florida homeowners' insurance market. As a result, the presence of MNIC in the Florida market increases our exposure to the factors that impact insurers in the Florida market generally, such as the occurrence of catastrophic events such as hurricanes, the trends experienced in administering and resolving claims resulting from the increased use of private adjusters, and the impact of changes in Florida's insurance laws and regulations. To the extent that these factors may adversely affect our operations, the presence of MNIC in the Florida market will have the effect of magnifying the effect of those factors.

MNIC writes insurance policies that have a higher risk profile than those written by FNIC, allowing MNIC to reach a broader market and charge higher premiums. While MNIC underwriting standards avoids the highest risk policies, the occurrence of a catastrophic event could result in greater losses per policy for MNIC and have a material adverse effect on the Company's results of operations, financial position and cash flows.

Our executive management team is critical to the strategic direction of our company. If there were an unplanned loss of service by any of our officers our business could be harmed.

We depend, and will continue to depend, on the services of our executive management team, which includes Michael H. Braun, our Chief Executive Officer and President. Our success also will depend in part upon our ability to attract and retain qualified executive officers, experienced underwriting talent and other skilled employees who are knowledgeable about our business. If we were to lose the services of one or more members of our executive management team, our business could be adversely affected. Although we have employment agreements with our executive officers, any unplanned loss of service could substantially harm our business.

New homeowners' insurance operations outside of the State of Florida may not be profitable.

We plan to continue the expansion of admitted homeowners' property and casualty programs into other states as opportunities avail themselves. Risks associated with execution of our planned operations include the inability to market an adequately priced policy, inadequate commission structures, and overpriced or unavailable catastrophic reinsurance for wind events. Additionally, each state has its own authoritative body designed to regulate the insurance products and operations of new and existing insurance companies under their respective authority.

There can be no guarantees that our operations will be profitable in a given state nor can there be any guarantees that the state authorities will allow us to do business in that state.

Risks Related to an Investment in Our Shares

Our stock price in recent years has been volatile and is likely to continue to be volatile. As a result, the market price of our common stock may drop below the price you pay, and you may not be able to resell your shares at a profit.

The market price of our common stock has experienced, and may continue to experience, significant volatility from time to time. Such volatility may be affected by various factors and events, such as:

- our quarterly operating results, including a shortfall in operating revenue or net income from that expected by securities analysts and investors;
- recognition of large unanticipated accounting charges, such as related to a loss reserve enhancement;
- changes in securities analysts' estimates of our financial performance or the financial performance of our competitors or companies in our industry generally;
- the announcement of a material event or anticipated event involving us or our industry or the markets in which we operate;
- the issuance of a significant number of shares; and
- the other risk factors described in this annual Form 10-K, the accompanying notes and the documents incorporated by reference herein.

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In recent years, the U.S. stock market has experienced extreme price and volume fluctuations, which have sometimes affected the market price of the securities issued by a particular company in a manner unrelated to the operational performance of the company. This type of market effect could impact our common stock price as well. The volatility of our common stock means that the price of our common stock may have declined substantially at such time as you may look to sell your shares of our common stock. If our share price decreases, the value of your investment could decline.

We have authorized but unissued preferred stock, which could affect rights of holders of common stock.

Our articles of incorporation authorize the issuance of preferred stock with designations, rights and preferences determined from time to time by our board of directors. Accordingly, our board of directors is empowered, without shareholder approval, to issue preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the voting power or other rights of the holders of common stock. In addition, the preferred stock could be issued as a method of discouraging a takeover attempt. Although we do not intend to issue any preferred stock at this time, we may do so in the future.

Provisions in our articles of incorporation and our bylaws, as amended, and the Florida Business Corporation Act could make it more difficult to acquire us and may reduce the market price of our common stock.

Our articles of incorporation and our bylaws presently contain certain provisions which may make it more difficult and time-consuming for shareholders or third parties to influence our management, policies or affairs, and may discourage, delay or prevent a transaction involving a change-in-control of the Company and offering a premium over the current market price of our common stock. These provisions include those which:

- prohibit cumulative voting in the election of our directors,
- establish a classified board of directors with staggered three-year terms,
- establish advance notice and disclosure procedures for shareholders to bring matters, including nominations for election to our board, before a meeting of our shareholders, and
- eliminate the ability of shareholders to take action by written consent in lieu of a shareholder meeting.

As a result, we may be less likely to receive unsolicited offers to acquire us that some of our shareholders might consider beneficial.

The Florida Business Corporation Act, as amended, contains provisions, which our directors have elected not to opt out of, that are designed to enhance the ability of our board to respond to and potentially defer attempts to acquire control of the Company. These provisions may discourage altogether takeover attempts that have not been approved by our board. These provisions may also adversely affect the price that a potential purchaser would be willing to pay for our common stock and, therefore, deprive you of the opportunity to obtain a takeover premium for your shares. These provisions could make the removal of our incumbent directors and management more difficult. These provisions may enable a minority of our directors and the holders of a minority of our outstanding voting stock or the holders of an existing control block to prevent, delay, discourage or make more difficult a merger, tender offer or proxy contest, even though the transaction may be favorable to the interests of a majority of our non-affiliate shareholders. These provisions could also potentially adversely affect the market price of our common stock.

As a holding company, we depend on the earnings of our subsidiaries and their ability to pay management fees and dividends to the holding company as the primary source of our income.

We are an insurance holding company whose primary assets are the stock of our wholly and partially owned subsidiaries. Our operations, and our ability to pay dividends or service future potential debt, are limited by the earnings of our subsidiaries and their payment of their earnings to us in the form of management fees, commissions, dividends, loans, advances or the reimbursement of expenses. These payments can be made only when our subsidiaries have adequate earnings. In addition, dividend payments made to us by our insurance subsidiary are restricted by Florida law governing the insurance industry. Generally, Florida law limits the dividends payable by insurance companies under complicated formulas based on the subsidiary’s available capital and earnings.

Payment of dividends in the future will depend on our earnings and financial position and such other factors, as our Board of Directors deems relevant.

Future sales of our common stock may depress our stock price.

Sales of a substantial number of shares of our common stock in the public market or otherwise, by us or by a major stockholder could depress the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.

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In addition, we may issue additional shares of our common stock from time to time in the future in amounts that may be significant. The sale of substantial amounts of our common stock, or the perception that these sales may occur, could adversely impact our stock price.

As of December 31, 2016, there were 79,484 shares issuable upon the exercise of outstanding and exercisable stock options and 243,759 additional shares available for grant under our equity-based compensation plans. The market price of the common shares may be depressed by the potential exercise of these options or grant of these shares. The holders of these options are likely to exercise them when we would otherwise be able to obtain additional capital on more favorable terms than those provided by the options.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our executive offices are located at 14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323 in an 18,554 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. During September 2015, we extended our lease term to expire in December 2022 and expanded the leased premises to include an additional 10,048 square feet. Refer to Note 8 set forth in Part II, Item 8 “Financial Statements and Supplemental Data” of this Form 10-K for further information about our leases.

ITEM 3. LEGAL PROCEEDINGS

In the ordinary course of conducting our business, we become involved in various legal actions and claims. Litigation is subject to many uncertainties and we may be unable to accurately predict the outcome of such matters, some of which could be decided unfavorably to us. Management does not believe the ultimate outcome of any pending matters of the nature described above would be material.

