

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, 2020

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

FedNat 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, 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 Act:

Table with 3 columns: Title of Each Class, Trading Symbol, Name of Each Exchange on Which Registered. Row 1: Common Stock, par value \$0.01 per share, FNHC, NASDAQ Global Market

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

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

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 [X]

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

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

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

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

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

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

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

The aggregate market value of the Registrant's common stock held by non-affiliates was \$139,671,662 as of June 30, 2020, computed on the basis of the closing sale price of the Registrant's common stock on June 30, 2020 (the last business day of the second fiscal quarter).

As of March 5, 2021, the total number of common shares outstanding of Registrant's common stock was 13,717,908.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information required by Part III of this Form 10-K will be incorporated by reference from the Registrant's definitive proxy statement or included in an amendment on Form 10-K/A that will be filed not later than 120 days after the end of the fiscal year ended December 31, 2020.

FEDNAT HOLDING COMPANY
TABLE OF CONTENTS

PART I		
ITEM 1	BUSINESS	2
ITEM 1A	RISK FACTORS	11
ITEM 1B	UNRESOLVED STAFF COMMENTS	25
ITEM 2	PROPERTIES	25
ITEM 3	LEGAL PROCEEDINGS	25
ITEM 4	MINE SAFETY DISCLOSURES	25
PART II		
ITEM 5	MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	25
ITEM 6	SELECTED FINANCIAL DATA	27
ITEM 7	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	29
ITEM 7A	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	49
ITEM 8	FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	50
ITEM 9	CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	102
ITEM 9A	CONTROLS AND PROCEDURES	102
ITEM 9B	OTHER INFORMATION	103
PART III		
ITEM 10	DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE	103
ITEM 11	EXECUTIVE COMPENSATION	103
ITEM 12	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	103
ITEM 13	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE	103
ITEM 14	PRINCIPAL ACCOUNTING FEES AND SERVICES	103
PART IV		
ITEM 15	EXHIBITS, FINANCIAL STATEMENT SCHEDULES	104
ITEM 16	FORM 10-K SUMMARY	111
SIGNATURES		

PART I

CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS AND NON-GAAP MEASURES

This Annual Report on Form 10-K ("Annual Report") 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," "intend," "may," "might," "outlook," "plan," "possibly," "potential," "predict," "probably," "pro-forma," "project," "seek," "should," "target," "will," "would," "will 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 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 Report, and discussed from time to time in our reports filed with the Securities and Exchange Commission ("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 Report 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.

In addition to providing consolidated revenues and net income (loss), in the Annual Report we also provide adjusted operating revenues and adjusted operating income (loss) because we believe these performance measures that are not United States of America generally accepted accounting principles ("GAAP") measures allow for a better understanding of the underlying trend in our business, as the excluded items are not necessarily indicative of our operating fundamentals or performance.

Non-GAAP measures do not replace the most directly comparable GAAP measures. Refer to Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" below for a detailed reconciliation.

We exclude the after-tax (using our prevailing income tax rate) effects of the following items from GAAP net income (loss) to arrive at adjusted operating income (loss):

- Net realized and unrealized gains (losses), including, but not limited to, gains (losses) associated with investments and early extinguishment of debt;
- Merger and acquisition, integration and other strategic costs, and the amortization of specifically identifiable intangibles (other than value of business acquired);
- Impairment of intangibles;
- Income (loss) from initial adoption of new regulations and accounting guidance; and
- Income (loss) from discontinued operations.

We also exclude the pre-tax effect of the first bullet above from GAAP revenues to arrive at adjusted operating revenues.

ITEM 1. BUSINESS

GENERAL

FedNat Holding Company (“FNHC,” the “Company,” “we,” “us,” or “our”) is a regional insurance holding company that controls substantially all aspects of the insurance underwriting, distribution and claims processes through our subsidiaries and contractual relationships with independent agents and general agents. We, through our wholly owned subsidiaries, are authorized to underwrite, and/or place homeowners multi-peril (“homeowners”), federal flood and other lines of insurance in Florida and other states. We market, distribute and service our own and third-party insurers’ products and other services through a network of independent and general agents.

FedNat Insurance Company (“FNIC”), our largest wholly-owned insurance subsidiary, is licensed as an admitted carrier to write homeowners property and casualty insurance by the state insurance departments in Florida, Louisiana, Texas, South Carolina, Alabama, Georgia and Mississippi.

Maison Insurance Company (“MIC”), an insurance subsidiary that we acquired on December 2, 2019 (see “Maison Companies Acquisition” below for more information), is licensed as an admitted carrier to write homeowners property and casualty insurance as well as wind/hail only exposures by the state insurance departments in Louisiana, Texas and Florida.

Monarch National Insurance Company (“MNIC”), an insurance subsidiary, is licensed to write homeowners property and casualty insurance in Florida.

Through our wholly-owned subsidiary, FedNat Underwriters, Inc. (“FNU”), we serve as managing general agent for FNIC and MNIC. MNIC was founded in 2015 through a joint venture. On February 21, 2018, FNIC acquired the non-controlling interests in MNIC’s indirect parent company, Monarch Delaware Holdings LLC (“Monarch Delaware”) from our joint venture partners (see “Monarch National Insurance Company,” below, for more information). Maison Managers, Inc. (“MMI”), a wholly-owned subsidiary, serves as the managing general agent for MIC. ClaimCor, LLC (“ClaimCor”), a wholly-owned subsidiary, is a claims solutions company that processes MIC’s claims.

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Gross Premiums Written			
Homeowners:			
Florida	\$ 444,576	\$ 451,856	\$ 458,652
Louisiana	93,331	45,043	36,063
Texas	127,005	66,429	22,492
South Carolina	35,261	25,172	17,592
Alabama	7,676	5,841	4,890
Mississippi	261	—	—
Total homeowners	708,110	594,341	539,689
Personal automobile:			
Texas	—	—	5,141
Georgia	—	(1)	3,078
Florida	—	—	384
Total personal automobile	—	(1)	8,603
Commercial general liability	(247)	(145)	5,384
Federal flood	19,022	16,413	14,088
Gross premiums written total	\$ 726,885	\$ 610,608	\$ 567,764

Acquisitions and Joint Ventures

Maison Companies Acquisition

On December 2, 2019, the Company closed its acquisition from 1347 Property Insurance Holdings, Inc., a Delaware corporation (“PIH”), of PIH’s insurance operations conducted through MIC, MMI and ClaimCor (collectively, “Maison Companies”). The results of operations of the Maison Companies are included herein only from the acquisition date forward.

Refer to Note 3 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for additional information regarding the acquisition.

Monarch National Insurance Company

In March 2015, we organized MNIC and obtained its certificate of authority to write homeowners property and casualty insurance in Florida from the Florida Office of Insurance Regulation (the “Florida OIR”). We and Crosswinds Investor Monarch LP (“Crosswinds Investor”), a wholly-owned subsidiary of Crosswinds Holdings Inc. (“Crosswinds Holdings”), a private equity firm and asset manager, each invested \$14.0 million for a 42.4% membership interest (each holding 50.0% of the voting interests in Monarch Delaware). Transatlantic Reinsurance Company (“TransRe”), an international property and casualty reinsurance company, invested \$5.0 million for a 15.2% non-voting membership interest in Monarch Delaware. TransRe also provided a loan represented by a six-year promissory note in the principal amount of \$5.0 million bearing annual interest of 6.0% payable by Monarch National Holding Company (“Monarch Holding”), the direct parent of MNIC and wholly-owned subsidiary of Monarch Delaware (together with MNIC and Monarch Holding, the “Monarch Entities”).

On February 21, 2018, we purchased Crosswinds Investor’s 42.4% Class A membership interest and 50.0% voting interest for \$12.3 million, and TransRe’s 15.2% non-voting membership interest in Monarch Delaware for \$4.4 million. We also repaid the outstanding principal balance and interest due on the \$5.0 million promissory note to TransRe. Following the closing, Monarch Delaware and Monarch Holdings were merged into MNIC. With the completion of these transactions, FNIC owns 100% of MNIC.

Material Distribution Relationships

We are a party to an insurance agency master agreement with Ivantage Select Agency, Inc. (“ISA”), an affiliate of Allstate Insurance Company (“Allstate”), pursuant to which we have been authorized by ISA to appoint Allstate agents to offer our homeowners insurance products to consumers in Florida.

We are a party to a managing general underwriting agreement with SageSure Insurance Managers, LLC (“SageSure”) in which they underwrite our FNIC homeowners business outside of Florida.

Executive Office

Our executive office is located at 14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323. 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 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 2021 we will advance our enterprise value through:

- increasing rates on our policies in all states, where warranted, based on claims experience and the increased cost of catastrophe and quota-share reinsurance, with a focus on generating an overall sustainable underwriting profit, irrespective of competitive pricing pressures within the markets where we operate, in all cases subject to required regulatory approvals;
- continuing to non-renew, within all relevant regulatory parameters, policies that no longer meet our underwriting and/or profitability standards as we continuously update our view of risk based on emerging trends and information;
- applying rigorous underwriting standards on all new and renewal business, even if that limits growth in our Florida book of business, due to the challenging claims environment;
- continued, controlled growth in our non-Florida markets;
- focusing on operational efficiencies to reduce expenses in conjunction with our continued investment in, and use of, technology;
- leveraging MNIC by developing and implementing a plan to expand upon MNIC's pricing and product offerings in 2021 to increase market share in the risk-adjusted portion of the Florida homeowners market;
- enhancing our property analytical metrics, such as an increased geographical dispersion of risks, while managing our underwriting appetite, whether new or renewal, to ensure a balanced book of business;
- maintaining our commitment to provide high quality customer service to our agents and insureds;
- continued focus of our marketing efforts by retaining key personnel and utilizing multiple distribution strategies;
- offering competitive compensation to our agents to place quality business with our companies;
- continuing with our comprehensive catastrophe reinsurance programs to reduce our exposure to risks;
- continuing our execution of the strategic review process initiated by our board of directors, as announced on November 4, 2020, which could result in, among other things, changes in our strategy or operations, a strategic business combination or other possible transactions, possible joint ventures or dispositions of assets, or continuing to execute on our current business plan; and
- optimizing the free cash flow generated by our managing general agencies and other insurance services businesses.

Refer to Note 18 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for information regarding recent developments. The Company will use the net proceeds of approximately \$15.2 million from its March 15, 2021 sale of the common stock for general corporate purposes, including to provide additional liquidity in its holding company to be available for future capital contributions to its insurance company subsidiaries, if necessary. This offering was part of our ongoing execution of the strategic review process initiated by the Company's Board of Directors announced in November 2020.

Overview of Insurance Lines of Business

Homeowners Property and Casualty Insurance

FNIC, MIC and MNIC underwrite homeowners insurance in Florida and FNIC and MIC also underwrites homeowners insurance in Louisiana and Texas, while FNIC also underwrites homeowners in South Carolina, Alabama and Mississippi. Homeowners insurance generally protects an owner of real and personal property against covered causes of loss to that property. As of December 31, 2020, the total homeowners policies in-force was 361,000, of which 207,000 were in Florida and 154,000 were outside of Florida. As of December 31, 2019, the total homeowners policies in-force was 374,000, of which 241,000 were in Florida and 133,000 were outside of Florida.

Florida

Our homeowners insurance products provide maximum dwelling coverage of approximately \$3.6 million, with the aggregate maximum policy limit being approximately \$6.3 million. We currently offer dwelling coverage "A" up to \$4.0 million with an aggregate total insured value of \$6.5 million. We continually review and update these limits. The approximate average premium on the policies currently in-force is \$2,100, as compared with \$1,940 for 2019. 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.

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. We continuously monitor and seek appropriate adjustment to our rates in order to remain competitive and profitable.

Through MIC, we have assumed Florida policies through the state-run insurer Citizens Property Insurance Corporation ("Citizens"). The following are our recent approved rate actions that we have taken across our three insurance subsidiaries:

- In late 2019, FNIC applied for a reinsurance-related statewide average increase of 2.8% for Florida homeowners multiple-peril insurance policies only, which was approved by the Florida OIR, and became effective for new policies on January 15, 2020 and effective for renewal policies on March 15, 2020.
- In 2019, FNIC applied for a statewide average rate increase of 3.6% for Florida dwelling fire insurance policies, which was approved by the Florida OIR, and became effective for new and renewal policies on June 1, 2019. Also in 2019, FNIC applied for a reinsurance-related statewide average rate increase of 4.1% for Florida dwelling fire insurance policies, and became effective for new policies on February 25, 2020 and for renewal policies on April 1, 2020.
- In 2020, FNIC applied for a statewide-average rate increase of 7.4% for Florida homeowners multiple-peril insurance policies, which was approved by the Florida Office of Insurance Regulations ("Florida OIR") and became effective for new and renewal policies on June 15, 2020.
- In 2020, FNIC applied for a statewide-average rate increase of 14.9% for Florida dwelling fire insurance policies, which was approved by the Florida OIR and became effective for new and renewal policies on July 15, 2020.
- In 2020, FNIC applied for a statewide-average rate increase of 5.6% for Florida homeowners multiple-peril insurance policies, which was approved by the Florida OIR and became effective for new policies on October 12, 2020 and for renewal policies on November 12, 2020.
- In 2020, FNIC applied for a statewide-average rate increase of 4.3% for Florida dwelling fire insurance policies, which was approved by the Florida OIR and became effective for new policies on October 12, 2020 and for renewal policies on November 12, 2020.
- Other rate filings have been filed with the Florida OIR and are pending approval in early 2021.

Non-Florida

Our FNIC non-Florida homeowners insurance products, produced through our partnership with SageSure, provide maximum dwelling coverage "A" up to \$1.8 million, with the aggregate maximum policy limit being approximately \$3.5 million. The approximate average premium on the policies currently in-force is \$1,761, as compared with \$1,753 for 2019. 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.

As part of our partnership with SageSure, previously we entered into a profit share agreement, whereby we shared 50% of net profits of this line of business through June 30, 2020, as calculated per the terms of the agreement, subject to limitations, which included limits on the net losses that SageSure could realize. The profit share cost was reflected in commissions and other underwriting expenses on our consolidated statement of operations. Effective July 1, 2020, FNIC entered into a quota-share treaty with Anchor Re, Inc. ("Anchor Re"), an Arizona captive that is an affiliate of SageSure, the non-affiliated managing general underwriter that writes FNIC's non-Florida homeowners business. The treaty provides 50% quota-share reinsurance protection on claims incurred subsequent to July 1, 2020 on in-force, new and renewal business through June 30, 2021, subject to certain limitations. The treaty arrangement is fully collateralized through Anchor Re. The financial economics of this treaty substantially mirror the 50% profit-sharing arrangement that was previously in place. Thus, this treaty is not expected to have any impact on the pre-tax operating results of the Company, though the components of the combined ratio will be affected by the ceding of premiums, claims and commissions. On November 3, 2020, FNIC increased its cession percentage in this treaty from 50% to 80%, effective December 1, 2020, on claims incurred subsequent to December 1, 2020 on in-force, new and renewal basis.

Our MIC non-Florida insurance products include homeowners insurance, manufactured home insurance and dwelling fire insurance. MIC writes both full peril property policies as well as wind/hail only exposures.

The following are our recent approved rate actions that we have taken across FNIC and MIC:

- In 2020, MIC applied for a statewide-average rate increase of 14.5% for Texas manufactured home insurance policies, which was approved by the Texas Department of Insurance ("TDI") and became effective for new policies on May 15, 2020 and renewal policies on June 15, 2020.
- In 2020, MIC applied for a statewide-average rate increase of 15.5% for Texas homeowners voluntary wind-only insurance policies, which was approved by the TDI and became effective for new policies on April 15, 2020 and renewal policies on June 1, 2020.
- In 2020, MIC applied for a statewide-average rate increase of 9.8% for Texas homeowners takeout wind-only insurance policies, which was approved by the TDI and became effective for new and renewal policies on June 15, 2020.

- In 2020, FNIC applied for a statewide-average rate increase of 6.9% for South Carolina homeowners insurance policies, which was approved by the respective regulatory agency and became effective for new policies on July 16, 2020 and effective for renewal policies on September 1, 2020.
- In 2020, FNIC applied for a statewide-average rate increase of 9.5% for Texas homeowners insurance policies, which was approved by the respective regulatory agency and became effective for new policies on July 16, 2020 and effective for renewal policies on November 16, 2020.
- Additional rate filings have been applied for by FNIC and MIC and are pending to be approved by the respective regulatory agency.

