FEDERATED NATIONAL HOLDING CO
Form 10-Q
May 06, 2016

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

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

FOR THE QUARTERLY PERIOD ENDED March 31, 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 0-2500111

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

Florida	65-0248866
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification Number)

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

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

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

Yes 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

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

Common Stock, $0.01 par value –13,826,654 outstanding as of May 6, 2016

FEDERATED NATIONAL HOLDING COMPANY

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PART I: FINANCIAL INFORMATION
Item 1. Financial Statements

FEDERATED NATIONAL HOLDING COMPANY and SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31, 2016	December 31, 2015
	(in thousands, except per share data)	
ASSETS		
Investments:		
Debt securities, available-for-sale, at fair value	$339,245	$339,178
Debt securities, held-to-maturity, at amortized cost	6,218	6,619
Equity securities, available-for-sale, at fair value	40,830	38,534
Total investments	386,293	384,331
Cash and cash equivalents	72,562	53,038
Prepaid reinsurance premiums	113,117	120,771
Premiums receivable, net of allowance of $123 and $302, respectively	48,232	38,594
Reinsurance recoverable, net	17,924	12,714
Deferred acquisition costs	15,764	15,547
Income taxes receivable	1,171	2,691
Property and equipment, net	3,236	2,894
Other assets	7,829	7,605
Total assets	$666,128	$638,185
LIABILITIES AND SHAREHOLDERS' EQUITY		
Loss and loss adjustment expense reserves	$101,615	$97,340
Unearned premiums	261,885	253,960
Debt from consolidated variable interest entity	4,893	4,887
Deferred income taxes, net	8,900	5,627
Other liabilities	27,645	25,612
Total liabilities	404,938	387,426
Preferred stock, $0.01 par value: 1,000,000 shares authorized	-	-
Common stock, $0.01 par value: 25,000,000 shares authorized; 13,826,654 and 13,798,773 shares issued and outstanding, respectively	138	138
Additional paid-in capital	132,928	131,998
Accumulated other comprehensive income	6,367	3,985
Retained earnings	103,354	96,461
Total shareholders' equity attributable to Federated National Holding Company shareholders	242,787	232,582
Noncontrolling interest	18,403	18,177
Total shareholders' equity	261,190	250,759
Total liabilities and shareholders' equity	$666,128	$638,185

See accompanying notes to consolidated financial statements.

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FEDERATED NATIONAL HOLDING COMPANY and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended March 31,				
	2016		2015		
	(in thousands, except per share data)				
Revenue:					
Net premiums earned	$	54,997	$	44,786	
Net investment income		2,040		1,546	
Net realized investment gains		927		1,704	
Other income		10,996		6,900	
Total revenue		68,960		54,936	
Costs and expenses:					
Losses and loss adjustment expenses		29,545		23,949	
Commissions and other underwriting expenses		19,852		12,694	
General and administrative expenses		4,081		3,798	
Interest expense		84		11	
Total costs and expenses		53,562		40,452	
Income before income taxes		15,398		14,484	
Income taxes		5,795		5,711	
Net income		9,603		8,773	
Net income (loss) attributable to noncontrolling interest		68		(511	)
Net income attributable to Federated National Holding Company shareholders	$	9,535	$	9,284	
Net income per share attributable to Federated National Holding Company shareholders:					
Basic	$	0.69	$	0.68	
Diluted	$	0.68	$	0.66	

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2016	2015
	(in thousands)	
Net income	$ 9,603	$ 8,773
Change in net unrealized gains on investments, available-for-sale	4,084	1,965
Comprehensive income before income taxes	13,687	10,738
Income tax expense related to items of other comprehensive income	(1,544)	(758)
Comprehensive income	12,143	9,980
Comprehensive income (loss) attributable to noncontrolling interest	226	(511)
Comprehensive income attributable to Federated National Holding Company shareholders	$ 11,917	$ 10,491

See accompanying notes to consolidated financial statements.