The Company is a party to a Co-Existence Agreement effective as of August 30, 2013 (the “Co-Existence Agreement”) with Federated Mutual Insurance Company (“Mutual”) pursuant to which the Company has agreed to certain restrictions on its use of the word “FEDERATED” without the word “NATIONAL” when referring to FNHC and Federated National Insurance Company. In response to Mutual’s allegations that the Company’s use of the word “FED” as part of the Company’s federally registered “FEDNAT” trademark infringes on Mutual’s federal and common law trademark rights, which the Company disputes, on July 21, 2016, the Company filed a declaratory judgment action for non-infringement of trademark in the U.S. District Court for the Southern District of Florida. Specifically, the Company seeks a declaration that its federally registered trademark "FEDNAT" does not infringe any alleged trademark rights of Mutual and that Mutual does not own any trademark rights to the name or mark "FED" in connection with insurance services outside of Owatonna, Minnesota. On July 26, 2016, Mutual filed a demand for arbitration against the Company before the American Arbitration Association (“AAA”) alleging a breach of the Co-Existence Agreement. On November 29, 2016, the U.S. District Court for the Southern District of Florida granted Mutual’s motion to compel arbitration of the Company’s declaratory judgment action for non-infringement of a trademark. On February 3, 2017, the AAA granted the Company’s motion to terminate the arbitration for lack of jurisdiction based upon Mutual’s failure to comply with the Co-Existence Agreement’s regarding the selection of an arbitrator. The parties are currently in the process of conferring upon the selection of a mutually agreeable arbitrator. The Company nevertheless intends to vigorously defend against Mutual's allegations, although there can be no assurances as to the outcome of this matter.

On March 2, 2017, the Company filed a complaint in Broward County, Florida court to enforce the terms of the restrictive covenants set forth in the Amended and Restated Non-Competition, Non-Disclosure and Non-Solicitation Agreement dated August 5, 2013, as amended, entered into between Peter J. Prygelski, III and the Company during Mr. Prygelski's employment with the Company and set forth in the separation agreement he entered into in connection with his separation from the Company. The Company believes that he accepted employment with a competitor in contravention of these restrictive covenants and therefore the Company is seeking injunctive relief, declaratory relief and damages, although there can be no assurances as to the outcome of this matter. The Company has not recognized a gain contingency in the financial statements as of December 31, 2016.

Refer to Note 9 set forth in Part II, Item 8 "Financial Statements and Supplemental Data" of this Form 10-K for additional information on legal proceedings.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Our common stock is listed for trading on The NASDAQ Global Market under the symbol "FNHC". The following table sets forth quarterly high and low closing sale prices as reported on the NASDAQ Global Market. These reported prices reflect prices between dealers, without accounting for retail mark-ups, markdowns or commissions, and may not represent actual transactions.

Quarter Ended:	High	Low
March 31, 2016	$ 29.08	$ 18.68
June 30, 2016	22.93	18.00
September 30, 2016	22.45	17.08
December 31, 2016	19.33	14.03
March 31, 2015	$ 31.87	$ 23.15
June 30, 2015	31.76	23.26
September 30, 2015	25.90	20.23
December 31, 2015	32.61	23.54

The closing price of our common stock on March 15, 2017 was $18.12.

HOLDERS

As of March 15, 2017, there were 94 holders of record of our common stock. We believe that the number of beneficial owners of our common stock is in excess of 5,800.

DIVIDENDS

The Board of Directors of FNHC declared regular quarterly dividends as follows:

- In September 2016, our Board of Directors declared a $0.08 per common share dividend payable December 1, 2016 to shareholders of record on November 1, 2016, totaling $1.1 million.

- In May and June 2016, our Board of Directors declared quarterly dividend payments of $0.06 per common share, respectively, paid in June and August 2016, respectively, totaling $1.7 million.

- In February 2016, our Board of Directors declared a quarterly dividend payment of $0.05 per common share, paid in March 2016, amounting to $0.7 million.

- $0.05 per common share payable on December 1, 2015 and March 1, 2016 to shareholders of record as of November 2, 2015 and February 1, 2016.

- $0.04 per common share payable on March 2, June 1 and September 1, 2015 to shareholders of record as of February 2, May 4 and August 3, 2015.

- $0.03 per common share payable on September 3 and December 2, 2013 and March 3, June 2, and September 2, 2014 to shareholders of record as of August 5 and November 4, 2013 and February 3, May 5, August 4, 2014. $0.04 per common share payable on and December 1, 2014 to shareholders of record as of November 3, 2014.

Payment of dividends in the future will depend on our earnings and financial position and such other factors, as our Board of Directors deems relevant. Moreover, our ability to continue to pay dividends may be restricted by regulatory limits on the amount of dividends that FNIC and MNIC are permitted to pay to the parent company.

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SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The following table summarizes our equity compensation plans as of December 31, 2016. All equity compensation plans were approved by our shareholders. We have not granted any options, warrants or rights to our shareholders outside of these equity compensation plans.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by stockholders	79,484	3.70	243,759

For additional information concerning our equity compensation, refer to Note 10 set forth in Part II, Item 8 "Financial Statements and Supplemental Data" of this Form 10-K.

STOCK PERFORMANCE GRAPH

The following graph shows the cumulative total shareholder return on our common stock over the last five fiscal years as compared with the total returns of the NASDAQ Composite Index and the SNL Property & Casualty Insurance Index. In accordance with SEC rules, this graph includes indices that we believe are comparable and appropriate.

Federated National Holding Company

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	Period Ending					
Index	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16
Federated National Holding Company	100.00	181.39	503.83	835.03	1,027.79	658.07
NASDAQ Composite	100.00	117.45	164.57	188.84	201.98	219.89
SNL Insurance P&C	100.00	118.04	156.39	179.61	185.79	219.27

Returns are based on the change in year-end to year-end price. The graph assumes $100 was invested on December 31, 2011 in our common stock, the NASDAQ Composite Index and the SNL Property & Casualty Insurance Index and that all dividends were reinvested. Past performance is not necessarily an indicator of future results.

Our filings with the SEC may incorporate information by reference, including this Form 10-K. Unless we specifically state otherwise, the information under this heading “Stock Performance Graph” shall not be deemed to be “soliciting materials” and shall not be deemed to be “filed” with the SEC or incorporated by reference into any of our filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934.

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ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and notes thereto and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” appearing elsewhere in this Annual Report on Form 10-K.

	Year Ended December 31,				
	2016	2015	2014	2013	2012
Statement of Operations Data:	(in thousands, except per share data)				
Revenue:					
Net premiums earned	$ 259,872	$ 210,020	$ 170,905	$ 104,381	$ 59,359
Net investment income	9,063	7,226	5,385	3,332	3,819
Net realized investment gains	3,045	3,616	4,426	2,881	1,072
Direct written policy fees	17,730	11,248	8,689	6,196	2,093
Other income	26,674	17,783	11,287	4,947	2,304
Total revenue	316,384	249,893	200,692	121,737	68,647
Costs and expenses:					
Losses and loss adjustment expenses	187,341	104,353	81,036	56,410	30,209
Commissions and other underwriting expenses	108,776	64,868	52,077	38,580	26,515
General and administrative expenses	17,186	15,223	10,272	7,529	5,175
Interest expense	348	256	—	—	—
Total costs and expenses	313,651	184,700	143,385	102,519	61,899
Income before income taxes	2,733	65,193	57,307	19,218	6,748
Income taxes	2,683	24,753	20,108	6,491	2,435
Net income	50	40,440	37,199	12,727	4,313
Net income (loss) attributable to noncontrolling interest	246	(445)	—	—	—
Net (loss) income attributable to Federated National Holding Company shareholders	$ (196)	$ 40,885	$ 37,199	$ 12,727	$ 4,313
Per share data:					
Net (loss) income per share attributable to Federated National Holding Company shareholders:					
Basic	$ (0.01)	$ 2.98	$ 3.08	$ 1.50	$ 0.53
Diluted	$ (0.01)	$ 2.92	$ 2.99	$ 1.45	$ 0.53
Dividends	$ 0.27	$ 0.18	$ 0.13	$ 0.11	$ 0.02

	December 31,				
	2016	2015	2014	2013	2012
	(in thousands, except per share data)				
Balance Sheet Data:					
Cash and invested assets	$ 484,275	$ 437,369	$ 370,920	$ 262,156	$ 151,238
Total assets	$ 813,127	$ 699,254	$ 503,631	$ 316,741	$ 185,888
Loss and loss adjustment expense reserves	$ 158,110	$ 97,340	$ 78,330	$ 61,016	$ 49,908
Total liabilities	$ 575,271	$ 448,495	$ 311,052	$ 208,247	$ 119,983
Total shareholders’ equity	$ 237,856	$ 250,759	$ 192,579	$ 108,494	$ 65,905
Book value per share	$ 17.65	$ 18.17	$ 14.13	$ 9.95	$ 8.26