Other Lines of Business

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. FNIC offers this line of business in Florida, Louisiana, Texas, Alabama, South Carolina and Mississippi. FNIC plans to file an admitted flood endorsement as an alternative to the NFIP program. MIC writes flood insurance through a partnership with Bintech who assumes 100% of the risk, in Louisiana only.

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 and MMI. FNU and MMI generally accept all coverage that falls within stated underwriting criteria. For all policies issued, FNU and MMI also have 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 by establishing relationships with independent agents and general agents, and in other states, through our partnership with SageSure. 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 our various lines of business.

LIABILITY FOR LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

We are directly liable for loss and loss adjustment expense (“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 by establishing a liability for those unpaid losses and LAE 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 loss and LAE payments. We based our estimate 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.

We also establish a liability on an aggregate basis to provide for incurred but not 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 becomes available, these estimates are revised, as required, resulting in an increase or decrease of 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 liability may deviate substantially from prior estimates.

Among our classes of insurance, the automobile and homeowners liability and 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

Reinsurance is used to mitigate the insurance loss exposure related to certain events such as natural and man-made catastrophes, manage overall capital adequacy and protect capital resources. We reinsure (cede) a portion of written premiums on an excess of loss or a quota-share basis 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 markets include:

- Traditional local and global reinsurance markets including those in the United States (“U.S.”), 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;
- Other insurers that engage in both direct and assumed reinsurance; and
- Other entities, including unrated reinsurance captives, to facilitate the sharing of the financial results of certain programs.

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.

Significant Reinsurance Contracts

FNIC, MIC and MNIC operate primarily by underwriting and accepting risks for their direct accounts 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. Our reinsurance contracts do not relieve FNIC, MIC or MNIC from their direct obligations to the insured.

While it is not always possible to reinsure every known and unknown risk to our 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 subject to review by Demotech, Inc. (“Demotech”). Demotech provides Financial Stability Ratings (“FSR”) for property and casualty insurance companies throughout the United States.

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 with the assistance of our reinsurance broker. As of December 31, 2020 and 2019, we had over 70 reinsurance companies on our program which 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. In addition, FNIC has a quota-share reinsurance treaty on a collateralized basis with Anchor Re, which is an affiliate of SageSure that does not have an AM Best rating.

Refer to Note 6 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for further information regarding our reinsurance programs.

HUMAN CAPITAL RESOURCES

As an insurance holding company, the Company relies on its employees to perform a substantial portion of the insurance- and support-related services for our insurance subsidiaries, including policy underwriting, marketing, risk management and claims management. As of December 31, 2020, we had 377 employees.

The Company considers its employees to be critical to accomplishing its corporate goals, which are focused on providing unparalleled service to its insureds. In addition to providing competitive compensation and benefits, the Company believes that providing a

compelling work environment for its employees is important to its success. To that end, the Company provides a variety of employee-focused benefits, including:

- The Company has for the past several years provided eligible employees with opportunities for remote work. Having an existing infrastructure for remote work allowed the Company to seamlessly transition to an entirely remote work environment during the Covid-19 pandemic. The Company provides varied support options for eligible employees, including Company-issued computers and monitors, IT support and flexible scheduling.
- The Company reimburses eligible employees who are required to maintain licenses or certifications as part of their job responsibilities all associated fees to maintain these licenses and certifications, and provides a Company-paid platform for all required continuing education.
- The Company encourages all of its employees to continue their education to improve knowledge, responsibility and growth in their professional careers. The Company has established, for the benefit of its employees, an Education Assistance Program, through which the Company provides stipends to eligible employees for collegiate degree programs and professional industry designations at approved institutions.
- In 2019, the Company adopted an environmental policy to promote social responsibility by integrating environmental concerns into the Company's business operations. The Company has provided resources and technology to its employees to reduce their use of consumables, including virtual printing and electronic document collaboration, file storage, signature collection and forms. These measures have enabled the Company to substantially reduce its use of paper and printer toner.

Our business depends on adequate levels of staff to service our new business and policies in force, manage and resolve reported claims, and provide support services to the Company. These support services include technology, human resources, finance and internal audit teams. We anticipate staffing needs and make changes to our staff as needed to meet the needs of our operations and regulatory requirements, and to achieve our service standards to our insureds. We are able to expand our workforce as needed in connection with weather events through relationships with trusted subcontractors. We continue our support of diversity to create an inclusive culture to enhance performance and broaden perspectives. None of our employees are represented by a labor union.

COMPETITION

We face competition from national, regional and residual market insurance companies in the homeowners and flood insurance markets in which we operate. Our competitors include companies that market their products through agents and companies that sell insurance directly to their customers. Large national captive writers may have certain competitive advantages over independent agency writers, including increased name recognition, increased loyalty of their customer base, and reduced policy acquisition costs. Adverse loss experience and increasing catastrophe reinsurance costs in recent years could also potentially disrupt smaller competitors that lack adequate scale.

Three of our larger competitors in Florida currently are Citizens, Universal Property and Casualty Insurance Company, and Heritage Property and Casualty Insurance Company. As the legislatively created insurance company in Florida, Citizens is free of many of the constraints on private carriers, such as minimum surplus, financial ratio requirements, income tax and reinsurance expense. Other states in which we operate have similar mechanisms to provide insurance to consumers who are not able to obtain coverage in the private market.

REGULATION

Overview

Our current insurance operations are subject to the laws and regulations of Florida, Georgia, Louisiana, Texas, South Carolina, Alabama and Mississippi. We are subject to employment regulations of Florida and potentially to other states in which we may 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, financial projections, 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 or Louisiana Department of Insurance ("LDI"). The Florida OIR is working on its regularly scheduled statutory examination of MNIC for the period ending December 31, 2019, which included an examination of FNIC for the same period. Additionally, the LDI is performing its regularly scheduled statutory examination of MIC for the five years ended December 31, 2019.

Various states routinely require deposits of assets for the protection of policyholders either in those states or for all policyholders. As of December 31, 2020, FNIC, MIC and MNIC held investment securities with a fair value of approximately \$11.5 million, as deposits with the state of Florida, Texas, Georgia, South Carolina, Alabama and Mississippi.

On July 1, 2019, Florida legislation to address Assignments of Benefits ("AOB") took effect. AOB is the assignment of 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. AOB has substantially increased over the last few years, leading to material adverse losses, particularly from our Florida homeowners insurance policies, due to inflated claims, attorney's fees and costs. Provisions and limitations in the new legislation are expected to reduce inflated claims as well as offset negative claims trends. Since AOB reform was enacted, the Company has seen a decrease in AOB-related lawsuits. Additionally, incremental adverse non-AOB claim trends are currently offsetting any initial favorable impact of the AOB legislation.

COVID-19 Impact

To slow and limit the COVID-19 outbreak and protect individuals and the health care systems worldwide, local and Federal governments have taken containment actions, including travel restrictions, testing, contact tracing and lockdowns. Companies have required working from home and in many cases laid off employees. These factors among others have caused global financial markets to experience extreme volatility and disruptions to capital and credit markets. In advance of government mandates, we implemented procedures to help reduce the spread of the outbreak, including having most of our employees work remotely, that are intended to prioritize the safety and health of our employees. In addition, we remained focused on the needs of our insureds and independent agents and fulfilling regulatory requirements and guidelines. During 2020, we did not see a material impact of COVID-19 to our operations, financial condition and results. We cannot at this time determine the comprehensive effect of the outbreak for the remainder of 2021. We currently believe, however, that we have limited, if any, exposure to the pandemic based on our product offerings and contractual coverages, although possible actions that our regulators or other governmental or judicial entities may take may materially adversely impact our coverages in both a retrospective and go-forward manner. We continue our focus on maintaining the safety, security and health of all our stakeholders, including policyholders, employees, partner agents, vendors and shareholders, and monitoring the impacts of the pandemic on our operations, financial condition and results. Based on the Company's already existing business continuity plan, which we have implemented to address local catastrophes events, and based on our financial condition and anticipated operating cash flows, we currently expect to continue to meet our working capital and operating expenditure requirements, even if there is further economic downturn from the pandemic.

Insurance Holding Company Regulation

FNHC, as the parent holding company, is subject to laws governing insurance holding companies in Florida where FNIC and MNIC are domiciled or Louisiana where MIC is domiciled. Among other things, these laws: (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; and (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, MIC or MNIC and is required to file an application with the Florida OIR or LDI to obtain approval of such acquisition.

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 surplus or (b) net income, not including realized capital gains, plus a two-year carryforward, (ii) 10.0% of surplus with dividends payable constrained to unassigned funds minus 25.0% of unrealized capital gains or (iii) the lesser of (a) 10.0% of 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 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 surplus equal to or exceeding 115.0% of the minimum required statutory 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 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.

Under Louisiana law, a domestic insurer may not declare or pay any dividend to its stockholders unless its capital is fully paid in cash and is unimpaired and it has a surplus beyond its capital stock and the initial minimum surplus required and all other liabilities equal to fifteen percent of its capital stock, provided that this restriction does not apply when an insurer's paid-in capital and surplus exceeds the minimum required by Louisiana law by one hundred percent or more. No extraordinary dividend or other extraordinary distribution to its shareholders may be made until 30 days after the Louisiana Commissioner of Insurance has received notice of the declaration thereof and has not within that period disapproved the payment, or has approved the payment within the thirty-day period. An extraordinary dividend or distribution includes any dividend or distribution of cash or other property, whose fair market value together with that of other dividends or distributions made within the preceding twelve months exceeds the lesser of (a) 10.0% percent of the insurer's surplus as regards policyholders as of the 31st day of December next preceding; or (b) the net income, not including realized capital gains, for the twelve-month period ending the 31st day of December next preceding, but shall not include pro rata distributions of any class of the insurer's own securities. In determining whether a dividend or distribution is extraordinary, an insurer may carry forward net income from the previous two calendar years that has not already been paid out as dividends. This carryforward shall be computed by taking the net income from the second and third preceding calendar years, not including realized capital gains, less dividends paid in the second and immediate preceding calendar years. Notwithstanding the foregoing, an insurer may declare an extraordinary dividend or distribution which is conditional upon regulatory approval. and the declaration shall confer no rights upon shareholders until either the payment is approved or has not been disapproved within the 30 day period referred to above.

No dividends were paid by FNIC or MNIC in 2020, 2019 and 2018, and none are anticipated in 2021. No dividends were paid by MIC since the acquisition date, and none are anticipated in 2021. 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 or LDI will allow any dividends to be paid by FNIC, MIC or MNIC to FNHC, 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 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 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 services (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 Risk-Based Capital Requirements

In order to enhance the regulation of insurer solvency, the National Association of Insurance Commissioners (“NAIC”), established risk-based capital (“RBC”) 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 four major areas of risk facing property and casualty insurers: (i) underwriting risks, which encompass the risk of adverse loss development and inadequate pricing; (ii) declines in asset values arising from credit risk; (iii) other business risks from investments; and (iv) catastrophe risk. 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 and LDI, which follows these requirements, could require FNIC, MIC or MNIC to cease operations in the event they fail to maintain the required statutory capital.

Based upon the 2020 and 2019 statutory financial statements for FNIC, MIC and MNIC, statutory surplus exceeded the regulatory action levels established by the NAIC’s RBC requirements.

Based on RBC 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% 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% 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% of the ACL amount. FNIC’s ratio of statutory surplus to its ACL was 303% and 324% as of December 31, 2020 and 2019, respectively. MNIC’s ratio of statutory surplus to its ACL was 736% and 1,129% as of December 31, 2020 and 2019, respectively. MIC’s ratio of statutory surplus to its ACL was 348% and 306% as of December 31, 2020 and 2019, respectively.

Industry Ratings Services

Third-party rating agencies assess and rate the ability of insurers to pay their claims. The insurance industry uses financial strength ratings to assess the financial strength and quality of insurers. Ratings are based upon 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 also 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, 2020 and 2019, FNIC, MIC 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 an 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.

ITEM 1A. RISK FACTORS

We are subject to various risks in our business operations as described below. The risks and uncertainties described below are the known risk factors we consider material. Additional risks and uncertainties not currently known, or currently deemed immaterial, may also impair our business operations. Investors should carefully consider these risks before making an investment decision.

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 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. The incidence and severity of these events are inherently unpredictable. Catastrophic losses 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. Our homeowners policyholders are disbursed throughout the southeast United States, although the majority of our policyholders are located in Florida. Further, a substantial portion of our Florida homeowners policyholders, are located in southeastern Florida, and therefore are especially subject to adverse weather conditions such as hurricanes and tropical storms.

The occurrence of claims from catastrophic events can result in substantial volatility in our results of operations or financial condition for any fiscal quarter or year, as seen in 2020, 2019 and 2018. An elevation in the values and concentrations of insured property may increase the severity of the occurrence of claims 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, Louisiana and Texas, all states in which we write homeowners policies, experienced several significant hurricanes in 2020, 2019 and 2018, which some weather analysts believe is consistent with a period of greater hurricane activity. Exposure risk management alternatives are carefully evaluated as they 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.

As a property and casualty insurer, we may be impacted by different severe weather events at different times of the year.

Our homeowners business is impacted by catastrophic and other severe weather events, which may cause our operating results and financial condition to vary significantly from one period to the next. The incidence and severity of weather conditions are largely unpredictable, although certain types of events are more likely to occur during particular times of year. For example, hurricane season in the Atlantic and Caribbean oceans and in the Gulf of Mexico is from June 1st to November 30th of each year, with the peak occurrence of storms typically from mid-August to late October. By comparison, severe storms resulting in hail and tornados are more likely to occur in the spring in the states in which we operate. The nature of spring storms also tends to result in multiple occurrences, none of which would typically exceed our catastrophe reinsurance retention on an individual basis. There is generally an increase in the frequency and severity of claims when severe weather conditions occur.

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 our analysis of historical data and estimations of the impact of numerous factors such as:

- per-claim information;
- company and industry historical loss experience, including the impact of trends such as the AOB (as described in more detail below) by insureds;
- legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and
- 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, 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.

Although we follow the industry practice of reinsuring a portion of our risks, our costs of obtaining reinsurance in each of the last two years has increased substantially and the terms have become less favorable, with the result that we may not be able to successfully alleviate risk through our 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 losses and LAE 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, MIC and MNIC.

The availability and costs associated with the acquisition of reinsurance varies year to year, with significant increases occurring in each of the last two years. We are not able to control additional future availability and price increases of reinsurance, which may be significant and may limit our ability to purchase adequate coverage. In addition, when the statutory surplus of our insurance subsidiaries decreases, it decreases the maximum per-event retention allowed by our rating agency and our regulators. While a lower per-event retention has the benefit of reducing our maximum exposure to any single catastrophic event, it also further increases the cost of our reinsurance program. The recovery of increased reinsurance costs through rate increases is not immediate and cannot be presumed, as rate increases are subject to approval of the Florida OIR or LDI.

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 subsidiaries 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 subsidiaries from their respective primary obligations to pay for losses insured under the policies they issue, 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 dependent upon the FHCF's and our other reinsurers' ability to pay their claims. With respect to the FHCF, we may, in turn, be dependent upon the ability of the State Board of Administration of Florida to issue bonds in amounts that would be required to meet its reinsurance obligations in the event of such a catastrophic loss.

We may experience increased financial exposure due to changes in private excess-of-loss reinsurance market terms and conditions.

The private reinsurance market goes through what are known in the industry as "soft" and "hard" market cycles based on factors such as variations in world-wide and regional weather patterns and other natural or man-made catastrophes that produce higher or lower loss experience for the reinsurance industry. During soft market cycles, where losses have been less than expected, advantageous terms are more readily available to us, which reduces our potential exposure by providing broader coverage. During a hard market cycle, where losses have been more than expected, private reinsurance markets typically tighten coverage, potentially resulting in more financial exposure to the Company. Examples of tighter terms include, but are not limited to, the removal of cascading protection and the elimination of individual insurance carrier per-event retentions when there are multiple insurance carriers in a group.