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FEDERATED NATIONAL HOLDING COMPANY and SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)

		Common Stock							
	Preferred Stock	Issued Shares	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
	(in thousands, except share data)								
Balance as of December 31, 2015	$ -	13,798,773	$ 138	$ 131,998	$ 3,985	$ 96,461	$ 232,582	$ 18,177	$ 250,759
Net income	-	-	-	-	-	9,535	9,535	68	9,603
Other comprehensive income	-	-	-	-	2,382	-	2,382	158	2,540
Dividends paid	-	-	-	-	-	(1,565)	(1,565)	-	(1,565)
Issuance of common stock for share-based awards	-	80,481	-	4	-	-	4	-	4
Common stock buyback	-	(52,600)	-	-	-	(1,077)	(1,077)	-	(1,077)
Share-based compensation	-	-	-	926	-	-	926	-	926
Balance as of March 31, 2016	$ -	13,826,654	$ 138	$ 132,928	$ 6,367	$ 103,354	$ 242,787	$ 18,403	$ 261,190

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

	Three Months Ended March 31,	
	2016	2015
	(in thousands)	
Cash flow from operating activities:		
Net income	$ 9,603	$ 8,773
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net realized investment gains	(927)	(1,704)
Amortization of investment premium or discount, net	1,313	1,253
Depreciation and amortization	187	152
Share-based compensation	926	1,282
Changes in operating assets and liabilities:		
Prepaid reinsurance premiums	7,654	8,463
Premiums receivable, net	(9,638)	(2,535)
Reinsurance recoverable, net	(5,210)	(500)
Deferred acquisition costs	(217)	(2,156)
Income taxes receivable, net	1,274	(280)
Loss and loss adjustment expense reserves	4,275	6,145
Unearned premiums	7,925	11,009
Deferred income taxes, net of other comprehensive income	1,729	(202)
Other, net	1,809	(1,348)
Net cash provided by operating activities	20,703	28,352
Cash flow from investing activities:		
Sales, maturities and redemptions of investment securities	72,669	56,264
Purchases of investment securities	(70,933)	(59,466)
Purchases of property and equipment	(523)	(122)
Net cash provided by (used in) investing activities	1,213	(3,324)
Cash flow from financing activities:		
Noncontrolling interest equity investment	-	17,987
Tax benefit related to share-based compensation	246	530
Issuance of debt in consolidated variable interest entity	-	5,000
Purchases of FNHC common stock	(1,077)	-
Issuance of common stock for share-based awards	4	27
Dividends paid	(1,565)	(566)
Net cash (used in) provided by financing activities	(2,392)	22,978
Net increase in cash and cash equivalents	19,524	48,006
Cash and cash equivalents at beginning of period	53,038	40,157
Cash and cash equivalents at end of period	$ 72,562	$ 88,163

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2016	2015
	(in thousands)	
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$ 2,300	$ 5,662
Non-cash investing and finance activities:		
Accrued dividends payable	$ 854	$ 567

See accompanying notes to consolidated financial statements.

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Federated National Holding Company and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

(1) ORGANIZATION AND BUSINESS

This report should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2015 of Federated National Holding Company (“FNHC”, “Company”, “we”, “us”).

FNHC is an insurance holding company that controls substantially all steps in the insurance underwriting, distribution and claims processes through our subsidiaries and our contractual relationships with our independent agents and general agents. We are authorized to underwrite, and/or place through our wholly owned subsidiaries, homeowners’ multi-peril (“homeowners”), commercial general liability, federal flood, personal auto and 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 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.

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.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PRACTICES

(a) BASIS OF PRESENTATION

The financial statements contained in this Quarterly Report on Form 10-Q are unaudited, but reflect all adjustments that, in the opinion of management, are necessary for a fair statement of results of the interim periods covered thereby.

The accompanying unaudited consolidated financial statements are prepared in accordance with US generally accepted accounting principles (“GAAP”). Certain GAAP policies, which significantly affect the determination of financial condition, results of operations and cash flows, are summarized below. The results of operations for any interim period are not necessarily indicative of results for the full year.

(b) PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of FNHC and all other entities in which we have a controlling financial interest and any variable interest entities ("VIE") in which we are the primary beneficiary. All material inter-company accounts and transactions have been eliminated in consolidation.

A VIE is an entity that does not have sufficient equity to finance its own activities without additional financial support or where investors lack certain characteristics of a controlling financial interest. We assess our contractual, ownership or other interests in a VIE to determine if our interest participates in the variability the VIE was designed to absorb and pass onto variable interest holders. We perform an ongoing qualitative assessment of our variable interests in VIEs to determine whether we have a controlling financial interest and would therefore be considered the primary beneficiary of the VIE. If we determine we are the primary beneficiary of a VIE, we consolidate the assets and liabilities of the VIE in our consolidated financial statements.