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Operating Results Overview - Year Ended December 31, 2016 Compared with Year Ended December 31, 2015

The following overview does not address all of the matters covered in the other sections of Management's Discussion and Analysis of Financial Condition and Results of Operations or contain all of the information that may be important to our shareholders or the investing public. This overview should be read in conjunction with the other sections of Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following table summarizes our audited results of operations for the years ended December 31, 2016 and 2015:

	Year Ended December 31,		
	2016	% Change	2015
Revenue:	(Dollars in thousands)		
Gross premiums written	$ 605,485	22.6%	$ 493,770
Increase in unearned premiums	(40,062)	(34.9)%	(61,536)
Gross premiums earned	565,423	30.8%	432,234
Ceded premiums earned	(305,551)	37.5%	(222,214)
Net premiums earned	259,872	23.7%	210,020
Net investment income	9,063	25.4%	7,226
Net realized investment gains	3,045	(15.8)%	3,616
Direct written policy fees	17,730	57.6%	11,248
Other income	26,674	50.0%	17,783
Total revenue	316,384	26.6%	249,893
Expenses:			
Losses and LAE	187,341	79.5%	104,353
Commissions and other underwriting expenses	108,776	67.7%	64,868
General and administrative expenses	17,186	12.9%	15,223

Interest expense	348	35.9%	256
Total costs and expenses	313,651	69.8%	184,700
Income before income taxes	2,733	(95.8)%	65,193
Income taxes	2,683	(89.2)%	24,753
Net income	50	(99.9)%	40,440
Net income (loss) attributable to noncontrolling interest	246	(155.3)%	(445)
Net (loss) income attributable to FNHC	$ (196)	(100.5)%	$ 40,885
Ratios to net premiums earned:			
Net loss ratio (1)	72.1%		49.7%
Net expense ratio (2)	48.5%		38.1%
Net combined ratio (3)	120.7%		87.9%

(1) The net loss ratio is calculated as losses and LAE divided by net premiums earned.
(2) The net expense ratio is calculated as all operating expenses less interest expense divided by net premiums earned.
(3) The net combined ratio is calculated as the sum of losses and LAE and all operating expenses less interest expense divided by net premiums earned.

Revenue

Total revenue for the year ended December 31, 2016 of $316.4 million increased $66.5 million, or 26.6%, compared to revenue of $249.9 million in 2015.

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Gross Premiums Written

The following table represents the gross premiums written breakout for the years ended December 31, 2016 and 2015:

	Year Ended December 31,	
	2016	2015
Gross premiums written:	(in thousands)	
Homeowners Florida	$ 477,489	$ 427,428
Homeowners non-Florida	35,248	22,338
Personal automobile	69,479	21,912
Commercial general liability	13,256	13,928
Federal flood	10,013	8,164
Total gross premiums written	$ 605,485	$ 493,770

Gross written premiums increased $111.7 million, or 22.6%, to $605.5 million for the year ended December 31, 2016, compared with $493.8 million for the same period last year. The increase predominantly reflects market share growth in our homeowners' and personal automobile lines of business. Homeowners' gross written premiums increased $63.0 million, or 14.0%, to $512.7 million for the year ended December 31, 2016, compared with $449.8 million for the same twelve-month period last year. Gross written premiums for our personal automobile line of business increased by $47.6 million to $69.5 million in 2016, compared to $21.9 million in the prior year period. This increase is also reflected in in the increase in our homeowners' in-force policy count to 279,109 as of December 31, 2016, compared with 254,105 as of December 31, 2015. These increases reflect management's strategy to continue to grow market share in Florida as well as expand operations outside of Florida with the growth in our personal automobile line of business. With the expansion into areas outside of Florida, we are able to continue to leverage our personnel and, at the same time, diversify our insurance risk.

Gross Premiums Earned

The following table represents the gross premiums earned breakout for the years ended December 31, 2016 and 2015:

	Year Ended December 31,	
	2016	2015
Gross premiums earned:	(in thousands)	
Homeowners Florida	$ 455,252	$ 381,027
Homeowners non-Florida	29,101	15,799
Personal automobile	58,312	14,108
Commercial general liability	13,675	13,542
Federal flood	9,083	7,758
Total gross premiums earned	$ 565,423	$ 432,234

Gross premiums earned increased $133.2 million, or 30.8%, to $565.4 million for the year ended December 31, 2016, compared with $432.2 million for the same period last year.

Ceded Premiums Earned

Ceded premiums earned increased by $83.3 million, or 37.5%, to $305.6 million for the year ended December 31, 2016, compared with $222.2 million in the same period last year. This increase is driven by the additional excess-of-loss reinsurance costs recorded in 2016 as compared to 2015 related to the homeowners' premium growth. Additionally, we recorded increased ceded premiums related to the premium growth in personal automobile in 2016, which is generally ceded at 75% to 80% through a quota share agreement. These increases were offset by lower ceded premiums in 2016 as compared to 2015 due to the expiration of the 30% Florida only property quota share treaty, which ended on July 1, 2016.

Net Investment Income

Net investment income increased $1.8 million, or 25.4%, to $9.1 million during the year ended December 31, 2016, compared with $7.2 million during the year ended December 31, 2015. This increase is mainly due to a year-over-year overall growth of our investment portfolio, specifically growth in the debt securities investments. Our debt securities investment yields, net, remained steady year over year at 2.3% for the years ended December 31, 2016 and 2015, respectively.

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Net Realized Investment Gains

Net realized investment gains totaled $3.0 million for the year ended December 31, 2016, compared with $3.6 million for the year ended December 31, 2015. From time to time, our portfolio managers, under our control, move out of positions due to both macro and micro conditions; these movements generate both realized gains and losses. The slight decrease is due to less favorable market conditions for the year ended December 2016, as compared to the year ended December 31, 2015.

Direct Written Policy Fees

Direct written policy fees increased by $6.5 million, or 57.6%, to $17.7 million for the year ended December 31, 2016, compared with $11.2 million in 2016. The increase in direct written policy fees is correlated to the increase in gross written premiums in our homeowners and personal automobile lines of business compared to the prior year. These fees are generated when the Company writes a policy and the fee varies from state to state and by line of business. Policy fees generated by the managing general agent are earned by the Company. All other policy fees are collected by us and passed through to the general agent as acquisition costs and recognized in commission and other underwriting expenses.

Other Income

Other income increased $8.9 million, or 50.0%, to $26.7 million for the year ended December 31, 2016, compared with $17.8 million for the year ended December 31, 2015. The following table represents the other income detail:

	Year Ended December 31,		
	2016	% Change	2015
	(Dollars in thousands)		
Other income:			
Commission income	$ 17,229	120.6%	$ 7,811
Brokerage revenue	7,301	46.6%	4,979
Quota-share profit sharing	-	(100.0)%	3,077

Finance revenue	2,144	11.9%	1,916
Total other income	$ 26,674	50.0%	$ 17,783

The increase in commission income is primarily a result of the premium growth in personal automobile, which has increased the ceded commissions and the fees we receive for managing that business. These fees are received by FNIC and passed through to FNU for its services as a managing general agent. The commission income from personal automobile is designed to offset the commission and other acquisition costs incurred when the Company writes the policies, which are recognized in the commissions and other underwriting expenses account.

The increase in brokerage revenue is driven by the increase in our homeowners reinsurance program, the type of reinsurance purchased, and the commissions paid on these reinsurance agreements in calendar year 2016 as compared to calendar year 2015.

The decrease in quota-share profit sharing is the result of our re-evaluation, effective September 30, 2015, of the accounting treatment for the quota-share reinsurance contracts with retrospective rating provisions. At that time, we eliminated recording of future estimated quota-share profits in one line, ("Quota-share profit sharing"), on the consolidated statement of operations.