Cascading protection provides broader coverage during years in which we experience multiple events. As the aggregate limit of the preceding layer is exhausted, the adjacent layers above drop down (cascade) in its place. Additionally, any unused layer protection drops down for subsequent events until exhausted. In the absence of cascading features, when events occur, a carrier may need to purchase supplemental coverage to backfill layers or potential gaps of coverage ("backfill coverage"), if available, and may have to do so at inopportune times, such as in the middle of hurricane season when availability is scarcer and pricing is higher. If such backfill coverage is not available, the carrier may experience gaps in reinsurance coverage. Because the existence and magnitude of potential gaps in coverage may be dependent on the ultimate catastrophe losses that emerge from preceding storms, some of which may be very recent, quantification of potential gaps can be highly uncertain. In addition, if another potential disturbance is already active at the time of binding backfill coverage, the active disturbance will generally be excluded from the newly bound coverage, which could result in gaps in the reinsurance tower with respect to the active disturbance, if it were to make landfall.

With individual insurance carrier per-event retentions, each insurance carrier has a retention that better matches its current risk appetite and surplus level. With an aggregate per-event retention for the entire group, if only one or two of the insurance carriers are involved in a given event, the larger corporate retention is split between the insurance carriers, usually resulting in a larger retention for the impacted carrier(s).

Restricted terms could also appear in the form of shortened time periods for coverage to be afforded on any one event or requiring 100% of the premium to be paid at the inception of coverage. Given these restrictions, the Company may incur or retain additional risk towards the end of hurricane season.

The reinsurance market for 2020 was a hard market, with less advantageous terms, as described above, on a portion of our July 1 through June 30, 2021 excess-of-loss reinsurance program. In addition, the Company anticipates that the reinsurance market will remain hard for 2021 such that, upon renewal, the less advantageous terms described above may be applicable to our entire excess-of-loss reinsurance program.

Contractual terms within our quota-share reinsurance treaties may limit the extent to which catastrophe losses can be ceded into the treaties, increasing the Company's net losses retained.

Many of the Company's quota-share reinsurance treaties include contractual terms that limit the nature or amount of catastrophe losses that can be ceded into the treaties. For example, the quota-share treaties covering FNIC's Florida homeowners book of business exclude named storm catastrophe losses and contain caps on non-named storm losses, or exclude them altogether. In addition, the quota-share treaty covering FNIC's non-Florida book of business includes limits on the net loss that the reinsurer can incur during the treaty year. As a result of catastrophe losses experienced during the second half of 2020, under the current terms of the applicable treaty, the Company will be limited in its ability to cede losses from Winter Storm Uri, which occurred during February 2021, or subsequent storms, into the treaty. Absent these limitations, the Company would expect to recover additional Winter Storm Uri losses pursuant to this treaty. Depending on the profitability of the business ceded into the treaty over the remainder of its term, the Company may be able to recover a portion of these losses, though not necessarily in the same period in which Winter Storm Uri occurred.

We may experience increased financial exposure from climate change.

A body of scientific evidence indicates that climate change is occurring. Climate change, to the extent that it affects weather patterns, is likely to 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, Louisiana and Texas. 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 wind and/or flood-prone areas. Our amount of maximum reinsurance coverage is determined in part by subjecting our homeowners 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. The statistical forecasting models have limitations, including the possible failure to contemplate emerging claims trends. This could include the impact of “social inflation,” where contractors and vendors extract more overages from an insurance policy than it was designed and price to provide, including the rise of “cottage industries” that are more active and aggressive than historical loss data may indicate. The potential failure of these models to capture such emerging trends, such as elevated claims litigation in Florida, gives rise to the risk that we may not purchase adequate catastrophic wind coverage. Our reinsurance coverage contemplates the effects of catastrophic events in a manner that satisfies our regulators, debtholders and our rating agency. Our amount of losses retained (our deductible) and the amount of coverage purchased in connection for any single event and in aggregate for a treaty year are influenced by market capacity, pricing conditions and our need for 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 operations, financial condition and results could be adversely affected by COVID-19 and other future contagious severe health viruses.

We are exposed to the risk of natural or man-made events, such as COVID-19 or other pandemics that could cause substantial deaths, illnesses and business disruptions. We continue to closely monitor developments related to COVID-19 and its variants to assess any potential future impact on our business, which continues to be an evolving and highly uncertain situation. As a means of limiting the exposure of FNHC’s team to the spread of infectious diseases, the Company has long supported a work-from-home culture in response to business continuity concerns by establishing and supporting the expansion of the Company’s network infrastructure to include dedicated home workstations for most employees. Nevertheless, material disruptions to the Company caused by the pandemic could include:

- Although we believe that our product offerings and contractual coverages limit our exposure to claims related to COVID-19, there may be a risk that legislative, regulatory, judicial or social influences could extend coverage beyond our contractual obligations or may result in an increase in the frequency or severity of claims beyond expected levels.
- Volatile and illiquid global financial markets resulting from the outbreak may adversely impact the fair value or credit quality of securities in our investment portfolio.
- Reduced liquidity, higher operating costs and strained profitability from legislative, regulatory or judicial actions may result in denials of rate increases, including rate increases we have already implemented, require premium payment grace periods, or prevent cancellations for non-payment of premium.
- A decline in demand for our product offerings or declining ability or willingness of our policy holders to pay premiums may reduce our revenues.
- We may require additional liquidity at a time when our cost of capital increases and/or access to capital is hampered.
- Social distancing impedes observing certain claims on-site and, in some cases, may adversely impact our ability to properly assess certain claims.
- The economic effects adversely impacting the liquidity and financial stability of our reinsurers may cause an increase in our reinsurance costs and/or counterparty risk with resulting write-offs of reinsurance recoverables.
- Market volatility and declining economic conditions adversely impacting the liquidity and financial stability of the issuers of securities we hold may result in realized losses.
- Our ability to maintain relationships with key vendors, and those vendors’ willingness or ability to perform services for us as expected, may be adversely impacted.
- We may experience cyber security losses due to our employees working remotely.

Additional localized or widespread events resulting from COVID-19 or its variants, or other infectious diseases that directly affect our workplace, insureds or reinsurers could cause a material adverse effect on our results of operations in any period and, depending on their severity, could also materially and adversely affect our ability to effectively conduct business, including our ability to write new business, and our financial condition. Therefore, additional prolonged periods of commercial disruption, reduced economic activity, high unemployment, extreme market volatility, disruptions to capital and credit markets, and other consequences of the COVID-19 pandemic, its variants or other infectious diseases could have a material adverse impact on our operations, financial condition and results.

If our capital must be used to pay greater than anticipated claims, instead of expanding our products or markets, our financial results may suffer.

Our ability to grow in the future 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. Our existing sources of funds include issuance of equity or debt securities (although the incurrence of additional debt would require the consent of existing debt holders), possible sales of our investment securities, and our earnings from operations and investments. Catastrophic events in our market areas, such as the hurricanes experienced in Florida, Louisiana and Texas in 2020, 2019 and 2018, and other catastrophic weather events, have resulted and may result in greater claims losses than anticipated, which could require us to limit or halt growth while we redeploy our capital to pay these unanticipated claims.

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 structured 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 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 failure of various risk mitigation strategies utilized could have a material, adverse effect on our financial condition, results of operations or reputation in the marketplace.

We utilize a number of tactics to mitigate risk exposure within our insurance business, which include:

- Avoidance of risks that do not conform to underwriting standards;
- Risk portfolio optimization;
- Transferring portfolio risk to financially sound reinsurance companies;
- Acquiring adequate primary insurance to ensure continued operations; and
- Promoting an enterprise risk management culture.

If we fail to effectively mitigate our risk exposures, the Company could experience increased claims, losses from catastrophic events that are not reinsured and/or damage of our reputation that makes agents and reinsurers reluctant to work with us.

Trends in claims and coverage issues have had, and may continue to have, a material adverse impact on our business.

As industry practices and legal, judicial, social and other conditions change, unexpected and unintended issues related to claims and coverage emerge. These issues 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 policies that are affected by the changes. As a result, the full extent of liability under our insurance policies may not be known for many years after a policy is issued.

An example of an existing trend, particularly in Florida homeowners insurance, is the assignment of benefits (“AOB”) 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 AOB phenomenon substantially increased, and may continue to increase, our exposure to inflated claims, attorney’s fees and costs. Although legislative actions in the State of Florida to limit the effect of AOB on insurance companies were passed in 2019, the effect of such legislation has been a shift in the volume of lawsuits from third-party/AOB suits from third party contractors and vendors, to first party suits from our policyholders instead. Another recent trend has been increased litigation regarding construction defect claims against the insureds under our commercial general liability policies written in prior years in Florida. This recent trend has resulted in low severity, high frequency claims that, although typically excluded by our policy language, nevertheless generate a high volume of litigation and related defense costs. There can be no assurances that the 2019 AOB legislation or any other future legislative actions for broader tort or insurance reform will become law or, if enacted, that such actions will have the effect of limiting the impact on us of “social inflation” and/or other causes of elevated levels of lawsuits.

Our failure to comply with the covenants in our senior note indenture, including as a result of events beyond our control such as a downgrade in our financial rating, could result in an event of default, which could materially and adversely affect our financial condition and results of operations.

The indenture for our senior notes requires us to maintain certain financial ratios and to comply with various operational and other covenants, including maintenance of certain financial ratings and limitations on our ability to incur additional debt without the approval of the existing noteholders. As of the date of this Annual Report, our debt is rated ‘BBB.’ If our rating were to decrease by two notches, to ‘BB+,’ the interest rate due on the senior notes would increase by 50 basis points and an additional 50 basis points for each additional notch below ‘BB+’. The terms of our senior note indenture currently prevent us from incurring additional debt, paying cash dividends or repurchasing our shares.

If there were an event of default under the indenture that was not cured or waived, the holders of the senior notes could cause all amounts outstanding with respect to the senior notes to be due and payable immediately. We cannot assure our shareholders that our assets or cash flow would be sufficient to fully repay the senior notes, either upon maturity or, if accelerated, upon an event of default, or that we would be able to refinance or restructure the payments on the senior notes. This would have a material adverse impact on our liquidity, financial condition and results of operations.

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, which would currently require the consent of existing debt holders, 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 insurance companies are subject to minimum capital and surplus requirements, and our failure to meet these requirements could subject us to regulatory action.

Our insurance companies are subject to RBC standards and other minimum capital and surplus requirements imposed under applicable state laws, including the laws of the State of Florida. The RBC standards, based upon the Risk Based Capital Model Act adopted by the NAIC, require our insurance companies 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 ACL RBC.

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 would be required to raise additional capital and we could be subject to further examination or corrective action imposed by state regulators, including limitations on our writing of additional business, additional state supervision, or liquidation.

Similarly, an increase in existing RBC requirements or minimum statutory capital requirements, such as the catastrophic risk component of RBC may require us to increase our statutory capital levels. Ratios calculated based on RBC also tend to be key criteria in the assignment of ratings by insurance rating agencies.

A reduction in our future capacity to enter new, renew, or maintain existing quota-share or excess of loss reinsurance treaties could potentially decrease the scope of options available to us in response to managing future statutory surplus needs.

Our company is dependent on reinsurance to manage our exposure to weather events. We purchase excess of loss reinsurance to satisfy requirements of our state regulators, insurance industry rating agency, debt rating agency, and debt covenants in our senior note indenture. We also purchase quota-share reinsurance, which assists us in managing the statutory surplus of our insurance subsidiaries. Our inability to maintain, renew or secure excess of loss or quota-share reinsurance at an affordable price, or at any price, could impact our ability to continue our business.

There are also practical constraints on the total percentage of a given book of business that can be ceded via quota-share reinsurance. During 2020, the quota-share cession percentage on FNIC's Florida homeowners book of business was increased from 10% to 40%, and the cession percentage on its non-Florida homeowners book was increased from zero to 80%, actions which benefited FNIC's statutory surplus and RBC ratio. As such, FNIC has reduced capacity to increase the level of quota-share cessions in the future. MIC and MNIC currently have no quota-share treaties in place.

A future reduction in the amount of quota-share reinsurance in place, primarily upon the expiration of the current treaties, could reduce existing statutory surplus of the impacted carrier, potentially triggering the need for a capital infusion.

To qualify as reinsurance for accounting purposes, a contract must embody substantive risk transfer, which is defined as the reasonable possibility that the reinsurer could experience a significant loss on the treaty. Contractual provisions in a treaty that excessively limit the extent or timing of the net loss that a reinsurer can experience can conceivably preclude the treaty from meeting the criteria for risk transfer, thereby disqualifying it from reinsurance accounting treatment. An assessment of risk transfer must be performed upon entry into a new treaty, as well as each time the treaty is renewed. Each of our in-force quota-share reinsurance treaties qualified for reinsurance accounting at the time of its most-recent inception. Each of these treaties has a one-year term (refer to Note 6 of the notes to our Consolidated Financial Statements in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report for further discussion of these reinsurance treaties). The Company currently expects to be able to renew each of the treaties that it determines beneficial to renew on terms that qualify for continued reinsurance accounting; however, there can be no assurance that the available market terms of these renewals (including pricing, coverage and exclusions) will also pass risk transfer. If a treaty that we desire to renew fails to qualify for reinsurance accounting based on its then-current renewal terms, it could adversely impact that carrier's statutory surplus, triggering the need for additional capital infusions within a short period of time.

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. Regulators may also exert influence over the loss and loss adjustment expense reserves we carry for future claims on the insurance policies we issue. 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.

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 Insurance Guaranty Association (“FIGA”), Citizens, the FHCF, Texas Windstorm Insurance Association (“TWIA”) and Louisiana Citizens Property Insurance (“LCPI”).

Insurance companies currently pass these assessments on to holders of 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, however, may adversely affect our overall marketing strategy due to the competitive landscape in Florida. As a result, the impact of possible future assessments on our balance sheet, results of operations or cash flow are indeterminable 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 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 consists primarily of 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. Declines in interest rates, such as occurred during 2020, could have an adverse effect on our investment income. Further, if periods of net cash outflows arise, whether due to catastrophe losses or for other reasons, we may need to draw down our bond portfolio, reducing the interest income we will earn in future periods.

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, declining economic conditions, such as a US or global economic slowdown, whether due to coronavirus, or other factors, could adversely impact the fair value or credit quality of securities in our portfolio and may have unforeseen consequences on the liquidity and financial stability of the issuers of securities we hold. 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.

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

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 upon 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, on a consolidated basis, we continue to file and obtain rate increases as the current Florida property and casualty market continues to harden. Elsewhere in the United States, we are experiencing increased competition. We cannot predict 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.

Homeowners insurance operations outside of Florida may not be profitable.

Our insurance subsidiaries currently conduct business in a limited number of states in addition to Florida, with concentrations of business in Texas, Louisiana and South Carolina and to a lesser extent in Alabama and Mississippi. Any single catastrophic occurrence or other condition affecting losses in these states could adversely affect our operating results. We have currently slowed our expansion of admitted homeowners property and casualty programs into other states, but may continue in the future as opportunities arise. Expanding our operations to additional states present risks similar to those we currently face with our existing operations, including risks associated with the inability to market adequately priced policies, inadequate commission structures, and overpriced or unavailable catastrophe reinsurance for wind events. Additionally, we would become subject to the insurance regulators in each state and the laws and regulations designed to regulate the insurance products and operations of new and existing insurance companies under their respective authorities. As a result, there can be no guarantees that state regulators will allow us to do business in those states or, if we are approved to operate in a state, that our operations will be profitable in that state.

If we determine to expand to additional states or to expand the types of insurance products we offer, we may incur additional costs and may not obtain the necessary regulatory approvals.

We may decide to expand our product offerings in the future 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. Before we can write insurance in a new state, or sell a new insurance product in a state, we must obtain a license or other approvals from the applicable state insurance regulators. These state insurance regulators 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 or offering that new product. There can be no assurance that we would be successful bringing new insurance products to our markets in a manner that is profitable.

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

The results of operations and the financial condition of our insurance companies 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 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, including, without limitation regulatory approval of rates sought; 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 companies could be materially and adversely affected.

Adverse ratings by insurance rating agencies may adversely impact our ability to write new policies, renew desirable policies or obtain adequate reinsurance, 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. The insurance industry uses financial strength ratings to assess the financial strength and quality of insurers. 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, capital and RBC ratios, and management. Ratings are also 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 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 or downgrade of our ratings could limit or prevent us from writing or renewing desirable insurance policies, from competing with insurers who have higher ratings, or from obtaining adequate reinsurance. 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.