In connection with the investment in Monarch Delaware, we have determined that we are the primary beneficiary of this VIE, as we possess both the power to direct the activities of the VIE that most significantly impact its economic performance. Accordingly, we consolidate the VIE in our consolidated financial statements.

Refer to note 12 for additional information on the VIE.

(c) ACCOUNTING ESTIMATES AND ASSUMPTIONS

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

Similar to other property and casualty insurers, our liability for loss and loss adjustment expense reserves, although supported by actuarial projections and other data is ultimately based on management's reasoned expectations of future events. Although considerable variability is inherent in these estimates, we believe that this liability is adequate. Estimates are reviewed regularly and adjusted as necessary. Such adjustments are reflected in current operations.

(d) RECLASSIFICATIONS

Certain amounts in prior year’s consolidated financial statements have been reclassified to conform to the 2016 presentation. These reclassifications had no effect on the reported results of operations, financial condition, and cash flows. In the current period, the Company concluded it was appropriate to reclassify certain revenue accounts that do not have material balances and include them within other income in the consolidated statements of operations. In addition, during the current period, the Company reclassified certain costs and expenses, principally, operating and underwriting expenses, salaries and wages and amortization of deferred policy acquisition costs. These respective account balances are now included in commissions and other underwriting expenses and general and administrative expenses in the consolidated statements of operations. The Company believes this reclassification provide greater clarity and insight into the consolidated financial statements for the periods presented.

(e) ADJUSTMENTS

During our third quarter 2015 analysis of actual experience to date under the July 1, 2014 quota share reinsurance contract, we re-evaluated the accounting treatment for quota share reinsurance contracts with retrospective rating provisions. As a result of this re-evaluation, we concluded reinsurance contracts which have retrospective rating provisions should be accounted for under Accounting Standards Codification 944, Financial Services — Insurance (“ASC 944”), where amounts due to (from) the assuming companies are accrued based on estimated contract experience to date as though the contracts were terminated. Refer to note 2 in our Form 10-Q for the period ended September 30, 2015 for additional information.

The adjustments to our accounting for the July 1, 2014 quota share reinsurance treaty, inclusive of other adjustments, are not material in any prior quarter or annual period based on an analysis of quantitative and qualitative factors in accordance with SEC guidance.

As a result, we recorded these adjustments during the year ended December 31, 2015. The prior period adjustments increased net income by $1.3 million for the three months ended March 31, 2015.

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Federated National Holding Company and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

(f) RECENT ACCOUNTING PRONOUNCEMENTS

Recently Adopted

In February 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis ("ASU 2015-02"). ASU 2015-02 amended the consolidation guidance by modifying the evaluation criteria for whether limited partnerships and similar legal entities are variable interest entities or voting interest entities, eliminating the presumption that a general partner should consolidate a limited partnership, and affecting the consolidation analysis of reporting entities that are involved with variable interest entities. We adopted the provisions of ASU 2015-02 effective January 1, 2016 and re-evaluated all legal entity investments under the revised consolidation model. The adoption of ASU 2015-02 did not have any impact on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest-Imputation of Interest. ASU 2015-03 reduces the complexity of disclosing debt issuance costs and debt discount and premium on the balance sheet by requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with debt discounts. The Company adopted this ASU retrospectively as of January 1, 2016. Other assets and debt from consolidated variable interest entity have been reclassified to be consistent with the adoption of this standard, which resulted in a reduction of $0.1 million each. There were no changes to shareholders' equity as a result of this adoption. There were no other impacts on the Company's consolidated financial statements.

Not Yet Adopted

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in United States Generally Accepted Accounting Principles when it becomes effective. In July 2015, the FASB voted to delay the effective date of ASU 2014-09 by one year, making it effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, with early adoption permitted as of the original effective date. ASU 2014-09 permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures.