Expenses

Losses and Loss Adjustment Expenses

Losses and LAE increased $83.0 million, or 79.5%, to $187.3 million for the year ended December 31, 2016, compared with $104.4 million for the same twelve-month period last year. The increase in losses and LAE is driven by $40.0 million of losses due to increased earned premiums in our homeowners and personal automobile lines of business, $33.3 million incurred in catastrophe losses resulting from a series of tornados and severe weather events that impacted the state of Florida and South Carolina (i.e., Hurricane Matthew, Hurricane Hermine, Tropical Storm Colin), and $16.0 million of losses related to increasing our Florida homeowners' attritional loss ratio throughout 2016. Additionally, losses and LAE were impacted by unfavorable development of $11.0 million for the 2015 accident year in our homeowners' coverage in the state of Florida as a result of assignment of benefits and other related adjusting expenses. The factors listed above were offset by ceded losses pertaining to the property quota-share treaty.

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As of December 31, 2016, the Company recorded $158.1 million in losses and LAE expense reserves for all lines of business, which includes $99.2 million in incurred but not yet reported ("IBNR") reserves. As of December 31, 2015, the Company recorded $97.3 million in losses and LAE expense reserves for all lines of business, which includes $51.1 million in IBNR reserves.

Commissions and Other Underwriting Expenses

The following table represents the commissions and other underwriting expenses breakout for the years ended December 31, 2016 and 2015:

	Year Ended December 31,	
	2016	2015
Commissions and other underwriting expenses:	(in thousands)	
Homeowners Florida	$ 61,319	$ 41,033
All others	23,742	14,739
Ceded commissions	(27,705)	(32,828)
Total commissions and other fees	57,356	22,944
Salaries and wages	22,387	17,934
Other underwriting expenses	29,033	23,990
Commissions and other underwriting expenses	$ 108,776	$ 64,868

Commissions and other underwriting expenses increased $43.9 million, or 67.7%, to $108.8 million for the year ended December 31, 2016, compared with $64.9 million for the year ended December 31, 2015. The $43.9 million increase is related to the premium growth in our homeowners' and personal automobile lines of business; with personal automobile and homeowners' non-Florida lines of business carrying higher acquisition costs as a result of our different distribution models we employ to market our insurance products. Although personal automobile quota-share treaties cede 75% to 90% of all premiums, the full expense for commissions and other acquisition costs are recognized in this line item, which partially offsets the related commission income recorded within the other income line in the statements of operations.

General and Administrative Expenses

General and administrative expenses increased $2.0 million, or 12.9%, to $17.2 million for the year ended December 31, 2016, compared with $15.2 million for the year ended December 31, 2015. The increase primarily reflects expenses incurred of $1.9 million in connection with the resignation of the Company’s former Chief Financial Officer during the second quarter of 2016.

Income Taxes

Income taxes decreased $22.1 million, or 89.2%, to an income tax expense of $2.7 million for the year ended December 31, 2016, compared with an income tax expense of $24.8 million for the year ended December 31, 2015. The change was primarily due to a decrease in taxable income. Additionally, in 2016, the Company recorded $2.2 million of additional tax expense related to a prior year adjustment impacting deferred taxes.

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Operating Results Overview - Year Ended December 31, 2015 Compared with Year Ended December 31, 2014

The following overview does not address all of the matters covered in the other sections of Management's Discussion and Analysis of Financial Condition and Results of Operations or contain all of the information that may be important to our shareholders or the investing public. This overview should be read in conjunction with the other sections of Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following table reports our audited results of operations for the years ended December 31, 2015 and 2014:

	Year Ended December 31,		
	2015	% Change	2014
Revenue:	(Dollars in thousands)		
Gross premiums written	$ 493,770	30.9%	$ 377,156
Increase in unearned premiums	(61,536)	(4.0)%	(64,081)
Gross premiums earned	432,234	38.1%	313,075
Ceded premiums earned	(222,214)	56.3%	(142,170)
Net premiums earned	210,020	22.9%	170,905
Net investment income	7,226	34.2%	5,385
Net realized investment gains	3,616	(18.3)%	4,426
Direct written policy fees	11,248	29.5%	8,689
Other income	17,783	57.6%	11,287
Total revenue	249,893	24.5%	200,692
Expenses:			
Losses and LAE	104,353	28.8%	81,036
Commissions and other underwriting expenses	64,868	24.6%	52,077
General and administrative expenses	15,223	48.2%	10,272
Interest expense	256	100.0%	-
Total costs and expenses	184,700	28.8%	143,385
Income before income taxes	65,193	13.8%	57,307
Income taxes	24,753	23.1%	20,108
Net income	40,440	8.7%	37,199
Net loss attributable to noncontrolling interest	(445)	(100.0)%	-
Net income attributable to FNHC	$ 40,885	9.9%	$ 37,199

Ratios to net premiums earned:		
Net loss ratio (1)	49.7%	47.4%
Net expense ratio (2)	38.1%	36.5%
Net combined ratio (3)	87.9%	83.9%

(1) The net loss ratio is calculated as losses and LAE divided by net premiums earned.
(2) The net expense ratio is calculated as all operating expenses less interest expense divided by net premiums earned.
(3) The net combined ratio is calculated as the sum of losses and LAE and all operating expenses less interest expense divided by net premiums earned.

Revenue

Total revenue for the year ended December 31, 2015 of $249.9 million increased $49.2 million, or 24.5%, compared to revenue of $200.7 million in 2014.

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Gross Premiums Written

The following table represents the gross premiums written breakout for the years ended December 31, 2015 and 2014:

	Year Ended December 31,	
	2015	2014
Gross premiums written:	(in thousands)	
Homeowners Florida	$ 427,428	$ 335,338
Homeowners non-Florida	22,338	9,600
Personal automobile	21,912	12,376
Commercial general liability	13,928	12,432
Federal flood	8,164	7,410
Total gross premiums written	$ 493,770	$ 377,156

Gross premiums written increased $116.6 million, or 30.9%, to $493.8 million for the year ended December 31, 2015, compared with $377.2 million for the same period in 2014. The increase predominantly reflects market share growth in our homeowners' and personal automobile lines of business. Homeowners' gross premiums written increased $104.8 million, or 30.4%, to $449.8 million for the year ended December 31, 2015, compared with $344.9 million in 2014. Gross premiums written for the personal automobile line of business increased by $9.5 million to $21.9 million in 2016, compared to $12.4 million in 2014. Additionally, this increase reflects an increase in our homeowners' in-force policy count to 254,105 as of December 31, 2015, compared with 182,557 as of December 31, 2014.

Gross Premiums Earned

The following table represents the gross premiums earned breakout for the years ended December 31, 2015 and 2014:

	Year Ended December 31,	
	2015	2014
Gross premiums earned:	(in thousands)	
Homeowners Florida	$ 381,027	$ 279,514
Homeowners non-Florida	15,799	4,052
Personal automobile	14,108	11,617
Commercial general liability	13,542	11,245
Federal flood	7,758	6,648
Total gross premiums earned	$ 432,234	$ 313,075

Gross premiums earned increased $119.2 million, or 38.1%, to $432.2 million for the year ended December 31, 2015, compared with $313.1 million for the same period in 2014.

Ceded Premiums Earned

Ceded premiums earned increased by $80.0 million, or 56.3%, to $222.2 million for the year ended December 31, 2015, compared with $142.2 million in the same twelve-month period last year. This increase is driven by the additional excess-of-loss reinsurance costs recorded in 2015 as compared to 2014 related to the homeowners' premium growth. Additionally, we recorded higher ceded premiums in 2015 as compared to 2014 as the 30% Florida-only property quota share treaty was in place for a full year in 2015 as compared to only 6 months in 2014 as well as having the 10% Florida-only property quota share treaty in place for 6 months in 2015.

Net Investment Income

Net investment income increased $1.8 million, or 34.2%, to $7.2 million during the year ended December 31, 2015, compared with $5.4 million during the year ended December 31, 2014. This increase is mainly due to a year-over-year overall growth of our investment portfolio and a decrease in our debt securities investment yields. Our investment yield, net was 2.3% and 2.7%, for the years ended December 31, 2015 and 2014, respectively.