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 select 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 ISA, an affiliate of Allstate, pursuant to which we are authorized by ISA to appoint Allstate agents to offer our homeowners 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 the years ended December 31, 2020, 2019 and 2018, 20.7%, 23.2% and 23.8%, respectively, of the homeowners premiums we underwrote were from Allstate's network of Florida agents. This concentration may increase further. 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.

We are a party to a managing general underwriting agreement with SageSure to facilitate growth in our FNIC homeowners business outside of Florida. As a percentage of our total homeowners premiums, 25.5%, 23.1% and 15.0%, for the years ended December 31, 2020, 2019 and 2018, respectively, were underwritten by SageSure. The profitability of the business we obtain outside of Florida through this agreement will depend substantially on the quality of underwriting performed by SageSure. An interruption in SageSure's services for us, or issues with the quality of SageSure's underwriting, could have a material adverse effect on the profitability of the business obtained through this relationship.

Certain of our agreements with agents provide that the renewal rights for policies written under those agreements belong to the agents, making it more difficult for us to maintain the policies written and the premium income generated through these relationships.

Our agreements with ISA and SageSure provide that ISA and SageSure, respectively, own the expirations of the policies underwritten under these agreements. This means that we do not have the right to solicit renewals of these policies. As a result, we may be less able to maintain the policies and the corresponding premium income from renewals of policies written by us under these agreements.

Cybersecurity breaches and other disruptions could compromise our information and expose us to loss of data or liability, which would cause our business and reputation to suffer.

In the ordinary course of our business, we store sensitive data, including our proprietary business information and personally identifiable information of our insureds and employees, on our networks. The secure processing and maintenance of this information is critical to our operations and business strategy. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. We have also promoted the ability of our team to work remotely, particularly through the COVID-19 pandemic, which could make our systems more vulnerable to breaches. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, or stolen. Any such access, disclosure or loss of information could result in legal claims against us, liability under laws that protect the privacy of personal information, regulatory penalties, disruption to our operations, and damage our reputation, which could materially adversely affect our results of operations. Although we have implemented security measures to protect our systems from viruses and other intrusions by third parties, there can be no assurances that these measures will be effective. 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 cover us 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.

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

We 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. Our networks could be compromised by the errors or actions of our vendors and other business partners with legitimate access to our systems. If one of our vendors or other business partners are the subject of a security breach or cyber-attack, such breach or attack may result in improper or unauthorized access to our systems, and the loss, theft or unauthorized publication of our information or the confidential information of our customers, agents or employees, notwithstanding our substantial efforts to protect our systems and sensitive or confidential information. An unauthorized disclosure or loss of policyholder or employee information or other sensitive or confidential information, including by cyber-attack or other security breach, could cause a loss of data, give rise to remediation or other expenses, expose us to liability under federal and state laws, and subject us to litigation and investigations, which could have an adverse effect on our business, cash flows, financial condition and results of operations. 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 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.

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 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 captive writers may have certain competitive advantages over independent 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 or increase our commissions 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.

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, Chief Executive Officer and President, and others. 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 certain of our executive officers, any unplanned loss of service could substantially harm our business.

We have identified a material weakness in our internal controls over financial reporting, which we are in the process of remediating. As a result, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock may be negatively affected.

As a public company, we are required to maintain internal controls over financial reporting and to report any material weaknesses in such internal controls. Section 404 of the Sarbanes-Oxley Act of 2002 requires that we evaluate and determine the effectiveness of our internal controls over financial reporting and provide a management report on the internal controls over financial reporting. Because we have a material weakness in our internal controls over financial reporting as described in more detail in Part II, Item 9A "Controls and Procedures" of this Annual Report, we may not detect errors on a timely basis and our financial statements may be materially misstated.

Due to our identified material weaknesses in our internal controls over financial reporting, we may not be able to comply with the requirements of Section 404 in a timely manner as currently we are unable to assert that our internal controls over financial reporting are effective; therefore, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock could be negatively affected. We could also become subject to investigations by the SEC, Nasdaq or other regulatory authorities, which could require additional financial and management resources to address.

Our reliance on insurance scoring in pricing and underwriting certain of our insurance policies may be limited by changes in applicable law, regulation or policies of regulatory authorities, which could cause our pricing and underwriting to be less effective.

We rely on insurance scoring, which combines credit scores and claims history of persons applying for insurance policies with us, in pricing and underwriting these policies. We believe that the use of this information, together with other relevant information provided to us in the application process, is important to our ability to effectively price our insurance products and determine the risks we are willing to underwrite. We also believe that we use this information in accordance with applicable law, regulations and policies. From time to time, however, the use of this information has come under review by insurance and other regulators. If the use of this information is limited or prohibited, our pricing and underwriting of our insurance policies may be less effective, with the result that our results of operations may be adversely affected.

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 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 strengthening;
- changes in securities analysts' estimates of our financial performance or the financial performance of our competitors or companies in our industry generally;

- a downgrade of our Demotech rating or the rating of our outstanding debt;
- 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 Report, the accompanying notes and the documents incorporated by reference herein.

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.

The removal of our common stock from the Russell 3000® and Russell 2000® Indexes could result in certain investors selling our shares and the market for our common stock becoming limited, with the result that the price at which you can sell your shares may decrease.

Because of the recent decline in the market prices of our common stock and the expected significant increase in the expected minimum market capitalization required for continued inclusion in the Russell 3000® and Russell 2000® Indexes, our market capitalization may no longer meet the expected minimum market capitalization required for continued inclusion in the Russell indexes. As a result, index funds, institutional investors and other investors attempting to track the composition of those indexes may be required to sell our common stock, which would adversely impact the price and frequency at which it trades.

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.

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 our subsidiaries. Our operations, and our ability to pay dividends or service our 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 subsidiaries are restricted by the applicable state laws governing our insurance subsidiaries. Generally, these laws limit the dividends permitted to be paid by insurance companies under complicated formulas based on the companies' available capital and earnings.

Payment of dividends in the future will depend upon our earnings and financial position and such other factors, as our board of directors deems relevant.

Our articles of incorporation, our bylaws and Florida law provide for anti-takeover provisions that could make it more difficult for a third party to acquire us.

Provisions of our articles of incorporation, our bylaws and Florida law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our shareholders. These provisions, alone or in combination with each other, may discourage transactions involving actual or potential changes of control, including transactions that otherwise could involve payment of a premium over prevailing market prices to holders of our common stock, or could limit the ability of our shareholders to approve transactions that they may deem to be in their best interests.

Future sales of our common stock by our existing shareholders in the public market, or the possibility or perception of such future sales, or sales of additional shares of common stock by us, could depress our stock price.

Investors currently known to be the beneficial owners of more than 5.0% of our common stock hold approximately 60% of our outstanding shares. Sales of a substantial number of shares of our common stock in the public market or otherwise by our existing shareholders, or the possibility or perception that such sales could occur, could depress the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities. 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 by us, or the perception that these sales may occur, could adversely impact our stock price. Refer to Note 3 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report for information regarding our acquisition of the Maison Companies.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our executive office is located at 14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323 in a 64,727 square foot office facility. Our lease for this office space is scheduled to expire in October 2028.

We also lease office space located at 7861 Woodland Center Boulevard, Tampa, Florida 33614 in a 5,880 square foot office facility, which serves as the principal office space for our subsidiary, MIC. Our lease for this office space is scheduled to expire in January 2025.

Refer to Note 12 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for further information regarding 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 this nature would be material.

Refer to Note 12 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for further information regarding our legal proceedings.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is listed for trading on the NASDAQ Global Market under the symbol "FNHC."

HOLDERS

As of March 5, 2021, there were 138 holders of record of our common stock.

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The following table summarizes our equity compensation plans as of December 31, 2020. 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 shareholders	25,417	4.01	524,659

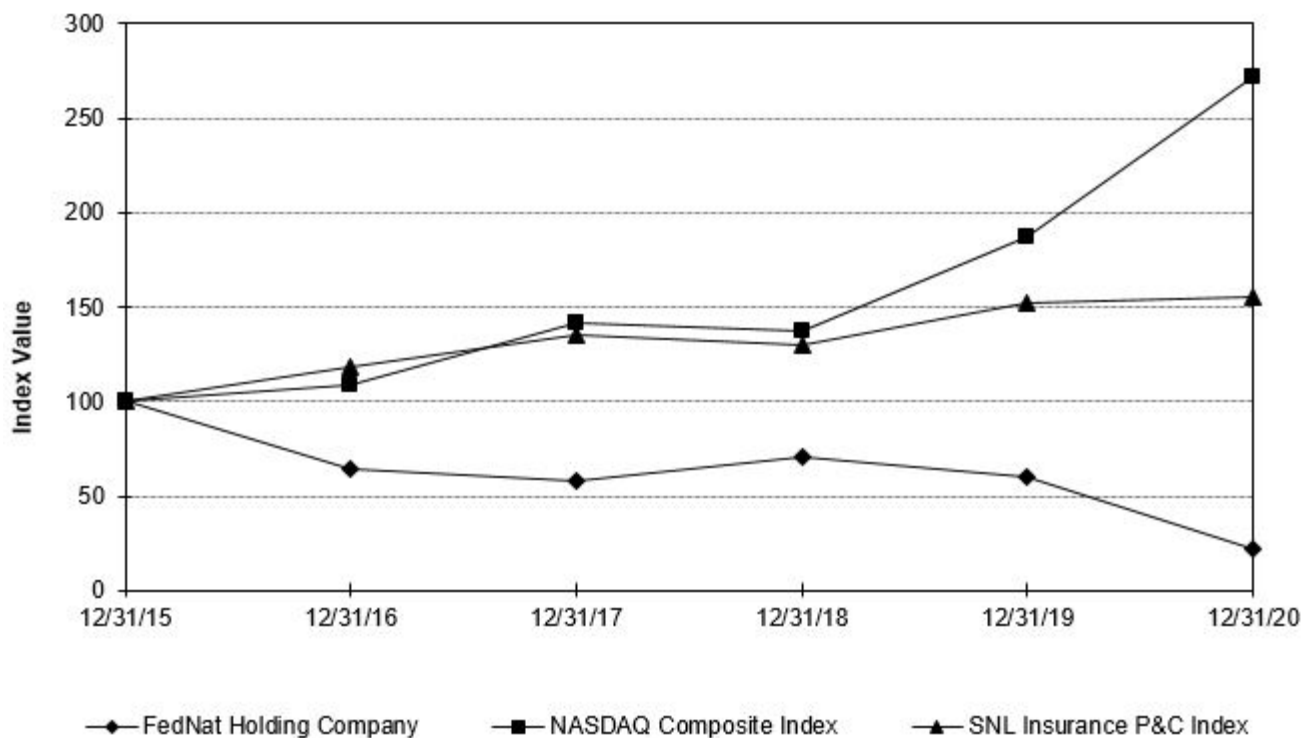
Refer to Note 13 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for additional information regarding our equity compensation.

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.

FedNat Holding Company

Total Return Performance



<i>Index</i>	<i>Period Ending</i>					
	<u>12/31/2015</u>	<u>12/31/2016</u>	<u>12/31/2017</u>	<u>12/31/2018</u>	<u>12/31/2019</u>	<u>12/31/2020</u>
FedNat Holding Company	100.00	63.85	57.72	70.56	60.23	22.24
NASDAQ Composite	100.00	108.87	141.13	137.12	187.44	271.64
SNL Insurance P&C	100.00	118.02	134.93	129.73	152.23	154.96

Returns are based on the change in year-end to year-end price. The graph assumes \$100 was invested on December 31, 2015 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 Annual Report. 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.

RECENT SALES OF UNREGISTERED SECURITIES

On December 2, 2019, we issued 1,773,102 shares of common stock to PIH as part of the consideration we paid for the Maison Companies. These shares were issued pursuant to the exemption from registration set forth in Section 4(a)(2) of the Securities Act of 1933, as amended.

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 set forth elsewhere in this Annual Report.

	Year Ended December 31,				
	2020	2019	2018	2017	2016
	(In thousands, except per share data)				
Statement of Operations Data					
Revenues:					
Net premiums earned	\$ 364,134	\$ 363,652	\$ 355,257	\$ 333,481	\$ 261,369
Net investment income	11,786	15,901	12,460	10,254	9,063
Net realized and unrealized investment gains (losses)	18,032	7,084	(4,144)	8,548	3,045
Direct written policy fees	13,970	10,200	13,366	17,173	16,619
Other income	23,941	18,124	19,154	22,206	17,429
Total revenues	431,863	414,961	396,093	391,662	307,525
Costs and expenses:					
Losses and loss adjustment expenses	376,449	273,080	228,416	247,557	197,810
Commissions and other underwriting expenses	124,288	107,189	121,109	114,867	90,378
General and administrative expenses	23,420	23,203	22,183	19,963	17,186
Interest expense	7,661	10,776	4,177	348	348
Impairment of intangibles	11,699	—	—	—	—
Total costs and expenses	543,517	414,248	375,885	382,735	305,722
Income (loss) before income taxes	(111,654)	713	20,208	8,927	1,803
Income tax expense (benefit)	(33,496)	(298)	5,498	3,585	542
Net income (loss)	(78,158)	1,011	14,710	5,342	1,261
Net income (loss) attributable to non-controlling interest	—	—	(218)	(2,647)	246
Net income (loss) attributable to FedNat Holding Company shareholders	\$ (78,158)	\$ 1,011	\$ 14,928	\$ 7,989	\$ 1,015
Net income (loss) per share attributable to FedNat Holding Company shareholders					
Basic	\$ (5.64)	\$ 0.08	\$ 1.17	\$ 0.61	\$ 0.07
Diluted	(5.64)	0.08	1.16	0.60	0.07
Dividends	0.36	0.33	0.24	0.32	0.27

	December 31,				
	2020	2019	2018	2017	2016
	(In thousands, except per share data)				
Balance Sheet Data					
Cash and invested assets	\$ 593,734	\$ 684,002	\$ 515,948	\$ 530,249	\$ 484,275
Total assets	1,428,537	1,179,016	925,371	904,873	815,390
Loss and loss adjustment expense reserves	540,367	324,362	296,230	230,515	158,110
Total liabilities	1,270,377	930,323	710,112	677,414	580,925
Total shareholders' equity	158,160	248,693	215,259	227,459	234,465
Book value per share, excluding non-controlling interest	11.53	17.25	16.84	16.29	16.01

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

RESULTS OF OPERATIONS

Operating Results Overview — Year Ended December 31, 2020 Compared to Year Ended December 31, 2019

The following table sets forth results of operations for the periods presented:

	Year Ended December 31,		
	2020	% Change	2019
	(Dollars in thousands)		
Revenues:			
Gross premiums written	\$ 726,885	19.0 %	\$ 610,608
Gross premiums earned	720,967	23.8 %	582,334
Ceded premiums	(356,833)	63.2 %	(218,682)
Net premiums earned	364,134	0.1 %	363,652
Net investment income	11,786	(25.9)%	15,901
Net realized and unrealized investment gains (losses)	18,032	154.5 %	7,084
Direct written policy fees	13,970	37.0 %	10,200
Other income	23,941	32.1 %	18,124
Total revenues	431,863	4.1 %	414,961
Costs and expenses:			
Losses and loss adjustment expenses	376,449	37.9 %	273,080
Commissions and other underwriting expenses	124,288	16.0 %	107,189
General and administrative expenses	23,420	0.9 %	23,203
Interest expense	7,661	(28.9)%	10,776
Impairment of intangibles	11,699	NCM	—
Total costs and expenses	543,517	31.2 %	414,248
Income (loss) before income taxes	(111,654)	NCM	713
Income tax expense (benefit)	(33,496)	NCM	(298)
Net income (loss)	\$ (78,158)	NCM	\$ 1,011
Ratios to net premiums earned:			
Net loss ratio	103.4 %		75.1 %
Net expense ratio	40.5 %		35.9 %
Combined ratio	143.9 %		111.0 %

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

The following table sets forth a reconciliation of GAAP to non-GAAP measures:

	Year Ended December 31,	
	2020	2019
	(Dollars in thousands)	
Revenue		
Total revenues	\$ 431,863	\$ 414,961
Less:		
Net realized and unrealized investment gains (losses)	18,032	7,084
Adjusted operating revenues	<u>\$ 413,831</u>	<u>\$ 407,877</u>
Net Income (Loss)		
Net income (loss)	\$ (78,158)	\$ 1,011
Less:		
Net realized and unrealized investment gains (losses)	10,801	5,347
Acquisition and strategic costs	(171)	(1,267)
Amortization of identifiable intangibles	(90)	(10)
Gain (loss) on early extinguishment of debt	—	(2,698)
Impairment of intangibles	(11,417)	—
Adjusted operating income (loss)	<u>\$ (77,281)</u>	<u>\$ (361)</u>
Income tax rate assumed for reconciling items above, excluding impairment of goodwill	40.100 %	24.522 %

Revenue

Total revenue increased \$16.9 million, or 4.1%, to \$431.9 million for the year ended December 31, 2020, as compared to \$415.0 million for the year ended December 31, 2019. The increase was primarily driven by higher net investment gains, policy fees and other income, partially offset by lower net investment income, all of which are discussed below.