In May 2015, the FASB issued ASU 2015-09, Financial Services – Insurance (Topic 944): Disclosures about Short-Duration-Contracts. The amendments in this ASU apply to all insurance entities that issue short-duration contracts as defined in Topic 944, Financial Services—Insurance. The amendments require insurance entities to disclose for annual reporting periods information on the liability for unpaid claims and claim adjustment expenses. The amendments in this ASU are effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. This new guidance affects disclosures only and will have no impact on the Company's consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, which addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most notably, this new guidance requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. This new guidance is effective for annual reporting periods beginning after December 15, 2017. We are currently evaluating the impact the adoption of this standard would have on the Company’s consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”). Upon the effective date, ASU 2016-02 will supersede the current lease guidance in Topic 840, Leases. Under the new guidance, lessees will be required to recognize for all leases, with the exception of short-term leases, a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis. Concurrently, lessees will be required to recognize a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. The guidance is required to be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative periods presented in the financial statements. We are currently evaluating the effects the adoption of ASU 2016-02 will have on the Company’s consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”), which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods therein. Early application is permitted. We are currently evaluating the impact of this guidance on our consolidated financial statements.

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(Unaudited)

(3) FAIR VALUE

Fair value measurements are generally based upon observable and unobservable inputs. Observable inputs are based on market data from independent sources, while unobservable inputs reflect the Company's view of market assumptions in the absence of observable market information. All assets and liabilities that are carried at fair value are classified and disclosed in one of the following categories:

Level 1 — Quoted prices (unadjusted) in active markets for identical assets or liabilities. An active market is defined as a market where transactions for the financial statement occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 — Quoted market prices for similar assets or liabilities and valuations, using models or other valuation techniques that use observable market data. All significant inputs are observable, or derived from observable information in the marketplace, or are supported by observable levels at which transactions are executed in the market place.

Level 3 — Instruments that use non-binding broker quotes or model driven valuations that do not have observable market data or those that are estimated based on an ownership interest to which a proportionate share of net assets is attributed. Currently, the Company has no level 3 investments.

The Company's financial instruments measured at fair value and the level of the fair value hierarchy of inputs used were as follows:

	March 31, 2016			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Debt securities:				
United States government obligations and authorities	$26,578	$26,895	$ -	$53,473
Obligations of states and political subdivisions	-	124,310	-	124,310
Corporate	-	148,926	-	148,926
International	-	12,536	-	12,536
	26,578	312,667	-	339,245
Equity securities	38,302	2,528	-	40,830
Total investments	$64,880	$315,195	$ -	$380,075

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Federated National Holding Company and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Debt securities:				
United States government obligations and authorities	$34,733	$26,820	$ -	$61,553
Obligations of states and political subdivisions	-	110,702	-	110,702
Corporate	-	154,620	-	154,620
International	-	12,303	-	12,303
	34,733	304,445	-	339,178
Equity securities	38,012	522	-	38,534
Total investments	$72,745	$304,967	$ -	$377,712

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Federated National Holding Company and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

(4) INVESTMENTS

Unrealized Gains and Losses

The amortized cost and the fair value of debt and equity securities as of March 31, 2016 and December 31, 2015 are summarized as follows:

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
March 31, 2016				
Debt Securities - available-for-sale:				
United States government obligations and authorities	$52,406	$ 1,075	$ 8	$53,473
Obligations of states and political subdivisions	122,143	2,206	39	124,310
Corporate	146,571	2,854	499	148,926
International	12,448	176	88	12,536
	333,568	6,311	634	339,245
Debt Securities - held-to-maturity:				
United States government obligations and authorities	4,238	65	82	4,221
Corporate	1,849	33	6	1,876
International	131	4	-	135
	6,218	102	88	6,232
Equity securities	36,312	6,297	1,779	40,830
Total investments	$376,098	$ 12,710	$ 2,501	$386,307

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
December 31, 2015				
Debt Securities - available-for-sale:				
United States government obligations and authorities	$61,384	$ 489	$ 320	$61,553
Obligations of states and political subdivisions	109,152	1,590	40	110,702
Corporate	154,957	1,153	1,490	154,620
International	12,528	18	243	12,303
	338,021	3,250	2,093	339,178
Debt Securities - held-to-maturity:				
United States government obligations and authorities	4,275	30	204	4,101
Corporate	2,253	14	20	2,247

International	91	-	-	91
	6,619	44	224	6,439
Equity securities	33,581	6,809	1,856	38,534
Total investments	$ 378,221	$ 10,103	$ 4,173	$ 384,151

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Federated National Holding Company and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