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Net Realized Investment Gains

Net realized investment gains were $3.6 million for the year ended December 31, 2015, compared with $4.4 million for the year ended December 31, 2014. From time to time, our portfolio managers, under our control, move out of positions due to both macro and micro conditions; these movements generate both realized gains and losses.

Direct Written Policy Fees

Direct written policy fees increased by $2.6 million, or 29.5%, to $11.2 million for the year ended December 31, 2015, compared with $8.7 million in 2014. The increase in direct written policy fees is correlated to the increase in gross written premiums in our homeowners and personal automobile lines of business compared to the prior year. These fees are generated when the Company writes a policy and the fee varies from state to state and by line of business. Policy fees generated by the managing general agent are earned by the Company. All other policy fees are collected by us and passed through to the general agent as acquisition costs and recognized in commission and other underwriting expenses.

Other Income

Other income increased $6.5 million, or 57.6%, to $17.8 million for the year ended December 31, 2015, compared with $11.3 million for the year ended December 31, 2014. The following table represents the other income detail:

	Year Ended December 31,		
	2015	% Change	2014
	(Dollars in thousands)		
Other income:			
Commission income	$ 7,811	72.9%	$ 4,517
Brokerage revenue	4,979	98.1%	2,513
Quota-share profit sharing	3,077	10.2%	2,792
Finance revenue	1,916	30.8%	1,465
Total other income	$ 17,783	57.6%	$ 11,287

The increase in commission income is primarily a result of the premium growth in personal automobile, which has increased the ceded commissions and the fees we receive for managing that business. These fees are received by FNIC and passed through to FNU for its services as a managing general agent. The commission income from personal automobile is designed to offset the commission and other acquisition costs incurred when the Company writes the policies, which are recognized in the commissions and other underwriting expenses account.

The increase in brokerage revenue is driven by the increase in our homeowners reinsurance program, the type of reinsurance purchased, and the commissions paid on these reinsurance agreements in calendar year 2015 as compared to calendar year 2014.

Expenses

Losses and Loss Adjustment Expenses

Losses and LAE increased $23.3 million, or 28.8%, to $104.4 million during the year ended December 31, 2015, compared with $81.0 million during the year ended December 31, 2014. The increase to losses and LAE is directly related to an increase in net premiums earned and an increase in our net loss ratio year over year. Our net loss ratio for 2015 was 49.7% compared with 47.4% for the same period in 2014. The increase in the ratio is the result of increasing our Florida homeowners' attritional loss ratio due to assignment of benefits and the temporary discontinuation of the underwriting analytics. The underwriting analytics were not used for several months in the second and third quarter of 2015, due to our compliance with a cease and desist order from the Florida OIR requiring us to obtain approval of these analytics without prior approval from them. The temporary discontinuation of the underwriting analytics caused us to underwrite polices outside of our standard process.

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Commissions and Other Underwriting Expenses

The following table represents commissions and other underwriting expenses breakout for the years ended December 31, 2015 and 2014:

	Year Ended December 31,	
	2015	2014
Commissions and other underwriting expenses:	(in thousands)	
Homeowners Florida	$ 41,033	$ 27,983
All others	14,739	11,802
Ceded commissions	(32,828)	(12,310)
Total commissions and other fees	22,944	27,475
Salaries and wages	17,934	11,125
Other underwriting expenses	23,990	13,477
Commissions and other underwriting expenses	$ 64,868	$ 52,077

Commissions and other underwriting expenses increased $12.8 million, or 24.6%, to $64.9 million for the year ended December 31, 2015, compared with $52.1 million for the year ended December 31, 2014. Our net expense ratio for 2015 was 38.1% compared with 36.5% for the same period in 2014. The increase is directly related to the significant increase in net premiums written and earned during the same period offset by an increase in ceded commissions from the 30% Florida-only property quota share treaty, which was in place for a full year in 2015 as compared to only 6 months in 2014 as well as the 10% Florida-only property quota share treaty, which was in place for 6 months in 2015.

General and Administrative Expenses

General and administrative expenses increased $5.0 million, or 48.2%, to $15.2 million for the year ended December 31, 2015, compared with $10.3 million for the year ended December 31, 2014. The change is due to an increase in salaries and benefits, including share-based compensation, legal and professional fees, including $0.9 million of start-up costs related to the organization of Monarch Delaware. Professional fees include audit, tax and actuarial fees. The increased costs are in support of the significant growth in our gross and net premiums written in 2015 as compared to 2014.

Income Taxes

Income taxes increased $4.7 million, or 23.1%, to $24.8 million for the year ended December 31, 2015, compared with $20.1 million for the year ended December 31, 2014. The change was due to an increase in taxable income and an increase in our effective tax rate. Our effective tax rate was 38.0% for the year ended December 31, 2015, compared with 35.1% for the year ended December 31, 2014. The increase in the effective tax rate is the result of having less permanent items and true up adjustments in 2015 as compared to 2014.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of funds are net premiums, investment income, commissions and fee income. Our primary uses of funds are the payment of claims and operating expenses. As of December 31, 2016, we had $74.6 million in cash and cash equivalents and $409.7 million in investments. As of December 31, 2015, we had $53.0 million in cash and cash equivalents and $384.3 million in investments.

Operating Activities

Net cash provided by operating activities for the year ended December 31, 2016 was $69.8 million, compared to net cash provided by operating activities for the year ended December 31, 2015 of $52.9 million. This increase was primarily as a result of the decrease in the prepaid reinsurance premium account and increase loss and LAE expense reserves in 2016, partly offset by decreases in reinsurance recoverables, unearned premiums, and deferred acquisition costs. Net cash provided by operating activities for the year ended December 31, 2015 was $52.9 million, compared to net cash provided by operating activities for the year ended December 31, 2014 of $63.1 million. This decrease was primarily as a result a decrease in prepaid reinsurance premium account.

Investing Activities

Net cash used in investing activities for the year ended December 31, 2016 was $33.2 million, compared to net cash used in investing activities for the year ended December 31, 2015 of $63.6 million. This decrease was the result of less net purchases of

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investment securities as compared to prior year. Net cash used in investing activities for the year ended December 31, 2015 was $63.6 million, compared to net cash used in investing activities for the year ended December 31, 2014 of $107.9 million. This decrease was the result of less net purchases, maturities and redemptions of investment securities as compared to prior year.

Financing Activities

Net cash used in financing activities for the year ended December 31, 2016 was $15.0 million, compared to net cash provided by financing activities for the year ended December 31, 2015 of $23.6 million. This decrease was primarily due to $18.7 million related to the noncontrolling interest equity investment and $5.0 million related to the issuance of debt in our consolidated VIE during the year ended December 31, 2015 and $11.3 million of common stock repurchases and dividends paid during the year ended December 31, 2016. Net cash provided by financing activities for the year ended December 31, 2015 was $23.6 million, compared to net cash provided by financing activities for the year ended December 31, 2014 of $43.5 million. This decrease was primarily due to $43.1 million related to issuance of common stock in public offering during the year ended December 31, 2014 offset by $18.7 million related to the noncontrolling interest equity investment and $5.0 million related to the issuance of debt in our consolidated VIE during the year ended December 31, 2015.

We believe that existing cash and investment balances, when combined with anticipated cash flows as noted above, will be adequate to meet our expected liquidity needs in both the short-term and the reasonably foreseeable future. We currently expect to continue declaring and paying dividends at comparable levels, subject to our future liquidity needs and reserve requirements. The Company also considers various opportunities, including common stock repurchases, to deploy its excess capital. Any future growth strategy may require external financing, and we may from time to time seek to obtain external financing. We cannot assure that additional sources of financing will be available to us on favorable terms, or at all, or that any such financing would not negatively impact our results of operations.

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.

CONTRACTUAL OBLIGATIONS

A summary of long-term contractual obligations as of December 31, 2016 follows (in thousands). The amounts represent estimates of gross undiscounted amounts payable over time.