Gross Premiums Written

The following table sets forth the gross premiums written for the periods presented:

	Year Ended December 31,	
	2020	2019
	(In thousands)	
Gross premiums written:		
Homeowners Florida	\$ 444,576	\$ 451,856
Homeowners non-Florida	263,534	142,485
Federal flood	19,022	16,413
Non-core (1)	(247)	(146)
Total gross premiums written	<u>\$ 726,885</u>	<u>\$ 610,608</u>

(1) Reflects exited lines of business.

Gross premiums written increased \$116.3 million, or 19.0%, to \$726.9 million for the year ended December 31, 2020, as compared to \$610.6 million for the year ended December 31, 2019. The gross premiums written increase was driven by our growth in our non-Florida book of business, including \$77.8 million from MIC's non-Florida business, partially offset by a decrease in our Florida business, as we reduce our exposure in the state of Florida, as a result of the challenging litigation environment. Overall, homeowners grew 19.1%.

Gross Premiums Earned

The following table sets forth the gross premiums earned for the periods presented:

	Year Ended December 31,	
	2020	2019
	(In thousands)	
Gross premiums earned:		
Homeowners Florida	\$ 459,511	\$ 452,730
Homeowners non-Florida	244,192	112,836
Federal flood	17,511	15,073
Non-core (1)	(247)	1,695
Total gross premiums earned	<u>\$ 720,967</u>	<u>\$ 582,334</u>

(1) Reflects exited lines of business.

Gross premiums earned increased \$138.7 million, or 23.8%, to \$721.0 million for the year ended December 31, 2020, as compared to \$582.3 million for the year ended December 31, 2019. The higher gross premiums earned was primarily driven by continued non-Florida growth, including \$73.3 million from MIC's non-Florida business.

Ceded Premiums Earned

Ceded premiums earned increased \$138.1 million, or 63.2%, to \$356.8 million for the year ended December 31, 2020, as compared to \$218.7 million for the year ended December 31, 2019. The increase was driven by approximately \$91.5 million higher excess of loss reinsurance spend, as prices and overall property exposures increased, including \$32.8 million from the Maison Companies acquisition, this year as compared to last year. Additionally, stemming from the non-cascading portion of our reinsurance tower and number of catastrophe events, we purchased supplemental coverage to backfill layers and gaps in coverage, which increased ceded premium earned by \$10.4 million when comparing these periods. Furthermore, there was approximately \$34.1 million of additional ceded premium related to the 50% quota-share treaty for FNIC's non-Florida book of business that became effective July 1, 2020 and was subsequently increased to 80% effective December 1, 2020. The increase to ceded premium earned associated with the aforementioned quota-share treaties is partially offset by corresponding reductions in loss and LAE, and commission and other underwriting expenses when comparing the periods. Refer to Note 6 of the notes to our Consolidated Financial Statements for additional information regarding these quota-share treaties.

Net Investment Income

Net investment income decreased \$4.1 million, or 25.9%, to \$11.8 million for the year ended December 31, 2020, as compared to \$15.9 million for the year ended December 31, 2019. The decrease was primarily due to the lower interest rate environment in 2020 and elevated second quarter 2019 income earned on debt proceeds that had not yet been deployed on the Maison Companies acquisition, partially offset by fixed income portfolio growth from the Maison Companies acquisition.

Net Realized and Unrealized Investment Gains (Losses)

Net realized and unrealized investment gains (losses) increased \$10.9 million, to \$18.0 million for the year ended December 31, 2020, as compared to \$7.1 million for the year ended December 31, 2019. We recognized \$(4.1) million (more than offset by realized gains on sales) and \$4.1 million in unrealized investment gains (losses) for equity securities during these respective periods. Our current and prior year net realized gains are primarily associated with our portfolio managers, under our control, moving out of positions due to both macro and micro conditions, a typical practice each and every quarter. Furthermore, to mitigate the potential COVID-19 related adverse impact on the financial stability of the issuers of securities we hold, certain positions were liquidated during 2020. In addition, to reduce the potential impact of equity market volatility on our capital and liquidity, we sold all of the Company's investments in common stock.

Direct Written Policy Fees

Direct written policy fees increased by \$3.8 million, or 37.0%, to \$14.0 million for the year ended December 31, 2020, as compared to \$10.2 million for the year ended December 31, 2019. The increase is primarily driven by the policy fees generated from MIC's policies in-force and higher fees as a result of FNIC's non-Florida premium growth.

Other Income

Other income increased \$5.8 million, or 32.1%, to \$23.9 million for the year ended December 31, 2020, as compared to \$18.1 million for the year ended December 31, 2019. Other income included the following for the periods presented:

	Year Ended December 31,		
	2020	% Change	2019
	(Dollars in thousands)		
Other income:			
Commission income	\$ 3,357	15.6 %	\$ 2,904
Brokerage	18,948	39.6 %	13,577
Financing and other revenue	1,636	(0.4)%	1,643
Total other income	<u>\$ 23,941</u>	<u>32.1 %</u>	<u>\$ 18,124</u>

The increase in other income was primarily driven by higher brokerage revenue. The brokerage revenue increase is the result of higher excess of loss reinsurance spend from the reinsurance programs in place in 2020 as compared to 2019.

Expenses

Losses and LAE

Losses and LAE incurred, net of reinsurance, included the following for the periods presented:

	Year Ended December 31,			
	2020		2019	
	Net Loss		Net Loss	
	Amount	Ratio	Amount	Ratio
	(In thousands)			
Current accident year, excluding catastrophes:				
Homeowners	\$ 230,602	63.3 %	\$ 207,808	57.1 %
Non-core (1)	—	— %	1,601	0.4 %
Total current accident year, excluding catastrophes	<u>230,602</u>	<u>63.3 %</u>	<u>209,409</u>	<u>57.5 %</u>
Current year catastrophes (2):				
Florida	55,533	15.3 %	26,250	7.4 %
Texas	26,204	7.2 %	12,400	3.4 %
Louisiana	44,174	12.1 %	8,900	2.4 %
Other states	2,386	0.7 %	5,150	1.4 %
Total current year catastrophes	<u>128,297</u>	<u>35.3 %</u>	<u>52,700</u>	<u>14.6 %</u>
Prior year loss development (redundancy):				
Homeowners	(655)	(0.2)%	615	0.2 %
Non-core (1)	19,022	5.2 %	12,845	3.5 %
Ceded losses subject to offsetting experience account adjustments (3)	(816)	(0.2)%	(2,489)	(0.7)%
Total prior year loss development (redundancy)	<u>17,551</u>	<u>4.8 %</u>	<u>10,971</u>	<u>3.0 %</u>
Total net losses and LAE	<u>\$ 376,449</u>	<u>103.4 %</u>	<u>\$ 273,080</u>	<u>75.1 %</u>

(1) Reflects exited lines of business.

(2) Includes Property Claims Services ("PCS") weather events and other events impacting multiple insureds for which the Company's insurance carriers established catastrophe event codes, net of the benefit of claims handling services. These

catastrophe events are typically wind, hail and tornado related weather events. Any individual catastrophe event with gross losses greater than \$20 million, on a pre-tax basis, are considered significant and specifically addressed in the commentary below.

- (3) Reflects homeowners losses ceded under retrospective reinsurance treaties to the extent there is an offsetting experience account adjustment, such that there is no impact on pre-tax net income (loss).

Losses and LAE increased \$103.3 million, or 37.9%, to \$376.4 million for the year ended December 31, 2020, as compared to \$273.1 million for the year ended December 31, 2019. The net loss ratio increased 28.3 percentage points, to 103.4% in 2020, as compared to 75.1% in 2019. The higher loss ratio was primarily the result of higher catastrophe net losses when comparing the periods, as 2020 included \$128.3 million, net of reinsurance. Approximately \$37 million of catastrophe net losses from FNIC's non-Florida book of business was subject to a 50% profit-sharing agreement prior to the 50% quota share becoming effective on July 1, 2020 and increasing to 80% effective December 1, 2020, as discussed above.

The 2020 catastrophe net losses were \$109.8 million, net of reinsurance and profit-share impact described above, which included Hurricanes Laura, Sally, Delta, Zeta and Eta, as well as a number of hail and wind-related severe weather events, which impacted Florida, Louisiana, Texas and other states. By comparison, 2019 catastrophe net losses were \$39.5 million, net of reinsurance and profit-share impact, which primarily included \$18.7 million attributed to a single hail storm in Brevard County, Florida, and hail and wind related events during the spring months in the southeastern part of the United States. The remaining variance was the result of higher prior year development, as detailed in the table above, and higher current year gross losses from a higher volume of policies, mostly offset by increased ceded losses in FNIC's Florida and non-Florida books of business as a result of additional quota-share agreements in place in the second half of 2020 as compared to the second half of 2019.

Commissions and Other Underwriting Expenses

The following table sets forth the commissions and other underwriting expenses for the periods presented:

	Year Ended December 31,	
	2020	2019
	(In thousands)	
Commissions and other underwriting expenses:		
Homeowners Florida	\$ 54,043	\$ 52,962
All other	49,384	25,491
Ceding commissions	(27,143)	(12,128)
Total commissions	76,284	66,325
Fees	5,079	3,368
Salaries and wages	13,791	12,114
Other underwriting expenses	29,134	25,382
Total commissions and other underwriting expenses	<u>\$ 124,288</u>	<u>\$ 107,189</u>

Commissions and other underwriting expenses increased \$17.1 million, or 16.0%, to \$124.3 million for the year ended December 31, 2020, as compared to \$107.2 million for the year ended December 31, 2019. The increase was primarily driven by higher non-Florida acquisition related costs, which includes gross commissions, fees and other underwriting expenses as a result of premium growth, including from MIC's non-Florida business. When comparing these periods, this increase was partially offset by a higher ceding commission driven in part by the new quota-share treaties in FNIC's Florida and non-Florida books of business. Refer to Ceded Premium Earned above for additional information.

The net expense ratio increased 4.6 percentage points to 40.5% in 2020, as compared to 35.9% in 2019 due primarily to higher excess of loss ceded reinsurance premiums in 2020.

General and Administrative Expenses

Despite the addition of the Maison Companies and enabled by our rigorous integration efforts, general and administrative expenses increased only \$0.2 million, or 0.9%, to \$23.4 million for the year ended December 31, 2020, as compared to \$23.2 million for the year ended December 31, 2019.

Interest Expense

Interest expense decreased \$3.1 million to \$7.7 million for the year ended December 31, 2020, as compared to \$10.8 million for the year ended December 31, 2019, which included \$3.6 million of prepayment fees, including the write-off of remaining debt issuance costs. This decline was partially offset by the fact that our March 2019 debt offering was only outstanding for a portion of the first quarter of 2019.

Impairment of Intangibles

Coinciding with the preparation of the financial statements for the year ended December 31, 2020, the Company's annual goodwill impairment testing has resulted in the conclusion that the goodwill intangible asset established in conjunction with the acquisition of the Maison Companies in December 2019 is impaired. Therefore, during the fourth quarter of 2020, we recorded a non-cash impairment charge of \$11.0 million, against which there is no tax offset, representing the write-off of the full amount of our goodwill asset. The Company's impairment analysis considered the earnings and share price of the Company and comparable companies, as well as projected cash flows. Continued adverse storm activity, higher excess of loss catastrophe reinsurance costs and the continued unfavorable claims environment in the state of Florida reduced the previously modeled fair value of the Company. These impacts, along with other information relevant to the estimated fair value of the Company, including the trading price of our shares, resulted in the impairment conclusion.

Correspondingly, effective as of October 1, 2020, we believed there was an indication of impairment for our identifiable intangible assets, therefore we performed a discounted cash flow method to measure and record a non-cash impairment of \$0.7 million, due primarily to a higher discount rate, which lowered the fair value below carrying value.

Refer to Note 8 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for additional information related to our goodwill and identifiable intangible assets.

Income Taxes

Income tax expense (benefit) decreased \$33.2 million to \$(33.5) million for the year ended December 31, 2020, as compared to \$(0.3) million for the year ended December 31, 2019. The decrease in income tax expense is predominantly the result of the pre-tax loss during the current year as compared to income during 2019. Additionally, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), signed into law on March 27, 2020, enabled us to carry back net operating loss to prior years when the statutory federal income tax rate was at 35%, which increased our effective tax rate during 2020. Refer to Note 11 of the notes to our Consolidated Financial Statements for additional information regarding the CARES Act.

Operating Results Overview — Year Ended December 31, 2019 Compared to Year Ended December 31, 2018

The following table sets forth selected results of operations for the periods presented:

	Year Ended December 31,		
	2019	% Change	2018
	(Dollars in thousands)		
Revenues:			
Gross premiums written	\$ 610,608	7.5 %	\$ 567,764
Gross premiums earned	582,334	0.4 %	580,020
Ceded premiums	(218,682)	(2.7)%	(224,763)
Net premiums earned	363,652	2.4 %	355,257
Net investment income	15,901	27.6 %	12,460
Net realized and unrealized investment gains (losses)	7,084	(270.9)%	(4,144)
Direct written policy fees	10,200	(23.7)%	13,366
Other income	18,124	(5.4)%	19,154
Total revenues	414,961	4.8 %	396,093
Costs and expenses:			
Losses and LAE	273,080	19.6 %	228,416
Commissions and other underwriting expenses	107,189	(11.5)%	121,109
General and administrative expenses	23,203	4.6 %	22,183
Interest expense	10,776	158.0 %	4,177
Total costs and expenses	414,248	10.2 %	375,885
Income (loss) before income taxes	713	(96.5)%	20,208
Income tax expense (benefit)	(298)	(105.4)%	5,498
Net income (loss)	1,011	(93.1)%	14,710
Net income (loss) attributable to non-controlling interest	—	(100.0)%	(218)
Net income (loss) attributable to FNHC shareholders	\$ 1,011	(93.2)%	\$ 14,928
Ratios to net premiums earned:			
Net loss ratio	75.1 %		64.3 %
Net expense ratio	35.9 %		40.3 %
Combined ratio	111.0 %		104.6 %

(1) Net loss ratio is calculated as losses and LAE divided by net premiums earned.

(2) Net expense ratio is calculated as all operating expenses less interest expense divided by net premiums earned.

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

The following table sets forth a reconciliation of GAAP to non-GAAP measures:

	Year Ended December 31,	
	2019	2018
	(Dollars in thousands)	
Revenue		
Total revenues	\$ 414,961	\$ 396,093
Less:		
Net realized and unrealized investment gains (losses)	7,084	(4,144)
Adjusted operating revenues	<u>\$ 407,877</u>	<u>\$ 400,237</u>
Net Income (Loss)		
Net income (loss)	\$ 1,011	\$ 14,928
Less:		
Net realized and unrealized investment gains (losses)	5,347	(3,094)
Acquisition and strategic costs	(1,267)	(1,968)
Amortization of identifiable intangibles	(10)	—
Gain (loss) on early extinguishment of debt	(2,698)	—
Adjusted operating income (loss)	<u>\$ (361)</u>	<u>\$ 19,990</u>
Income tax rate assumed for reconciling items above	24.522 %	25.345 %

Revenue

Total revenue increased \$18.9 million, or 4.8%, to \$415.0 million for the year ended December 31, 2019, as compared to \$396.1 million for the year ended December 31, 2018. The increase was primarily driven by higher net premiums growth from homeowners and higher net investment gains offset by lower net premiums earned in automobile and commercial general liability, all of which are discussed below.