Contractual Maturity

The amortized cost and estimated fair value of debt securities as of March 31, 2016 and December 31, 2015 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	March 31, 2016		December 31, 2015	
	Amortized		Amortized	
Securities with maturity dates:	Cost	Fair Value	Cost	Fair Value
	(in thousands)			
Debt securities, available-for-sale:				
One year or less	$30,152	$30,177	$24,470	$24,488
Over one through five years	173,698	175,777	170,797	171,113
Over five through ten years	129,692	133,258	142,728	143,545
Over ten years	26	33	26	32
	333,568	339,245	338,021	339,178
Debt securities, held-to-maturity:				
One year or less	478	480	486	487
Over one through five years	1,927	1,976	1,899	1,915
Over five through ten years	3,813	3,776	4,234	4,037
	6,218	6,232	6,619	6,439
Total	$339,786	$345,477	$344,640	$345,617

Net Investment Income

Net investment income was as follows:

	Three Months Ended March 31,	
	2016	2015
	(in thousands)	
Interest income	$ 1,853	$ 1,440
Dividends income	187	106
Net investment income	$ 2,040	$ 1,546

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Federated National Holding Company and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

Net Realized Gains and Losses

The amount of gross realized gains and losses were as follows:

	Three Months Ended March 31, 2016	2015
	(in thousands)	
Gross realized gains:		
Debt securities	$ 1,304	$ 515
Equity securities	738	1,395
Total gross realized gains	2,042	1,910
Gross realized losses:		
Debt securities	(540)	(103)
Equity securities	(575)	(103)
Total gross realized losses	(1,115)	(206)
Net realized gains on investments	$ 927	$ 1,704

During the three months ended March 31, 2016 and 2015, the proceeds from sales of available-for-sale investment securities were $66.7 million and $53.5 million, respectively.

Aging of Gross Unrealized Losses

As of March 31, 2016 and December 31, 2015, gross unrealized losses and related fair values for debt and equity securities, grouped by duration of time in a continuous unrealized loss position, were as follows:

	Less than 12 months		12 months or longer		Total	
March 31, 2016	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
			(in thousands)			
Debt securities:						
United States government obligations and authorities	$ 1,058	$ 2	$ 660	$ 6	$ 1,718	$ 8
Obligations of states and political subdivisions	15,750	38	1,032	1	16,782	39
Corporate	31,204	466	2,935	33	34,139	499
International	2,092	60	603	28	2,695	88
	50,104	566	5,230	68	55,334	634
Equity securities	10,905	1,777	25	2	10,930	1,779
Total investments	$ 61,009	$ 2,343	$ 5,255	$ 70	$ 66,264	$ 2,413

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	Less than 12 months		12 months or longer		Total	
December 31, 2015	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
			(in thousands)			
Debt securities:						
United States government obligations and authorities	$ 30,464	$ 303	$ 659	$ 17	$ 31,123	$ 320
Obligations of states and political subdivisions	16,652	40	-	-	16,652	40
Corporate	87,176	1,420	3,590	70	90,766	1,490
International	8,660	191	281	52	8,941	243
	142,952	1,954	4,530	139	147,482	2,093
Equity securities	11,790	1,850	84	6	11,874	1,856
Total investments	$ 154,742	$ 3,804	$ 4,614	$ 145	$ 159,356	$ 3,949

The Company holds its equity and debt securities as available-for-sale and as such, these securities are recorded at fair value. The Company continually monitors the difference between cost and the estimated fair value of its investments, which involves uncertainty as to whether declines in value are temporary in nature. If the decline of a particular investment is deemed temporary, the Company records the decline as an unrealized loss in shareholders' equity. If the decline is deemed to be other than temporary, the Company writes its cost-basis or amortized cost-basis down to the fair value of the investment and records an other than temporarily impaired ("OTTI") loss on its statement of operations. 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 charged against income.

The Company's assessment of equity securities initially involves an evaluation of all securities that are in an unrealized loss position, regardless of the duration or severity of the loss, as of the applicable balance sheet date. Such initial review consists primarily of assessing whether: (i) there has been a negative credit or news event with respect to the issuer that could indicate the existence of an OTTI; and (ii) the Company has the ability and intent to hold an equity security for a period of time sufficient to allow for an anticipated recovery (generally considered to be one year from the balance sheet date).

To the extent that an equity security in an unrealized loss position is not impaired based on the initial review described above, the Company then further evaluates such equity security by considering qualitative and quantitative factors, including facts and circumstances specific to individual securities, asset classes, the financial condition of the issuer, changes in dividend payment, the length of time fair value had been less than cost, the severity of the decline in fair value below cost, industry outlook and our ability and intent to hold each position until its forecasted recovery.