	Payments Due By Period				
	Total	Less than 1 Year	1 - 3 Years	3 - 5 Years	More than 5 Years
Loss and loss adjustment expense reserves (1)	$ 158,110	$ 93,854	$ 55,196	$ 7,654	$ 1,406
Debt from consolidated variable interest entity	5,000	—	—	5,000	—
Operating leases	4,057	644	1,996	1,417	—
Other liabilities	120	120	—	—	—
Total	$ 167,287	$ 94,618	$ 57,192	$ 14,071	$ 1,406

(1) Loss and loss adjustment expense reserves do not have contractual maturity dates; however, based on historical payment patterns, the amount presented is our estimate of the expected timing of these payments. The timing of payments is subject to significant uncertainty. We maintain a portfolio of marketable investments with varying maturities and a substantial amount of cash and cash equivalents intended to provide adequate cash flows for such payments.

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CRITICAL ACCOUNTING POLICIES

The preparation of consolidated 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.

We believe our most critical accounting estimates inherent in the preparation of our financial statements are: (i) fair value measurements of our investments, (ii) accounting for investments, (iii) premium and unearned premium calculation, (iv) reinsurance contracts, (v) the amount and recoverability of Deferred Acquisition Costs (“DAC”), (vi) reserve for loss and losses adjustment expenses and (vii) income taxes. The accounting estimates that result require the use of assumptions about certain matters that are highly uncertain at the time of estimation. To the extent actual experience differs from the assumptions used, our financial condition, results of operations, and cash flows would be affected.

FAIR VALUE

The fair value is the price that would be received to sell an asset or paid to transfer a liability between market participants in the principal market or in the most advantageous market when no principal market exists. Adjustments to transaction prices or quoted market prices may be required in illiquid or disorderly markets in order to estimate fair value. Alternative valuation techniques may be appropriate under the circumstances to determine the value that would be received to sell an asset or paid to transfer a liability in an orderly transaction. Market participants are assumed to be independent, knowledgeable, able and willing to transact an exchange and not acting under duress. Our nonperformance or credit risk is considered in determining the fair value of liabilities. Considerable judgment may be required in interpreting market data used to develop the estimates of fair value. Accordingly, estimates of fair value presented herein are not necessarily indicative of the amounts that could be realized in a current or future market exchange.

INVESTMENTS

Investments consist of debt and equity securities. Debt securities consist of securities with an initial fixed maturity of more than one year, which include corporate bonds, municipal bonds and United States government bonds. Equity securities generally consist of securities that represent ownership interests in an enterprise. The Company determines the appropriate classification of investments in debt and equity securities at the acquisition date and re-evaluates the classification at each balance sheet date.

Held-to-maturity investments are recorded at the amortized cost, reflecting the ability and intent to hold the securities to maturity. All other securities were classified as available-for-sale and recorded at fair value. Unrealized gains and losses during the year, net of the related tax effect applicable to available-for-sale, are excluded from income and reflected in other comprehensive income, and the cumulative effect is reported as a separate component of shareholders' equity until realized. If a decline in fair value is deemed to be other-than-temporary, the investment is written down to its fair value and the amount of the write-down is recorded as an other-than-temporary impairment ("OTTI") loss on the statement of income. In addition, any portion of such decline related to debt securities that is believed to arise from factors other than credit is recorded as a component of other comprehensive income rather than against income.

Net realized gains and losses on investments are determined in accordance with the specific identification method.

Net investment income consists primarily of interest income from debt securities, cash and cash equivalents, including any premium amortization or discount accretion and dividend income from equity securities; less expenses related to investments.

PREMIUMS AND UNEARNED PREMIUMS

Premiums are recognized as revenue on a pro-rata basis over the term of an insurance policy. Assumed reinsurance premiums written and earned are based on reports received from ceding companies for pro-rata treaty contracts and are generally recorded as written based on contract terms for excess-of-loss and quota share contracts. Premiums are earned ratably over the terms of the related coverage.

Unearned premiums and ceded unearned premiums represent the portion of gross premiums written and ceded premiums written, respectively, relating to the unexpired terms of such coverage.

Premium receivable balances are reported net of an allowance for estimated uncollectible premium amounts. Such allowance is based upon an ongoing review of amounts outstanding, length of collection periods, the creditworthiness of the insured and other relevant factors. Amounts deemed to be uncollectible are written off against the allowance.

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REINSURANCE

Reinsurance is used to mitigate the exposure to losses, manage capacity and protect capital resources. Reinsuring loss exposures does not relieve a ceding entity from its obligations to policyholders and cedants. Reinsurance recoverables (including amounts related to claims incurred but not reported) and ceded unearned premiums are reported as assets. To minimize exposure to losses from a reinsurer's inability to pay, the financial condition of such reinsurer is evaluated initially upon placement of the reinsurance and periodically thereafter. In addition to considering the financial condition of the reinsurer, the collectability of the reinsurance recoverables is evaluated (and where appropriate, whether an allowance for estimated uncollectible reinsurance recoverables is to be established) based upon a number of other factors. Such factors include the amounts outstanding, length of collection periods, disputes, any collateral or letters of credit held and other relevant factors. To the extent that an allowance for uncollectible reinsurance recoverable is established, amounts deemed to be uncollectible are written off against the allowance for estimated uncollectible reinsurance recoverables. The Company currently has no allowances for uncollectible reinsurance recoverables.

Ceded premiums written are recorded in accordance with applicable terms of the various reinsurance contracts and ceded premiums earned are charged against revenue over the period of the various reinsurance contracts. This also generally applies to reinstatement premiums paid to a reinsurer, which arise when contractually-specified ceded loss triggers have been breached. Ceded commissions reduce commissions, brokerage and other underwriting expenses and ceded losses incurred reduce net loss and loss adjustment expense incurred over the applicable periods of the various reinsurance contracts with third party reinsurers. If premiums or commissions are subject to adjustment (for example, retrospectively-rated or experience-rated), the estimated ultimate premium or commission is recognized over the period of the contract.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured business and consistent with the terms of the underlying reinsurance contract.

DEFERRED ACQUISITION COSTS ("DAC")

DAC represent those costs that are incremental and directly related to the successful acquisition of new or renewal of existing insurance contracts. The Company defers incremental costs that result directly from, and are essential to, the acquisition or renewal of an insurance contract. Such DAC generally include agent or broker commissions, premium taxes, medical and inspection fees that would not have been incurred if the insurance contract had not been acquired or renewed. Each cost is analyzed to assess whether it is fully deferrable.

The Company also defers a portion of the employee total compensation and payroll-related fringe benefits directly related to time spent performing specific acquisition or renewal activities, including costs associated with the time spent on underwriting, policy issuance and processing, and sales force contract selling.

The acquisition costs are deferred and amortized over the period in which the related premiums written are earned, generally 12 months. It is grouped consistent with the manner in which the insurance contracts are acquired, serviced and measured for profitability and is reviewed for recoverability based on the profitability of the underlying insurance contracts. Investment income is anticipated in assessing the recoverability of DAC. The Company assesses the recoverability of DAC on an annual basis or more frequently if circumstances indicate impairment may have occurred.

LOSSES AND LOSS ADJUSTMENT EXPENSES ("LAE")

Overview

The estimation of the liability for unpaid loss and LAE is inherently difficult and subjective, especially in view of changing legal and economic environments that impact the development of loss reserves, and therefore, quantitative techniques frequently have to be supplemented by subjective considerations and managerial judgment. In addition, trends that have affected development of liabilities in the past may not necessarily occur or affect liability development to the same degree in the future.

Each of our insurance companies establishes reserves on its balance sheet for unpaid loss and LAE related to its property and casualty insurance and related reinsurance contracts. As of any balance sheet date, there are claims that have not yet been reported, and some claims may not be reported for many years after the date a loss occurs. As a result of this historical pattern, the liability for unpaid loss and LAE includes significant estimates for IBNR claims. Additionally, reported claims are in various stages of the settlement process. Each claim is settled individually based upon its merits, and certain claims may take years to settle, especially if legal action is involved. As a result, the liabilities for unpaid loss and LAE include significant judgments, assumptions and estimates made by management relating to the actual ultimate losses that will arise from the claims. Due to the inherent uncertainties in the process of establishing these liabilities, the actual ultimate loss from a claim is likely to differ, perhaps materially, from the liability initially recorded.