Gross Premiums Written

The following table sets forth the gross premiums written for the periods presented:

	Year Ended December 31,	
	2019	2018
	(In thousands)	
Gross premiums written:		
Homeowners Florida	\$ 451,856	\$ 458,652
Homeowners non-Florida	142,485	81,037
Federal flood	16,413	14,088
Non-core (1)	(146)	13,987
Total gross premiums written	<u>\$ 610,608</u>	<u>\$ 567,764</u>

(1) Reflects exited lines of business.

Gross premiums written increased \$42.8 million, or 7.5%, to \$610.6 million for the year ended December 31, 2019, as compared to \$567.8 million for the year ended December 31, 2018. Gross premiums written increased primarily due to the growth in homeowners non-Florida, including \$6.6 million from MIC, partially offset by the decline in the non-core lines we exited, automobile and commercial general liability, as well as a decline in homeowners Florida. Overall, homeowners grew 10.1%.

Gross Premiums Earned

The following table sets forth the gross premiums earned for the periods presented:

	Year Ended December 31,	
	2019	2018
	(In thousands)	
Gross premiums earned:		
Homeowners Florida	\$ 452,730	\$ 473,121
Homeowners non-Florida	112,836	66,571
Federal flood	15,073	13,132
Non-core (1)	1,695	27,196
Total gross premiums earned	<u>\$ 582,334</u>	<u>\$ 580,020</u>

(1) Reflects exited lines of business.

Gross premiums earned increased \$2.3 million, or 0.4%, to \$582.3 million for the year ended December 31, 2019, as compared to \$580.0 million for the year ended December 31, 2018. Gross premiums earned increased primarily due to a 4.8% increase in earned premiums in homeowners, which includes \$7.9 million from MIC, partially offset by our decision to exit the automobile and commercial general liability lines.

Ceded Premiums Earned

Ceded premiums earned decreased \$6.1 million, or 2.7%, to \$218.7 million for the year ended December 31, 2019, as compared to \$224.8 million for the year ended December 31, 2018. The decrease was primarily driven by lower ceded premiums in automobile as we have exited that line of business, partially offset by higher excess of loss reinsurance spend in homeowners.

Net Investment Income

Net investment income increased \$3.4 million, or 27.6%, to \$15.9 million for the year ended December 31, 2019, as compared to \$12.5 million for the year ended December 31, 2018. The increase was due to fixed income portfolio growth and the improvement in the yield as a result of rising interest rates during 2018 and from portfolio repositioning.

Net Realized and Unrealized Investment Gains (Losses)

Net realized and unrealized investment gains (losses) increased \$11.2 million, to \$7.1 million for the year ended December 31, 2019, as compared to \$(4.1) million for the year ended December 31, 2018. We recognized \$4.1 million and \$(1.2) million in unrealized investment gains (losses) for equity securities during these respective periods. Our current year net realized gains and prior year net realized losses are primarily associated with our portfolio managers, under our control, moving out of positions due to both macro and micro conditions, a typical practice each and every quarter. Our prior year net realized losses are resulted from our decision to liquidate certain bond positions, including positions related to tax-free municipal securities during the first quarter of 2018.

Direct Written Policy Fees

Direct written policy fees decreased by \$3.2 million, or 23.7%, to \$10.2 million for the year ended December 31, 2019, as compared to \$13.4 million for the year ended December 31, 2018. The decrease in direct written policy fees is correlated to our decision to exit the automobile line, as discussed earlier.

Other Income

Other income decreased \$1.1 million, or 5.4%, to \$18.1 million for the year ended December 31, 2019, as compared to \$19.2 million for the year ended December 31, 2018. Other income included the following for the periods presented:

	Year Ended December 31,		
	2019	% Change	2018
	(Dollars in thousands)		
Other income:			
Commission income	\$ 2,904	(37.5)%	\$ 4,649
Brokerage	13,577	10.3 %	12,305
Financing and other revenue	1,643	(25.3)%	2,200
Total other income	<u>\$ 18,124</u>	<u>(5.4)%</u>	<u>\$ 19,154</u>

The decrease in other income was driven by lower commission income and financing revenue, partially offset by higher brokerage revenue. The year over year decrease in commission income were driven by lower automobile fee income from the reduction in premiums earned, as we exited this line of business, and, to a lesser extent, lower fee income from other areas of the business. The brokerage revenue increase is the result of higher excess of loss reinsurance spend from the reinsurance programs in place during 2019 as compared to 2018.

Expenses

Losses and LAE

Losses and LAE incurred, net of reinsurance, included the following for the periods presented:

	Year Ended December 31,			
	2019		2018	
	Amount	Net Loss Ratio	Amount	Net Loss Ratio
	(In thousands)			
Current accident year, excluding catastrophes:				
Homeowners	\$ 207,808	57.1 %	\$ 189,567	53.4 %
Non-core (1)	1,601	0.4 %	10,066	2.8 %
Total current accident year, excluding catastrophes	<u>209,409</u>	<u>57.5 %</u>	<u>199,633</u>	<u>56.2 %</u>
Current year catastrophes (2):				
Florida	26,250	7.4 %	27,500	7.8 %
Texas	12,400	3.4 %	—	— %
Louisiana	8,900	2.4 %	—	— %
Other states	5,150	1.4 %	4,000	1.1 %
Total current year catastrophes	<u>52,700</u>	<u>14.6 %</u>	<u>31,500</u>	<u>8.9 %</u>
Prior year loss development (redundancy):				
Homeowners	615	0.2 %	(7,576)	(2.1)%
Non-core (1)	12,845	3.5 %	9,742	2.7 %
Ceded losses subject to offsetting experience account adjustments (3)	(2,489)	(0.7)%	(4,883)	(1.4)%
Total prior year loss development (redundancy)	<u>10,971</u>	<u>3.0 %</u>	<u>(2,717)</u>	<u>(0.8)%</u>
Total net losses and LAE	<u>\$ 273,080</u>	<u>75.1 %</u>	<u>\$ 228,416</u>	<u>64.3 %</u>

(1) Reflects exited lines of business.

- (2) Includes PCS weather events and other events impacting multiple insureds for which the Company's insurance carriers established catastrophe event codes, net of the benefit of claims handling services. These catastrophe events are typically wind, hail and tornado related weather events. Any individual catastrophe event with gross losses greater than \$20 million, on a pre-tax basis, are considered significant and specifically addressed in the commentary below.
- (3) Reflects homeowners losses ceded under retrospective reinsurance treaties to the extent there is an offsetting experience account adjustment, such that there is no impact on pre-tax net income (loss).

Losses and LAE increased \$44.7 million, or 19.6%, to \$273.1 million for the year ended December 31, 2019, as compared to \$228.4 million for the year ended December 31, 2018. The net loss ratio increased 10.8 percentage points, to 75.1% in 2019, as compared to 64.3% in 2018. The higher ratio was primarily the result of higher catastrophe net losses when comparing the periods, as 2019 included \$52.7 million, net of reinsurance (of which \$26.5 million was from FNIC's non-Florida losses that are subject to a 50% profit-sharing agreement), as compared to \$31.5 million, net of reinsurance, from 2018 catastrophe events, which is discussed below.

Also contributing to the higher loss ratio was prior year net development of \$11.0 million during 2019, as compared to prior year net redundancy of \$2.7 million in 2018. Additionally, we increased the current accident year loss and LAE selection for our homeowners Florida line of business in response to higher severity trends from AOB and the overall litigation environment in Florida. The 2019 prior year net development was driven primarily by our exited non-core lines of business, personal automobile and commercial general liability. The 2018 prior year net redundancy was driven by a combination of favorable net redundancy from lower LAE expenses, primarily associated with Hurricane Irma, and ceded losses related to the retrospective reinsurance treaties, mostly offset by unfavorable net development from our exited non-core personal automobile line of business.

Commissions and Other Underwriting Expenses

The following table sets forth commissions and other underwriting expenses for the periods presented:

	Year Ended December 31,	
	2019	2018
	(In thousands)	
Commissions and other underwriting expenses:		
Homeowners Florida	\$ 52,962	\$ 56,693
All others	25,491	19,948
Ceding commissions	(12,128)	(12,743)
Total commissions and other fees	<u>66,325</u>	<u>63,898</u>
Fees	3,368	6,469
Salaries and wages	12,114	14,279
Other underwriting expenses	25,382	36,463
Total commissions and other underwriting expenses	<u>\$ 107,189</u>	<u>\$ 121,109</u>

Commissions and other underwriting expenses decreased \$13.9 million, or 11.5%, to \$107.2 million for the year ended December 31, 2019, as compared to \$121.1 million for the year ended December 31, 2018. The decrease is the result of lower profit share costs recorded within the other underwriting expenses account. As noted above, we have a 50% profit share agreement with our managing general underwriter on FNIC's non-Florida business, whereby we split 50% of the profits. Accordingly, in 2019, non-Florida incurred higher losses from severe weather events (as previously discussed in the Losses and Loss Adjustment Expenses section), resulting in a \$13.3 million reduction.

Additionally, the lower automobile fees and lower homeowners Florida commissions are driven by the corresponding change in premiums earned across periods. The decline in salaries and wages is due in part to our continued focus on operational efficiencies. These items are partially offset by an increase in homeowners non-Florida commissions and fees as a result of higher premiums earned across periods.

The net expense ratio decreased 4.4 percentage points to 35.9% in 2019, as compared to 40.3% in 2018. The decrease in the ratio is attributable to the lower non-Florida profit share expense and other expense reductions. Refer to the discussion above for more information.

General and Administrative Expenses

General and administrative expenses increased \$1.0 million, or 4.6%, to \$23.2 million for the year ended December 31, 2019, as compared to \$22.2 million for the year ended December 31, 2018. The increase was primarily the result of higher professional fees, including deal costs and due diligence costs relating to the acquisition of the Maison Companies, as previously discussed.

Interest Expense

Interest expense increased \$6.6 million to \$10.8 million for the year ended December 31, 2019, as compared to \$4.2 million for the year ended December 31, 2018. The increase in interest expense is the result of \$3.6 million of prepayment fees, including the write-off of remaining debt issuance costs, and an increase in the outstanding debt as a result of our first quarter 2019 borrowing. Refer to Notes 3 and 10 of the notes to our Consolidated Financial Statements included herein, for information regarding debt issued and debt retirement that occurred in March 2019.

Income Taxes

Income tax expense (benefit) decreased \$5.8 million, or 105.4%, to \$(0.3) million for the year ended December 31, 2019, as compared to \$5.5 million for the year ended December 31, 2018. The decrease in income tax expense is the result of lower income during 2019, compared to 2018. Additionally, in 2019, we recognized a benefit of \$0.4 million relating to an election to carry back capital losses and a benefit of \$0.2 million relating to a reduction in the uncertain tax position reserve. Lastly, the State of Florida announced a reduction in its state income tax rate effective January 1, 2019.

LIQUIDITY AND CAPITAL RESOURCES

Overview

Our primary sources of funds are gross written premiums, investment income, commission income and fee income. Our primary uses of funds are the payment of claims, catastrophe and other reinsurance premiums and operating expenses. As of December 31, 2020, the Company held \$102.4 million in cash and cash equivalents and \$491.4 million in investments. As of December 31, 2019, the Company held \$133.4 million in cash and cash equivalents and \$550.6 million in investments. Total shareholders' equity decreased \$90.5 million, to \$158.2 million as of December 31, 2020, as compared to \$248.7 million as of December 31, 2019, due primarily to our net loss in 2020 and repurchases of common stock executed early in 2020.

On March 5, 2019, the Company closed on an offering of \$100 million of Senior Unsecured Notes due 2029, which bear interest at the annual rate of 7.5%. The net proceeds of the offering were in part used to redeem all \$45 million of the Company's Senior Unsecured Fixed Rate Notes due 2022 and the Company's Senior Notes due 2027. Additionally, the remaining cash from the offering was used to purchase the Maison Companies and for other general corporate purposes, including repurchases of shares of our common stock and managing the capital needs of our subsidiaries. Refer to Notes 3 and 8 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for additional information regarding the 2029 Notes as well as the acquisition of the Maison Companies.

Among other things, the 2029 Notes contain customary covenants that limit the Company's ability to enter into certain operational and financial transactions, including, but not limited to incurring additional debt above certain thresholds. The Company's debt to capital ratio exceeds 35%; therefore, the Company is currently precluded from incurring additional debt (absent the consent of existing debt holders), repurchasing shares of our common stock or paying common stock dividends. No acceleration of the related debt is mandated due to the fact that catastrophic weather events drove the ratio over 35% rather than specific actions taken by the Company. The Company's actual debt to capital ratio as of December 31, 2020 was approximately 38.4%.

Historically, we have met our liquidity requirements primarily through cash generated from operations. During 2020, property and casualty businesses, including FNHC's insurance carriers, have been impacted by catastrophes, hail, and wind-related severe weather events and private reinsurers have tightened coverage provisions and raised the cost of their coverages. As a result, sales of our portfolio of fixed income securities was a significant source of liquidity for the Company during 2020. Quota-share reinsurance treaties are another liquidity management tool, via the ceding commission the Company receives upon inception and the related reduction to statutory surplus requirements. New quota-share treaties entered or increased during 2020 were responsive to these purposes, as well as to reduce the Company's exposure to non-named storm catastrophes.

On March 15, 2021, the Company closed an underwritten public offering of 3,500,000 shares of its common stock at a price of \$4.75 per share for gross proceeds of \$16.6 million. The offering generates net proceeds to the Company of approximately \$15.2 million,

after deducting the underwriter's discount and estimated offering expenses payable by the Company. The Company will use the net proceeds from this sale of the common stock for general corporate purposes, including to provide additional liquidity in its holding company to be available for future capital contributions to its insurance company subsidiaries, if necessary. This offering is part of our ongoing execution of the strategic review process initiated by the Company's Board of Directors announced in November 2020.

Management continually monitors and adjusts its liquidity and capital plans for FNHC and its subsidiaries in light of the aforementioned challenges to ensure that we have adequate liquidity and capital. Additional weather-related events and actions by reinsurers could adversely affect the Company's ability to access sources of liquidity, especially due to our elevated debt to capital ratio and debt covenants discussed above, which currently preclude us from incurring additional debt, absent the approval of existing debt holders.

Statutory Capital and Surplus of our Insurance Subsidiaries

As described more fully in Part I, Item 1. Business, Regulation of this Annual Report, our insurance operations are subject to the laws and regulations of the states in which we operate. The Florida OIR and their regulatory counterparts in other states utilize the National Association of Insurance Commissions ("NAIC") risk-based capital ("RBC") requirements, and the resulting RBC ratio, as a key metric in the exercise of their regulatory oversight. The RBC ratio is a measure of the sufficiency of an insurer's statutory capital and surplus. In addition, the RBC ratio is used by insurance industry ratings services in the determination of the financial strength ratings (i.e. claims paying ability) they assign to insurance companies. As of December 31, 2020, FNIC's statutory surplus, which includes MNIC, was \$105.9 million. As of December 31, 2020, MIC's statutory surplus was \$39.3 million.

Based upon the 2020, 2019 and 2018 statutory financial statements for FNIC, MIC and MNIC, statutory surplus exceeded the regulatory action levels established by the NAIC's RBC requirements.

Based on RBC requirements, the extent of regulatory intervention and action increases as the ratio of an insurer's statutory surplus to its 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% 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% 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% of the ACL amount. FNIC's ratio of statutory surplus to its ACL was 303% and 324% as of December 31, 2020 and 2019, respectively. MNIC's ratio of statutory surplus to its ACL was 736% and 1,129% as of December 31, 2020 and 2019, respectively. MIC's ratio of statutory surplus to its ACL was 348% and 306% as of December 31, 2020 and 2019, respectively.

As of December 31, 2020, the Company has \$59 million of liquidity in its holding company and non-regulated subsidiaries (collectively referred to "holding company liquidity") that is available for general corporate purposes, including supporting the capital requirements of its insurance subsidiaries, which the RBC levels are above 300%.

Refer to "Part I, Item 1A., Risk Factors" for more information on how over time, additional weather-related events and actions by reinsurers could adversely affect the Company's insurance carriers' ability to maintain adequate capital levels or FNHC's ability to contribute necessary capital.