If the Company intends to sell, or it is more likely than not that, the Company will sell, a debt security before recovery of its amortized cost basis, the total amount of the unrealized loss position is recognized as an OTTI loss in income. To the extent that a debt security that is in an unrealized loss position is not impaired based on the preceding, the Company will consider a debt security to be impaired when it believes it to be probable that the Company will not be able to collect the entire amortized cost basis.

During the three months ended March 31, 2016 and 2015, we did not have any material OTTI losses.

Collateral Deposits

As of March 31, 2016, investments with fair values of approximately $12.0 million, the majority of which were debt securities, were deposited with governmental authorities and into custodial bank accounts as required by law or contractually obligated.

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(5) REINSURANCE

Overview

The Company reinsures (cedes) a portion of written premiums on an excess of loss or a quota share basis to nonaffiliated insurance companies in order to limit our loss exposure. To the extent that reinsuring companies are unable to meet their obligations assumed under these reinsurance agreements, we remain primarily liable to our policyholders.

Reinsurance Recoverables

Amounts recoverable from reinsurers are recognized in a manner consistent with the claims liabilities associated with the reinsurance placement and presented on the balance sheet as reinsurance recoverables. The following reinsurance recoverable is reflected in the consolidated balance sheets as of the dates presented as follows:

	March 31, 2016	December 31, 2015
	(in thousands)	
Reinsurance recoverable on paid losses	$6,767	$ 5,218
Reinsurance recoverable on unpaid losses	11,157	7,496
Reinsurance recoverable, net	$17,924	$ 12,714

Premiums Written and Earned

The following table indicates premiums written and earned as follows:

	Three Months Ended March 31, 2016	2015
	(in thousands)	
Premiums written:		
Direct	$ 136,025	$ 106,702
Ceded	(43,570)	(25,958)
	$ 92,455	$ 80,744
Premiums earned:		
Direct	$ 128,099	$ 95,693
Ceded	(73,102)	(50,907)
	$ 54,997	$ 44,786

Significant Reinsurance Contracts

FNIC operates 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. MNIC does not have any material reinsurance contracts as of March 31, 2016. All of our reinsurance contracts do not relieve FNIC from their direct obligations to insured.

The Company’s reinsurance program, which runs either from June 1 to May 31 or from July 1 to June 30 of the following year, consists of excess of loss placed with the private market and the Florida Hurricane Catastrophe Fund (“FHCF”) and quota share, which is a form of proportional reinsurance, treaties which insure the homeowners’ property lines from catastrophes in Florida and other states. The excess of loss and FHCF treaties, which became effective on July 1, 2015, insures 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. The FHCF treaty only affords coverage for losses sustained in Florida and represents only a portion of the reinsurance coverage in Florida.

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The Company's quota share treaties, which are included in the reinsurance program, runs from July 1 to June 30 of the following year. The 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 provide a 40% quota share reinsurance treaty on the first $100 million of covered losses for the homeowners' 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.

The quota share reinsurance agreements require FNIC to secure the credit, regulatory and business risk. Fully funded trust agreements securing these risks totaled $3.5 million, as of March 31, 2016 and December 31, 2015.

(6) LOSS AND LAE RESERVES

The liability for loss and LAE reserves is determined on an individual-case basis for all incidents reported. The liability also includes amounts for unallocated expenses, anticipated future claim development and IBNR.

Activity in the liability for loss and LAE reserves is summarized as follows:

	Three Months Ended March 31, 2016	Year Ended December 31, 2015
	(in thousands)	
Gross reserves, beginning of period	$97,340	$ 78,330
Less: reinsurance recoverable (1)	(7,496)	(10,394)
Net reserves, beginning of period	89,844	67,936
Incurred loss, net of reinsurance, related to:		
Current year	30,093	113,819
Prior years	(548)	(9,466)
Total incurred loss and LAE, net of reinsurance	29,545	104,353
Paid loss, net of reinsurance, related to:		
Current year	9,221	49,531
Prior years	19,710	32,914
Total paid loss and LAE, net of reinsurance	28,931	82,445
Net reserves, end of period	90,458	89,844
Plus: reinsurance recoverable (1)	11,157	7,496
Gross reserves, end of period	$101,615	$ 97,340

(1) Reinsurance recoverable in this table includes only ceded loss and LAE reserves.