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As noted above, as of any balance sheet date, not all claims that have occurred have been reported to us, and if reported may not have been settled. The time period between the occurrence of a loss and the time it is settled is referred to as the "claim tail." In general, actuarial judgments for shorter-tailed lines of business generally have much less of an effect on the determination of the loss reserve amount than when those same judgments are made regarding longer-tailed lines of business. Reported losses for the shorter-tailed classes, such as property and certain marine, aviation and energy classes, generally reach the ultimate level of incurred losses in a relatively short period of time. Rather than having to rely on actuarial assumptions for many accident years, these assumptions are generally only relevant for the more recent accident years.

The process of recording quarterly and annual liabilities for unpaid loss and LAE for short-tail lines is primarily focused on maintaining an appropriate reserve level for reported claims and IBNR. Specifically, we assess the reserve adequacy of IBNR in light of such factors as the current levels of reserves for reported claims and expectations with respect to reporting lags, catastrophe events, historical data, legal developments, and economic conditions, including the effects of inflation.

Standard actuarial methodologies employed to estimate ultimate losses incorporate the inherent lag from the time claims occur to when they are reported to an insurer and, if applicable, to when an insurer reports the claims to a reinsurer. Certain actuarial methodologies may be more appropriate than others in instances where this lag may not be consistent from period to period. Consequently, additional actuarial judgment is employed in the selection of methodologies to best incorporate the potential impact of this situation.

Our insurance companies provide coverage on both a claims-made and occurrence basis. Claims-made policies generally require that claims occur and be reported during the coverage period of the policy. Occurrence policies allow claims which occur during a policy's coverage period to be reported after the coverage period, and as a result, these claims can have a very long claim tail, occasionally extending for decades. Casualty claims can have a very long claim tail, in certain situations extending for many years. In addition, casualty claims are more susceptible to litigation and the legal environment and can be significantly affected by changing contract interpretations, all of which contribute to extending the claim tail. For long-tail casualty lines of business, estimating the ultimate liabilities for unpaid loss and LAE is a more complex process and depends on a number of factors, including the line and volume of the business involved. For these reasons, our insurance companies will generally use actuarial projections in setting reserves for all casualty lines of business.

In conformity with GAAP, our insurance companies are not permitted to establish reserves for catastrophe losses that have not occurred. Therefore, losses related to a significant catastrophe, or accumulation of catastrophes, in any reporting period could have a material adverse effect on our results of operations and financial condition during that period.

We believe that the reserves for unpaid loss and LAE established by our insurance companies are adequate as of December 31, 2016; however, additional reserves, which could have a material impact upon our financial condition, results of operations and cash flows, may be necessary in the future.

Methodologies and Assumptions

Our insurance companies use a variety of techniques that employ significant judgments and assumptions to establish the liabilities for unpaid loss and LAE recorded at the balance sheet date. These techniques include detailed statistical analyses of past claims reporting, settlement activity, claims frequency, internal loss experience, changes in pricing or coverages and severity data when sufficient information exists to lend statistical credibility to the analyses. More subjective techniques are used when statistical data is insufficient or unavailable. These liabilities also reflect implicit or explicit assumptions regarding the potential effects of future inflation, judicial decisions, changes in laws and recent trends in such factors, as well as a number of actuarial assumptions that vary across our reinsurance and insurance subsidiaries and across lines of business. This data is analyzed by line of business, coverage, accident year or underwriting year and reinsurance contract type, as appropriate.

Our loss reserve review processes use actuarial methods that vary by operating subsidiary and line of business and produce point estimates for each class of business. The actuarial methods used include the following methods:

· Reported Loss Development Method: a reported loss development pattern is calculated based on historical loss development data, and this pattern is then used to project the latest evaluation of cumulative reported losses for each accident year or underwriting year, as appropriate, to ultimate levels;

· Paid Development Method: a paid loss development pattern is calculated based on historical paid loss development data, and this pattern is then used to project the latest evaluation of cumulative paid losses for each accident year or underwriting year, as appropriate, to ultimate levels;

· Expected Loss Ratio Method: expected loss ratios are applied to premiums earned, based on historical company experience, or historical insurance industry results when company experience is deemed not to be sufficient; and

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- Bornhuetter-Ferguson Method: the results from the Expected Loss Ratio Method are essentially blended with either the Reported Loss Development Method or the Paid Development Method.

The primary actuarial assumptions used by insurance companies include the following:

- Expected loss ratios represent management's expectation of losses, in relation to earned premium, at the time business is written, before any actual claims experience has emerged. This expectation is a significant determinant of the estimate of loss reserves for recently written business where there is little paid or incurred loss data to consider. Expected loss ratios are generally derived from historical loss ratios adjusted for the impact of rate changes, loss cost trends and known changes in the type of risks underwritten. For certain longer-tailed reinsurance business that are typically lower frequency, high severity classes, expected loss ratios are often used for the last several accident years or underwriting years, as appropriate.

- Rate of loss cost inflation (or deflation) represents management's expectation of the inflation associated with the costs we may incur in the future to settle claims. Expected loss cost inflation is particularly important for longer-tailed classes

- Reported and paid loss emergence patterns represent management's expectation of how losses will be reported and ultimately paid in the future based on the historical emergence patterns of reported and paid losses and are derived from past experience of our subsidiaries, modified for current trends. These emergence patterns are used to project current reported or paid loss amounts to their ultimate settlement value.

In the absence of sufficiently credible internally-derived historical information, each of the above actuarial assumptions may also incorporate data from the insurance industries as a whole, or peer companies writing substantially similar coverages. Data from external sources may be used to set expectations, as well as assumptions regarding loss frequency or severity relative to an exposure unit or claim, among other actuarial parameters. Assumptions regarding the application or composition of peer group or industry reserving parameters require substantial judgment.

Loss Frequency and Severity

Loss frequency and severity are measures of loss activity that are considered in determining the key assumptions described above. Loss frequency is a measure of the number of claims per unit of insured exposure, and loss severity is a measure of the average size of claims. Factors affecting loss frequency include the effectiveness of loss controls and safety programs and changes in economic conditions or weather patterns. Factors affecting loss severity include changes in policy limits, retentions, rate of inflation and judicial interpretations. Another factor affecting estimates of loss frequency and severity is the loss reporting lag, which is the period of time between the occurrence of a loss and the date the loss is reported to our insurance companies. The length of the loss reporting lag affects their ability to accurately predict loss frequency (loss frequencies are more predictable for lines with short reporting lags), as well as the amount of reserves needed for IBNR. If the actual level of loss frequency and severity is higher or lower than expected, the ultimate losses will be different than management's estimates.

Prior Year Development

Our insurance companies continually evaluate the potential for changes, both favorable and unfavorable, in their estimates of their loss and LAE liabilities and use the results of these evaluations to adjust both recorded liabilities and underwriting criteria. With respect to liabilities for unpaid loss and LAE established in prior years, these liabilities are periodically analyzed and their expected ultimate cost adjusted, where necessary, to reflect favorable or unfavorable development in loss experience and new information, including, for certain catastrophe events, revised industry estimates of the magnitude of a catastrophe. Adjustments to previously recorded liabilities for unpaid loss and LAE, both favorable and unfavorable, are reflected in our financial results in the periods in which these adjustments are made and are referred to as prior accident year reserve development. We adjusted our prior year loss and LAE reserve estimates during 2016, 2015 and 2014 based on current information that differed from previous assumptions made at the time such loss and LAE reserves were previously estimated.

Refer to Notes 1 and 6 to Notes to Consolidated Financial Statements set forth in Part II, Item 8, "Financial Statements and Supplementary Data" of this Form 10-K for additional information on our loss and LAE.

INCOME TAXES

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss, capital loss and tax-credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected

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to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income or expense in the period that includes the enactment date.

RECENT ACCOUNTING PRONOUNCEMENTS

Refer to Note 2, "Summary of Significant Accounting Policies – Recent Accounting Pronouncements" in the Notes to the Consolidated Financial Statements set forth in Part II, Item 8 "Financial Statements and Supplemental Data" of this Form 10-K for a discussion of recent accounting pronouncements and their effect, if any, on the Company.