Cash Flows Discussion

We currently believe that existing cash and investment balances, when combined with anticipated cash flows, will be adequate to meet our expected liquidity needs in both the short-term and the reasonably foreseeable future. We currently believe the combined balances will be sufficient to meet our ongoing operating requirements and anticipated cash needs. Future growth strategies may require additional 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 the terms of any such financing would not negatively impact our results of operations. Under the terms of our senior note indenture, we are currently precluded from incurring additional debt, repurchasing shares of our common stock or paying common stock dividends.

Operating Activities

Net cash (used in) operating activities decreased to \$(91.9) million for the year ended December 31, 2020 compared to net cash provided of \$35.3 million for the year ended December 31, 2019. This decrease reflects higher expenses paid, including those related

to commissions and underwriting expenses and losses and LAE, including higher net catastrophe losses, in the year ended December 31, 2020, as compared to prior year.

Net cash provided by operating activities increased to \$35.3 million for the year ended December 31, 2019 from \$30.3 million for the year ended December 31, 2018. This increase reflects higher premiums collected, partially offset by higher expenses paid, including those related to losses and LAE in the year ended December 31, 2019, as compared to the year ended December 31, 2018.

Investing Activities

Net cash provided by (used in) investing activities was \$76.4 million for the year ended December 31, 2020, as compared to \$(9.0) million for the year ended December 31, 2019. The change was due to higher proceeds from sales of debt and equity securities of \$578.5 million for the year ended December 31, 2020, as compared to \$173.4 million for the year ended December 31, 2019 and higher maturities and redemptions of debt securities of \$86.8 million for 2020, as compared to \$43.9 million for the year ended 2019. This was partially offset by higher purchases of debt and equity securities of \$585.6 million for the year ended December 31, 2020, as compared to \$234.7 million for the year ended December 31, 2019. The net sales of our fixed income portfolio during 2020 stemmed directly from the higher net catastrophe losses experienced in 2020.

Net cash provided by (used in) investing activities was \$(9.0) million for the year ended December 31, 2019, as compared to \$(21.2) million for the year ended December 31, 2018. The change was due to lower purchases of debt and equity securities of \$234.7 million for the year ended December 31, 2019, as compared to \$351.3 million for the year ended December 31, 2018 and net cash acquired from the acquisition of the Maison Companies of \$10.4 million in 2019. This was partially offset by lower proceeds from sales of debt and equity securities of \$173.4 million for the year ended December 31, 2019, as compared to \$239.4 million for the year ended December 31, 2018 and lower maturities and redemptions of debt securities of \$43.9 million during 2019, as compared to \$92.7 million during 2018.

Financing Activities

Net cash provided by (used in) financing activities was \$(15.5) million for the year ended December 31, 2020, as compared to net cash provided by \$42.6 million for the year ended December 31, 2019. The change was primarily due to proceeds from issuance of long-term debt of \$98.4 million for the year ended December 31, 2019 and repurchases of FedNat common stock of \$10.4 million in 2020, as compared to \$3.4 million in 2019. These changes were partially offset by payment of long-term debt of \$48.0 million for the year ended December 31, 2019.

Net cash provided by (used in) financing activities was \$42.6 million for the year ended December 31, 2019, as compared to net cash (used) of \$(30.9) million for the year ended December 31, 2018. The change was primarily due to proceeds from issuance of long-term debt of \$98.4 million for the year ended December 31, 2019, and the purchase of non-controlling interest of \$16.7 million for the year ended December 31, 2018. These changes were partially offset by payment of long-term debt of \$48.0 million for the year ended December 31, 2019 as compared to payment of \$5.0 million during 2018.

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

The table sets forth a summary of long-term contractual obligations as of December 31, 2020, and includes amounts that represent estimates of gross undiscounted amounts payable over time, as follows:

	Payments Due By Period				
	Total	Less than 1 Year	1 - 3 Years	3 - 5 Years	More than 5 Years
	(In thousands)				
Loss and loss adjustment expense reserves (1)	\$ 540,367	\$ 318,817	\$ 162,110	\$ 32,422	\$ 27,018
Long-term debt (2)	100,000	—	—	—	100,000
Operating leases	8,892	1,066	2,229	2,279	3,318
Total long-term contractual obligations	<u>\$ 649,259</u>	<u>\$ 319,883</u>	<u>\$ 164,339</u>	<u>\$ 34,701</u>	<u>\$ 130,336</u>

- (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.
- (2) Represents the principal amounts of debt only. See Note 10 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report for additional information.

CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States ("GAAP"), which requires us 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 may materially differ from those estimates.

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 and value of business acquired; (vi) goodwill and other intangible assets; (vii) reserve for loss and losses adjustment expenses; and (viii) income taxes. The accounting estimates 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

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 pay 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. Refer to Note 4 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report for additional information.

Investments

Investments consist of debt and equity securities. Debt securities consist of securities with an initial fixed maturity of more than three months, including 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 debt securities are recorded at the amortized cost, reflecting the ability and intent to hold the securities to maturity. All other debt securities are 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 (loss) as a separate component of shareholders' equity until realized. Prior to January 1, 2020, if a decline in fair value was deemed to be other-than-temporary, the investment was 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 operations. As the result of the adoption of Accounting Standards Update ("ASU") 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instrument* ("ASU 2016-13") beginning on January 1, 2020, we instead record an allowance for credit loss. Refer to Note 7 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report for additional information regarding allowances for credit loss. Any portion of the market decline related to debt securities that is believed to arise from factors other than credit is recorded as a component of other comprehensive income (loss) rather than against income. Equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) are measured at fair value with changes in fair value recognized in net income (loss).

When we invest in certain companies, such as limited partnerships and limited liability companies, and if we determine we are not the primary beneficiary, we account for them using the equity method to determine the carry value, which is included in other assets on our Consolidated Balance Sheets. Our maximum exposure to loss is limited to the capital we invest.

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.

Refer to Note 5 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report for additional information regarding investments.

Premiums and Unearned Premiums

We recognize premiums 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. Refer to Note 7 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report for additional information allowances for credit loss.

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. Refer to Note 7 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report for additional information regarding allowances for credit loss.

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 losses and LAE 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 and Value of Business Acquired

Deferred acquisition costs represent those costs that are incremental and directly related to the successful acquisition of new or renewal of existing insurance contracts. We defer incremental costs that result directly from, and are essential to, the acquisition or renewal of an insurance contract. Such deferred acquisition costs generally include agent or broker commissions, referral fees, 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.

We also defer 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 twelve months. Deferred acquisition cost balances are 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 deferred acquisition costs. We assess the recoverability of deferred acquisition costs on an annual basis or more frequently if circumstances indicate impairment may have occurred.

Value of business acquired ("VOBA") is an asset that reflects the estimated fair value of in-force contracts in an acquisition and represents the portion of the purchase price that is allocated to the value of the right to receive future cash flows from the business in-force at the acquisition date. VOBA is amortized over the period in which the related premiums written are earned, generally twelve months or less for property insurance business. VOBA amortization is reported within commissions and other underwriting expenses on our consolidated statements of operations. VOBA is reviewed to ensure that the unamortized portion does not exceed the expected recoverable amount as of October 1, each year, and more frequently if circumstances indicate impairment may have occurred.

Goodwill and Other Intangible Assets

Goodwill and identifiable intangible assets with indefinite lives are not amortized but are reviewed for impairment annually as of October 1 and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value below its associated carrying value. Identifiable intangibles that do not have indefinite lives are amortized on a straight-line basis over their estimated useful lives.

When we perform a quantitative goodwill impairment test, the fair value of the reporting unit, which we define as consolidated FNHC, is determined and compared to its carrying value. If the carrying value of the reporting unit is greater than the reporting unit's fair value, goodwill is impaired and written down to the reporting unit's fair value; and a charge is reported in impairment of intangibles on our consolidated statements of operations. The fair value of our reporting unit is comprised of the value of in-force (i.e., existing) business and the value of new business. To determine the value of in-force and new business, we use a discounted cash flows technique that applies a discount rate reflecting the market expected, weighted-average rate of return adjusted for the risk factors associated with operations to the projected future cash flow for our reporting unit.

For identifiable intangible assets, if there is an indication of impairment, then the discounted cash flow method would be used to measure the impairment, and the carrying value would be adjusted as necessary.

We apply significant judgment when determining the estimated fair values discussed above. Factors that can influence these values include any items that can directly or indirectly affect future production levels, profitability and cash flows. Examples of unfavorable changes to assumptions or factors that could result in future impairment include, but are not limited to, the following:

- Lower expectations for future production levels or future profitability;
- Higher discount rates;

- Customer acceptance, capital market, legislative, regulatory or tax changes that affect the cost of, or demand for, our products, the required amount of reserves and/or surplus, or otherwise affect our ability to conduct business, including changes to statutory reserve requirements or changes to RBC requirements; and
- Valuations of significant mergers or acquisitions of companies or blocks of business that would provide relevant market-based inputs for our impairment assessment that could support less favorable conclusions regarding the estimated fair value of our reporting unit.

Estimates of fair value are inherently uncertain and represent only management's reasonable expectation regarding future developments.

Coinciding with the preparation of the financial statements for the year ended December 31, 2020, the Company's annual goodwill impairment testing has resulted in the conclusion that the goodwill intangible asset established in conjunction with the acquisition of the Maison Companies in December 2019 is impaired. Therefore, during the fourth quarter of 2020, we recorded a non-cash impairment charge of \$11.0 million, against which there is no tax offset, representing the write-off of the full amount of our goodwill asset. The Company's impairment analysis considered the earnings and share price of the Company and comparable companies, as well as projected cash flows. Continued adverse storm activity, higher excess of loss catastrophe reinsurance costs and the continued unfavorable claims environment in the state of Florida reduced the previously modeled fair value of the Company. These impacts, along with other information relevant to the estimated fair value of the Company, including the trading price of our shares, resulted in the impairment conclusion.

Correspondingly, effective as of October 1, 2020, we believed there was an indication of impairment for our identifiable intangible assets, therefore we performed a discounted cash flow method to measure and record a non-cash impairment of \$0.7 million, due primarily to a higher discount rate, which lowered the fair value below carrying value.

Refer to Note 8 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for additional information related to our goodwill and identifiable intangible assets.

Losses and Loss Adjustment Expenses

Overview

The estimation of the liability for unpaid losses 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 losses 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 losses 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 losses 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.

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 losses 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 losses 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 losses and LAE established by our insurance companies are adequate as of December 31, 2020; 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 losses 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
- *Bornbuetter-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 losses 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 losses 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 based on current information that differed from previous assumptions made at the time such loss and LAE reserves were previously estimated.

Refer to Note 1 and Note 9 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for additional information regarding our losses 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 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. Refer to Note 11 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for additional information regarding our income taxes.

Recent Accounting Pronouncements

Refer to Note 2 of the notes to our Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data of this Annual Report, for a discussion of recent accounting pronouncements and their effect, if any, on our company.

Off-Balance Sheet Transactions

For the years ended December 31, 2020 and 2019, we did not have any off balance sheet transactions.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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, 2020, approximately 99% 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. Our 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.

Principal cash flows and the related weighted average interest rate by expected maturity date, based upon par values, for the financial instruments sensitive to changes in interest rates, includes the following:

	2021	2022	2023	2024	2025	Thereafter	Total	Carrying Amount
	(Dollars in thousands)							
Principal amount by expected maturity:								
United States government obligations and authorities	\$ 9,473	\$ 13,345	\$ 6,100	\$ 200	\$ 3,850	\$ 4,155	\$ 37,123	\$ 38,512
Obligations of states and political subdivisions	755	3,525	1,135	995	3,605	10,940	20,955	22,264
Corporate	15,039	38,604	21,554	16,783	27,876	91,018	210,874	228,717
International	2,098	8,764	1,465	6,099	300	7,122	25,848	27,643
Collateralized mortgage obligations	3,746	7,025	46,706	32,259	30,721	39,936	160,393	171,074
Total investments	<u>\$ 31,111</u>	<u>\$ 71,263</u>	<u>\$ 76,960</u>	<u>\$ 56,336</u>	<u>\$ 66,352</u>	<u>\$ 153,171</u>	<u>\$ 455,193</u>	<u>\$ 488,210</u>
Weighted average interest rate by expected maturity:								
United States government obligations and authorities	2.67 %	1.58 %	2.47 %	2.50 %	1.45 %	0.77 %	1.90 %	
Obligations of states and political subdivisions	2.08 %	3.57 %	2.98 %	3.10 %	2.02 %	2.69 %	2.74 %	
Corporate securities	2.54 %	2.82 %	3.32 %	3.34 %	2.82 %	3.34 %	3.11 %	
International securities	2.08 %	2.07 %	4.04 %	2.25 %	2.85 %	4.07 %	2.79 %	
Collateralized mortgage obligations	3.47 %	3.14 %	3.33 %	3.77 %	2.68 %	2.62 %	3.11 %	
Total investments	2.65 %	2.56 %	3.26 %	3.46 %	2.63 %	3.07 %	2.98 %	

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	<u>PAGE</u>
Report of Independent Registered Public Accounting Firm	51
Consolidated Balance Sheets as of December 31, 2020 and 2019	53
Consolidated Statements of Operations For the Years Ended December 31, 2020, 2019 and 2018	54
Consolidated Statements of Comprehensive Income (Loss) For the Years Ended December 31, 2020, 2019 and 2018	55
Consolidated Statements of Changes in Shareholders' Equity For the Years Ended December 31, 2020, 2019 and 2018	56
Consolidated Statements of Cash Flows For the Years Ended December 31, 2020, 2019 and 2018	57
Notes to Consolidated Financial Statements	59

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of
FedNat Holding Company

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of FedNat Holding Company and subsidiaries (the "Company") as of December 31, 2020 and 2019, the related consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2020, and the related notes and the financial statement schedules listed in the index at Item 15 (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2020, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2020, 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 29, 2021 expressed an adverse opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Valuation of incurred but not reported reserves

Description of the Matter

At December 31, 2020, the Company's reserve for losses and loss adjustment expense ("LAE") balance was \$540.4 million of which a significant portion is incurred but not reported reserves ("IBNR"). The carrying amount represents management's best estimate of the ultimate liability, which in turn is composed of the Company's assessment of claims pending and the development of prior years' loss liability, including liabilities based upon individual case estimates for reported losses and LAE and estimates of IBNR. As described in Note 9 of the consolidated financial statements, the establishment of loss reserves is an inherently uncertain process and there is significant uncertainty in determining management's best estimate of the ultimate liability which is used to determine the IBNR reserves. In particular, the estimate is subject to a number of variables including loss frequency and severity, payment patterns, expected loss ratios and the weighting of the four actuarial methods used for each accident year and line of business.

Auditing management's best estimate of IBNR was complex due to the judgmental nature of the significant assumptions used in the valuation of the estimate. The significant judgment was primarily due to the sensitivity of management's estimate to the actuarial methods applied and the assumptions used in the determination of the loss factors and ultimate costs.

*How We Addressed
the Matter in Our
Audit*

We obtained an understanding, evaluated the design, and tested the operating effectiveness of controls over the process to estimate the IBNR reserves. This included, among others, controls over the review and approval processes that management has in place for the methods and assumptions used in estimating the IBNR reserves.

To test the IBNR reserves, our procedures included among others, the involvement of our actuarial specialists to assess the selection and the weighting of actuarial methods used by management with those methods and weightings used in prior periods and those used in the industry. Additionally, to evaluate the significant assumptions used in the actuarial methods, we compared the significant assumptions, including severity, frequency, payment patterns and expected loss ratios to factors historically used. We performed a review of historical results of the development of the loss and loss adjustment expense reserves related to prior years. We also independently calculated a range of reasonable reserve estimates and compared the range of reasonable reserve estimates to management's recorded best estimate and performed a review of the historical results of the development of the estimate

Reinsurance

*Description of the
Matter*

At December 31, 2020, the Company's reinsurance recoverable, net of allowance, was \$413.0 million. As discussed in Note 6 to the consolidated financial statements, during 2020 the Company expanded its reinsurance program that provides quota share and excess of loss coverage for the risks inherent in the business written and the concentration of the Company's exposure in certain geographies. Certain of these reinsurance arrangements are complex as they contain risk limiting provisions. To qualify as reinsurance for accounting purposes, a contract must embody substantive risk transfer, which is defined as the reasonable possibility that the reinsurer could experience a significant loss on the treaty.