The favorable development in 2015 and first quarter of 2016 is primarily a result of continued favorable loss experience (mostly caused by decreased severity in reported claims) in the Company's all other peril homeowners coverage caused in part by the absence of severe weather in Florida. Specifically, we have experienced better severity than expected on the 2014 and 2013 accident years.

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(7) DEBT

On March 17, 2015, MNHC, a wholly owned subsidiary of Monarch Delaware, our consolidated VIE, issued a promissory note with a principal amount of $5.0 million bearing 6% annual interest, due March 17, 2021 with interest payable on an annual basis due March 17 each year. The debt was issued to TransRe, a related party, and is being carried at the unpaid principal balance, net of debt issuance costs, and any accrued and unpaid interest is recognized in other liabilities in the consolidated balance sheet. The Company recorded $0.1 million of debt issuance costs related to the 6% promissory note.

(8) INCOME TAXES

A summary of the provision for income tax expense is as follows.

	Three Months Ended March 31,	
	2016	2015
	(in thousands)	
Federal:		
Current	$ 3,544	$ 4,652
Deferred	1,439	259
Federal income tax expense	4,983	4,911
State:		
Current	276	731
Deferred	536	69
State income tax expense	812	800
Total income taxes	$ 5,795	$ 5,711

The actual income tax expense differs from the "expected" income tax expense (computed by applying the combined applicable effective federal and state tax rates to income before income tax expense as follows:

	Three Months Ended March 31,	
	2016	2015
	(in thousands)	
Computed expected tax expense provision, at federal rate	$ 5,389	$ 5,248
State tax, net of federal tax benefit	534	543
Other	(128)	(80)
Total income taxes	$ 5,795	$ 5,711

The Company files a federal income tax return and various state and local tax returns. The Company’s consolidated federal and state income tax returns for 2012 - 2014 are open for review by the Internal Revenue Service (“IRS”) and other state taxing authorities.

As of March 31, 2016 and December 31, 2015, we have determined that there are no uncertain tax positions.

(9) COMMITMENTS AND CONTINGENCIES

Legal Proceedings

In the ordinary course of conducting business, the Company is involved in various legal proceedings, specifically claims litigation. The Company’s insurance subsidiaries participate in most of these proceedings by either defending third-party claims brought against insureds or litigating first-party coverage claims. The Company accounts for such activity through the establishment of loss and loss adjustment expense reserves. We believe that the ultimate liability, if any, with respect to such ordinary-course claims litigation, after consideration of provisions made for potential losses and costs of defense, is immaterial to our consolidated financial statements. The Company is also occasionally involved in other legal and regulatory proceedings, some of which may assert claims for substantial amounts. These other legal proceedings may occasionally make us party to individual actions in which extra-contractual damages, punitive damages or penalties are sought, such as claims alleging bad faith in the handling of insurance claims.

On a quarterly basis, the Company reviews these outstanding matters, if any. Consistent with GAAP, the Company establishes accruals when it is probable that a loss has been incurred and the Company can reasonably estimate its potential exposure. We record for such probable and estimable losses, if any, through the establishment of legal expense reserves. Based on our quarterly review, the Company believes that our accruals for probable and estimable losses are reasonable and that the amounts accrued do not have a material effect on our consolidated financial statements.

Assessment Related Activity

We operate in a regulatory environment where certain entities and organizations have the authority to require us to participate in assessments. Currently these entities and organizations include, but are not limited to, Florida Insurance Guaranty Association (“FIGA”), Citizens Property Insurance Corporation (“Citizens”), FHCF and Florida Joint Underwriters Insurance Association (“JUA”). As a direct premium writer in the state of Florida, we are required to participate in certain insurer solvency associations under Florida Statutes Section 631.57(3) (a), administered by FIGA. Future assessments are likely, although the impact of these assessments on our balance sheet, results of operations or cash flow are undeterminable at this time.

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

(10) SHAREHOLDERS’ EQUITY

Common Stock Repurchases

In March 2016, our Board of Directors authorized a program to repurchase shares of common stock of FNHC, at such times and at prices as management determines advisable, up to an aggregate of $10.0 million through March 31, 2017.