OFF BALANCE SHEET TRANSACTIONS

For the years ended December 31, 2016 and 2015, the Company had no off balance sheet transactions.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE 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.

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 December 31, 2016, approximately 93% of investments were in debt securities and cash and cash equivalents, which are considered to be either held-to-maturity or available-for-sale, based upon our estimates of required liquidity. Approximately 99% 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 provides information about the financial instruments, as of December 31, 2016, that is 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.

	2017	2018	2019	2020	2021	Thereafter	Total	Carrying Amount
Principal amount by expected maturity:								
United States government obligations and authorities	$ 9,721	$ 6,509	$ 1,765	$ 4,921	$ 3,425	$ 14,600	$ 40,941	$ 40,553
Obligations of states and political subdivisions	21,600	12,690	22,825	21,525	10,520	48,250	137,410	151,183
Corporate securities	15,677	17,567	14,573	15,249	20,888	58,015	141,969	144,646

International securities	1,300	2,335	406	551	1,469	5,641	11,702	11,934
Collateralized mortgage obligations	3,071	1,280	955	1,311	4,809	19,422	30,848	31,991
Total investments	$ 51,369	$ 40,381	$ 40,524	$ 43,557	$ 41,111	$ 145,928	$ 362,870	$ 380,307
Weighted average interest rate by expected maturity:								
United States government obligations and authorities	0.83%	0.76%	1.90%	0.46%	1.24%	1.54%	1.11%	
Obligations of states and political subdivisions	4.53%	5.00%	4.99%	4.93%	4.87%	4.92%	4.88%	
Corporate securities	3.59%	3.74%	3.47%	3.56%	3.29%	3.69%	3.59%	
International securities	3.00%	3.77%	7.38%	3.31%	2.98%	4.08%	3.84%	
Collateralized mortgage obligations	4.38%	2.48%	3.03%	3.34%	4.09%	3.69%	3.73%	
Total investments	3.49%	3.62%	4.29%	3.88%	3.61%	3.90%	3.82%	

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Federated National Holding Company and Subsidiaries

We have audited the accompanying consolidated balance sheets of Federated National Holding Company and subsidiaries as of December 31, 2016 and 2015 and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity and cash flows for the years ended December 31, 2016 and 2015. Our audits also included the financial statement schedules listed in the Index at Item 15(a). These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Federated National Holding Company and subsidiaries at December 31, 2016 and 2015 and the consolidated results of their operations and their cash flows for the years ended December 31, 2016 and 2015, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Federated National Holding Company and subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 16, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Charlotte, North Carolina

March 16, 2017

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and

Stockholders of Federated National Holding Company

We have audited the accompanying consolidated balance sheets of Federated National Holding Company as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2014. In connection with our audits of the financial statements, we have also audited the financial statement schedules listed in the accompanying index. We also have audited Federated National Holdings Company's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Federated National Holdings Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A Controls and Procedures. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall consolidated financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Federated National Holding Company as of December 31, 2014 and 2013, and the consolidated results of its operations and its cash flows for each of the years in the three year period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Federated National Holdings Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/Goldstein Schechter Koch

Fort Lauderdale, FL

March 16, 2015, except for Schedule II dated March 14, 2016

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FEDERATED NATIONAL HOLDING COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	December 31, 2016	2015
ASSETS		
Investments:		
Debt securities, available-for-sale, at fair value (amortized cost of $376,644 and $338,021, respectively)	$ 374,756	$ 339,178
Debt securities, held-to-maturity, at amortized cost	5,551	6,619
Equity securities, available-for-sale, at fair value (cost of $24,163 and $33,581, respectively)	29,375	38,534
Total investments (including $28,704 and $22,670 related to the VIE, respectively)	409,682	384,331
Cash and cash equivalents (including $15,668 and $14,616 related to the VIE, respectively)	74,593	53,038
Prepaid reinsurance premiums	156,932	181,840
Premiums receivable, net of allowance of $55 and $302, respectively (including $1,584 and $355 related to the VIE, respectively)	54,854	38,594
Reinsurance recoverable, net	48,530	12,714
Deferred acquisition costs	38,962	15,547
Income taxes receivable	13,871	2,691
Property and equipment, net	4,194	2,894
Other assets (including $1,910 and $1,037 related to the VIE, respectively)	11,509	7,605
TOTAL ASSETS	$ 813,127	$ 699,254
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Loss and loss adjustment expense reserves	$ 158,110	$ 97,340
Unearned premiums	294,022	253,960
Reinsurance payable	79,154	61,069
Debt from consolidated variable interest entity	4,909	4,887
Deferred income taxes, net	1,433	5,627
Other liabilities	37,643	25,612
Total liabilities	575,271	448,495
SHAREHOLDERS' EQUITY:		
Preferred stock, $0.01 par value: 1,000,000 shares authorized	—	—
Common stock, $0.01 par value: 25,000,000 shares authorized; 13,473,120 and 13,798,773 shares issued and outstanding, respectively	134	138
Additional paid-in capital	136,779	131,998

Accumulated other comprehensive income	1,941	3,985
Retained earnings	80,275	96,461
Total shareholders' equity attributable to Federated National Holding Company shareholders equity	219,129	232,582
Noncontrolling interest	18,727	18,177
Total shareholders' equity	237,856	250,759
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 813,127	$ 699,254

See accompanying notes to consolidated financial statements.

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FEDERATED NATIONAL HOLDING COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Year Ended December 31, 2016	2015	2014
Revenue:			
Net premiums earned	$ 259,872	$ 210,020	$ 170,905
Net investment income	9,063	7,226	5,385
Net realized investment gains	3,045	3,616	4,426
Direct written policy fees	17,730	11,248	8,689
Other income	26,674	17,783	11,287
Total revenue	316,384	249,893	200,692
Costs and expenses:			
Losses and loss adjustment expenses	187,341	104,353	81,036
Commissions and other underwriting expenses	108,776	64,868	52,077
General and administrative expenses	17,186	15,223	10,272
Interest expense	348	256	-
Total costs and expenses	313,651	184,700	143,385
Income before income taxes	2,733	65,193	57,307
Income taxes	2,683	24,753	20,108
Net income	50	40,440	37,199
Net income (loss) attributable to noncontrolling interest	246	(445)	-
Net (loss) income attributable to Federated National Holding Company shareholders	$ (196)	$ 40,885	$ 37,199
Net (loss) income per share attributable to Federated National Holding Company shareholders:			
Basic	$ (0.01)	$ 2.98	$ 3.08
Diluted	$ (0.01)	$ 2.92	$ 2.99
Weighted average number of shares of common stock outstanding:			
Basic	13,758	13,729	12,082
Diluted	13,758	13,997	12,438

Dividends declared per share of common stock	$ 0.27	$ 0.18	$ 0.13

See accompanying notes to consolidated financial statements.

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FEDERATED NATIONAL HOLDING COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Year Ended December 31, 2016	2015	2014
Net income	$ 50	$ 40,440	$ 37,199
Change in net unrealized (losses) gains on investments, available-for-sale	(2,786)	(6,308)	2,856
Comprehensive (loss) income before income taxes	(2,736)	34,132	40,055
Income tax benefit (expense) related to items of other comprehensive income	1,046	2,454	(1,102)
Comprehensive (loss) income	(1,690)	36,586	38,953
Less: comprehensive income (loss) attributable to noncontrolling interest	550	(566)	—
Comprehensive (loss) income attributable to Federated National Holding Company shareholders	$ (2,240)	$ 37,152	$ 38,953

See accompanying notes to consolidated financial statements.

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FEDERATED NATIONAL HOLDING COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In thousands, except per share data)

	Preferred Stock	Common Stock Issued Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total Shareholders' Equity Attributable to Federated National Holding Company Shareholders	Noncontrolling Interest	Total Shareholders' Equity
Balance as of December 31, 2013	$ —	10,901,716	$ 109	$ 80,525	$ 5,964	$ 21,896	$ 108,494	$ —	$ 108,494
Net income	—	—	—	—	—	37,199	37,199		