Pursuant to our Board of Directors authorizations, the Company repurchased 52,600 shares of its common stock at a total cost of $1.1 million, which is an average price per share of $20.44, during the three months ended March 31, 2016.

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Share-based Compensation Expense

The following table provides certain information in connection with the Company’s share-based compensation arrangements as follows:

	Three months ended March 31,	
	2016	2015
	(in thousands)	
Restricted stock	$ 680	$ 728
Stock options	-	24
Total share-based compensation expense	$ 680	$ 752
Excess tax benefits from stock-based awards	$ 246	$ 530
Intrinsic value of options exercised	$ 193	$ 2,346
Fair value of restricted stock vested	$ 12,358	$ 17,387

The intrinsic value of options exercised represents the difference between the stock option exercise price and the weighted average closing stock price of FNHC common stock on the exercise dates, as reported on The NASDAQ Global Market.

The unamortized share-based compensation expense is $8.7 million as of March 31, 2016, which will be recognized over the remaining weighted average vesting period of approximately 3.23 years.

Stock Option Awards

A summary of the Company’s stock option activity for the period from January 1, 2016 to March 31, 2016 is as follows:

	Number of Shares	Weighted Average Option Exercise Price
Outstanding at January 1, 2016	174,633	$ 3.79
Granted	-	$ -
Exercised	(1,100)	$ 4.20
Cancelled	-	$ -
Outstanding at March 31, 2016	173,533	$ 3.78

Restricted Stock

On March 10, 2016, the Company’s Board of Directors granted 128,472 restricted shares to the Company’s Directors, Executives and other key employees. The restricted shares vest over three or five years.

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A summary of the Company's restricted stock activity for the period from January 1, 2016 to March 31, 2016 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2016	418,807	$ 20.14
Granted	128,472	$ 19.16
Vested	(79,381)	$ 15.57
Cancelled	-	$ -
Outstanding at March 31, 2016	467,898	$ 20.64

The weighted average grant date fair value is measured at the closing price of FNHC common stock on the grant date, as reported on The NASDAQ Global Market.

Accumulated Other Comprehensive Income

The following table presents a reconciliation of the changes in accumulated other comprehensive income during the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31,					
	2016			2015		
	Before Tax	Income Tax	Net	Before Tax	Income Tax	Net
	(in thousands)					
Accumulated other comprehensive income, beginning of period	$6,111	$ (2,247)	$3,864	$12,417	$ (4,699)	$7,718
Other comprehensive income before reclassifications	5,570	(2,103)	3,467	4,717	(1,806)	2,911
Reclassification adjustment for realized gains included in net income	(1,486)	559	(927)	(2,752)	1,048	(1,704)
	4,084	(1,544)	2,540	1,965	(758)	1,207
Accumulated other comprehensive income, end of period	$10,195	$ (3,791)	$6,404	$14,382	$ (5,457)	$8,925

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(11) EARNINGS PER SHARE

The following table illustrates our computations of basic and diluted net income per share.

	Three Months Ended March 31,	
	2016	2015
	(in thousands, except per share data)	
Net income attributable to Federated National Holding Company shareholders	$ 9,535	$ 9,284
Weighted average number of common shares outstanding - basic	13,826	13,656
Net income per share - basic	$ 0.69	$ 0.68
Weighted average number of common shares outstanding - basic	13,826	13,656
Dilutive effect of stock compensation plans	$ 218	$ 320
Weighted average number of common shares outstanding - diluted	14,044	13,976
Net income per share - diluted	$ 0.68	$ 0.66
Dividends per share	$ 0.05	$ 0.04

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(12) VARIABLE INTEREST ENTITY

The carrying amounts of the assets of Monarch Delaware, our consolidated VIE, which can only be used to settle obligations of Monarch Delaware, and liabilities of Monarch Delaware for which creditors do not have recourse are as follows:

	March 31, 2016	December 31, 2015
ASSETS	(in thousands)	
Investments		
Debt maturities, held-to-maturity, at amortized cost	$19,836	$ 21,312
Equity securities, available-for-sale, at fair value	3,151	1,358
Total investments	22,987	22,670
Cash and cash equivalents	14,990	14,616
Prepaid reinsurance premiums	14	34
Premiums receivable, net	344	355
Deferred income taxes	5	646
Income taxes receivable	395	-
Deferred acquisition costs	237	234
Other assets	156	