Auditing the reinsurance arrangements was complex due to contractual provisions in certain of the reinsurance arrangements that limit the extent or timing of the net loss that the reinsurers can experience and the judgmental nature of the significant assumptions included in the assessment to determine risk transfer.

*How We Addressed
the Matter in Our
Audit*

We obtained an understanding, evaluated the design, and tested the operating effectiveness of the controls over the reinsurance process including, among others and controls related to assessing risk transfer.

Our audit procedures included, among others, gaining an understanding of the terms of the reinsurance agreements with the counterparties and evaluating management's risk transfer assessment.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 2015.

Charlotte, North Carolina
March 29, 2021

FEDNAT HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	December 31,	
	2020	2019
ASSETS		
Investments:		
Debt securities, available-for-sale, at fair value (amortized cost of \$473,126 and \$512,645, respectively)	\$ 488,210	\$ 526,265
Debt securities, held-to-maturity, at amortized cost	—	4,337
Equity securities, at fair value	3,157	20,039
Total investments	491,367	550,641
Cash and cash equivalents	102,367	133,361
Prepaid reinsurance premiums	278,272	145,659
Premiums receivable, net of allowance of \$233 and \$159, respectively	50,803	41,422
Reinsurance recoverable, net of allowance of \$65 and \$0, respectively	413,026	209,615
Deferred acquisition costs and value of business acquired, net	25,405	56,136
Current and deferred income taxes, net	35,035	2,552
Goodwill	—	10,997
Other assets	32,262	28,633
Total assets	<u>\$ 1,428,537</u>	<u>\$ 1,179,016</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Loss and loss adjustment expense reserves	\$ 540,367	\$ 324,362
Unearned premiums	366,789	360,870
Reinsurance payable and funds withheld liabilities	202,827	102,467
Long-term debt, net of deferred financing costs of \$1,317 and \$1,478, respectively	98,683	98,522
Deferred revenue	7,187	6,856
Other liabilities	54,524	37,246
Total liabilities	<u>1,270,377</u>	<u>930,323</u>
Commitments and contingencies (see Note 12)		
Shareholders' Equity		
Preferred stock, \$0.01 par value: 1,000,000 shares authorized	—	—
Common stock, \$0.01 par value: 25,000,000 shares authorized; 13,717,908 and 14,414,821 shares issued and outstanding, respectively	137	144
Additional paid-in capital	169,298	167,677
Accumulated other comprehensive income (loss)	11,386	10,281
Retained earnings (deficit)	(22,661)	70,591
Total shareholders' equity	<u>158,160</u>	<u>248,693</u>
Total liabilities and shareholders' equity	<u>\$ 1,428,537</u>	<u>\$ 1,179,016</u>

The accompanying notes are an integral part of the consolidated financial statements.

FEDNAT HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)

	Year Ended December 31,		
	2020	2019	2018
Revenues:			
Net premiums earned	\$ 364,134	\$ 363,652	\$ 355,257
Net investment income	11,786	15,901	12,460
Net realized and unrealized investment gains (losses)	18,032	7,084	(4,144)
Direct written policy fees	13,970	10,200	13,366
Other income	23,941	18,124	19,154
Total revenues	<u>431,863</u>	<u>414,961</u>	<u>396,093</u>
Costs and expenses:			
Losses and loss adjustment expenses	376,449	273,080	228,416
Commissions and other underwriting expenses	124,288	107,189	121,109
General and administrative expenses	23,420	23,203	22,183
Interest expense	7,661	10,776	4,177
Impairment of intangibles	11,699	—	—
Total costs and expenses	<u>543,517</u>	<u>414,248</u>	<u>375,885</u>
Income (loss) before income taxes	(111,654)	713	20,208
Income tax expense (benefit)	(33,496)	(298)	5,498
Net income (loss)	(78,158)	1,011	14,710
Net income (loss) attributable to non-controlling interest	—	—	(218)
Net income (loss) attributable to FedNat Holding Company shareholders	<u>\$ (78,158)</u>	<u>\$ 1,011</u>	<u>\$ 14,928</u>
Net Income (Loss) Per Common Share			
Basic	\$ (5.64)	\$ 0.08	\$ 1.17
Diluted	(5.64)	0.08	1.16
Weighted Average Number of Shares of Common Stock Outstanding			
Basic	13,846	12,977	12,775
Diluted	13,846	13,023	12,867
Dividends Declared Per Common Share	\$ 0.36	\$ 0.33	\$ 0.24

The accompanying notes are an integral part of the consolidated financial statements.

FEDNAT HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)

	Year Ended December 31,		
	2020	2019	2018
Net income (loss)	\$ (78,158)	\$ 1,011	\$ 14,710
Change in net unrealized gains (losses) on investments, available-for-sale, net of tax	1,105	14,031	(5,444)
Comprehensive income (loss)	(77,053)	15,042	9,266
Less: comprehensive income (loss) attributable to non-controlling interest, net of tax	—	—	(447)
Comprehensive income (loss) attributable to FedNat Holding Company shareholders	<u>\$ (77,053)</u>	<u>\$ 15,042</u>	<u>\$ 9,713</u>

The accompanying notes are an integral part of the consolidated financial statements.

FEDNAT HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(In thousands, except per share data)

	Preferred Stock	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Total Shareholders' Equity Attributable to		Total Shareholders' Equity
		Issued Shares	Amount				FedNat Holding Company Shareholders	Non- Controlling Interest	
Balance as of January 1, 2018	\$ —	12,988,247	\$ 130	\$ 139,728	\$ 1,770	\$ 70,009	\$ 211,637	15,822	\$ 227,459
Cumulative effect of new accounting standards	—	—	—	—	(994)	994	—	—	—
Net income (loss)	—	—	—	—	—	14,928	14,928	(218)	14,710
Other comprehensive income (loss)	—	—	—	—	(4,221)	—	(4,221)	(229)	(4,450)
Dividends declared	—	—	—	—	—	(3,120)	(3,120)	—	(3,120)
Acquisition of non-controlling interest	—	—	—	(1,005)	(305)	—	(1,310)	(15,375)	(16,685)
Shares issued under share-based compensation plans	—	122,905	1	38	—	—	39	—	39
Repurchases of common stock	—	(326,708)	(3)	—	—	(5,058)	(5,061)	—	(5,061)
Share-based compensation	—	—	—	2,367	—	—	2,367	—	2,367
Balance as of December 31, 2018	—	12,784,444	128	141,128	(3,750)	77,753	215,259	—	215,259
Net income (loss)	—	—	—	—	—	1,011	1,011	—	1,011
Other comprehensive income (loss)	—	—	—	—	14,031	—	14,031	—	14,031
Dividends declared	—	—	—	—	—	(4,309)	(4,309)	—	(4,309)
Shares issued for acquisition	—	1,773,102	18	24,373	—	—	24,391	—	24,391
Shares issued under share-based compensation plans	—	94,922	1	—	—	—	1	—	1
Repurchases of common stock	—	(237,647)	(3)	—	—	(3,864)	(3,867)	—	(3,867)
Share-based compensation	—	—	—	2,176	—	—	2,176	—	2,176
Balance as of December 31, 2019	—	14,414,821	144	167,677	10,281	70,591	248,693	—	248,693
Net income (loss)	—	—	—	—	—	(78,158)	(78,158)	—	(78,158)
Other comprehensive income (loss)	—	—	—	—	1,105	—	1,105	—	1,105
Dividends declared	—	—	—	—	—	(5,077)	(5,077)	—	(5,077)
Cumulative effect of new accounting standards	—	—	—	—	—	(25)	(25)	—	(25)
Shares issued under share-based compensation plans	—	103,322	1	41	—	—	42	—	42
Repurchases of common stock	—	(800,235)	(8)	—	—	(9,992)	(10,000)	—	(10,000)
Share-based compensation	—	—	—	1,580	—	—	1,580	—	1,580
Balance as of December 31, 2020	—	13,717,908	\$ 137	\$ 169,298	\$ 11,386	\$ (22,661)	\$ 158,160	\$ —	\$ 158,160

The accompanying notes are an integral part of the consolidated financial statements.

FEDNAT HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2020	2019	2018
Cash flow from operating activities:			
Net income (loss)	\$ (78,158)	\$ 1,011	\$ 14,710
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Net realized and unrealized investment (gains) losses	(18,032)	(7,084)	4,144
Impairment of intangibles	11,699	—	—
Loss (gain) on early extinguishment of debt	—	3,575	—
Amortization of investment premium or discount, net	3,740	916	1,546
Depreciation and amortization	1,904	1,477	1,385
Share-based compensation	1,580	2,176	2,367
Changes in operating assets and liabilities:			
Prepaid reinsurance premiums	(132,613)	(11,803)	26,915
Premiums receivable, net	(9,381)	(8,654)	16,602
Reinsurance recoverable, net	(203,443)	9,412	(86,823)
Deferred acquisition costs and value of business acquired, net	30,731	(7,979)	1,457
Current and deferred income taxes, net	(32,835)	(3,723)	6,109
Deferred revenue	331	756	(1,637)
Loss and loss adjustment expense reserves	216,005	11,472	65,715
Unearned premiums	5,919	28,365	(12,431)
Reinsurance payable and funds withheld liabilities	100,360	14,797	(8,345)
Other	10,285	602	(1,444)
Net cash provided by (used in) operating activities	<u>(91,908)</u>	<u>35,316</u>	<u>30,270</u>
Cash flow from investing activities:			
Proceeds from sales of equity securities	22,050	9,203	10,639
Proceeds from sales of debt securities	556,463	164,196	228,777
Purchases of equity securities	(4,727)	(6,565)	(13,542)
Purchases of debt securities	(580,876)	(228,132)	(337,776)
Maturities and redemptions of debt securities	86,814	43,925	92,744
Payment for acquisition, net of cash acquired	—	10,402	—
Purchases of property and equipment	(3,357)	(2,040)	(2,026)
Net cash provided by (used in) investing activities	<u>76,367</u>	<u>(9,011)</u>	<u>(21,184)</u>
Cash flow from financing activities:			
Proceeds from issuance of long-term debt, net of issuance costs	—	98,390	—
Payment of long-term debt and prepayment penalties	—	(48,000)	(5,000)
Purchase of non-controlling interest	—	—	(16,685)
Purchases of FedNat Holding Company common stock	(10,418)	(3,449)	(5,061)
Issuance of common stock for share-based awards	42	1	39
Dividends paid	(5,077)	(4,309)	(4,184)
Net cash provided by (used in) financing activities	<u>(15,453)</u>	<u>42,633</u>	<u>(30,891)</u>
Net increase (decrease) in cash and cash equivalents	(30,994)	68,938	(21,805)
Cash and cash equivalents at beginning-of-period	133,361	64,423	86,228
Cash and cash equivalents at end-of-period	<u>\$ 102,367</u>	<u>\$ 133,361</u>	<u>\$ 64,423</u>

The accompanying notes are an integral part of the consolidated financial statements.

FEDNAT HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(In thousands)

	Year Ended December 31,		
	2020	2019	2018
Supplemental disclosure of cash flow information:			
Cash paid (received) during the period for interest	\$ 7,500	\$ 4,860	\$ 4,266
Cash paid (received) during the period for income taxes	(635)	3,504	(1,104)
Significant non-cash investing and financing transactions:			
Right-of-use asset	(7,430)	(8,096)	—
Lease liability	7,430	8,096	—

The accompanying notes are an integral part of the consolidated financial statements.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2020

1. ORGANIZATION, CONSOLIDATION AND BASIS OF PRESENTATION

Organization

FedNat Holding Company (“FNHC,” the “Company,” “we,” “us,” or “our”) is a regional insurance holding company that controls substantially all aspects of the insurance underwriting, distribution and claims processes through our subsidiaries and contractual relationships with independent agents and general agents. We, through our wholly owned subsidiaries, are authorized to underwrite and/or place homeowners multi-peril (“homeowners”), federal flood and other lines of insurance in Florida and other states. We market, distribute and service our own and third-party insurers’ products and other services through a network of independent and general agents.

FedNat Insurance Company (“FNIC”), our largest wholly owned insurance subsidiary, is licensed as an admitted carrier to write homeowners property and casualty insurance by the state’s insurance departments in Florida, Louisiana, Texas, Georgia, South Carolina, Alabama and Mississippi.

Maison Insurance Company (“MIC”), an insurance subsidiary, is licensed as an admitted carrier to write homeowners property and casualty insurance as well as wind/hail-only exposures by the state’s insurance departments in Louisiana, Texas and Florida.

Monarch National Insurance Company (“MNIC”), an insurance subsidiary, is licensed as an admitted carrier to write homeowners property and casualty insurance in Florida.

Material Distribution Relationships

Ivantage Select Agency, Inc.

The Company is a party to an insurance agency master agreement with Ivantage Select Agency, Inc. (“ISA”), an affiliate of Allstate Insurance Company (“Allstate”), pursuant to which the Company has been authorized by ISA to appoint Allstate agents to offer our FNIC homeowners insurance products to consumers in Florida. As a percentage of the total homeowners premiums we underwrote, 20.7%, 23.2% and 23.8%, were from Allstate’s network of Florida agents, for the years ended December 31, 2020, 2019 and 2018, respectively.

SageSure Insurance Managers, LLC

The Company is a party to a managing general underwriting agreement with SageSure Insurance Managers, LLC (“SageSure”) to facilitate growth in our FNIC homeowners business outside of Florida. As a percentage of the total homeowners premiums, 25.5%, 23.1% and 15.0% of the Company’s premiums were underwritten by SageSure, for the years ended December 31, 2020, 2019, and 2018, respectively. As part of our partnership with SageSure, previously we entered into a profit share agreement, whereby we shared 50% of net profits of this line of business through June 30, 2020, as calculated per the terms of the agreement, subject to certain limitations, which included limits on the net losses that SageSure could realize. The limit was based on the amount of inception to date profits within the profit share agreement. In addition, refer to Note 6 for information regarding a fully collateralized quota-share treaty on this book of business that became effective July 1, 2020.

Basis of Presentation and Principles of Consolidation

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (“GAAP”). The consolidated financial statements include the accounts of FNHC and its wholly-owned subsidiaries and all entities in which the Company has a controlling financial interest and any variable interest entity (“VIE”) of which the Company is the primary beneficiary. The Company’s management believes the consolidated financial statements reflect all material adjustments, including normal recurring adjustments, necessary to fairly state the financial position, results of operations and cash flows of the Company for the periods presented. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company identifies a VIE as an entity that does not have sufficient equity to finance its own activities without additional financial support or where the equity investors lack certain characteristics of a controlling financial interest. The Company assesses its contractual, ownership or other interests in a VIE to determine if the Company’s interest participates in the variability the VIE was designed to absorb and pass onto variable interest holders. The Company performs an ongoing qualitative assessment of its variable interests in a VIE to determine whether the Company has a controlling financial interest and would therefore be considered the

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

primary beneficiary of the VIE. If the Company determines it is the primary beneficiary of a VIE, the Company consolidates the assets and liabilities of the VIE in its consolidated financial statements.

We completed our acquisition of MNIC in February 2018 by acquiring the membership interests in MNIC's indirect parent, Monarch Delaware Holdings LLC ("Monarch Delaware"), held by our joint venture partners. As such, the Company consolidated Monarch Delaware in its consolidated financial statements. In accordance with the accounting standard on consolidation, a primary beneficiary that acquires additional ownership of the previously controlled and consolidated subsidiaries is accounted for as an equity transaction and re-measurement of assets and liabilities of previously controlled and consolidated subsidiaries is not permitted. As a result, we accounted for this transaction by eliminating the carrying value of the non-controlling interest to reflect our 100% ownership interest in MNIC as of February 21, 2018. The difference between the consideration paid and the amount by which the non-controlling interest was eliminated has been recognized in additional paid-in capital. Following the closing, Monarch Delaware and Monarch Holdings were merged into MNIC.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PRACTICES

Accounting Estimates and Assumptions

The Company prepares the accompanying consolidated financial statements in accordance with GAAP, which 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 may materially differ from those estimates.

Similar to other property and casualty insurers, the Company's liability for loss and loss adjustment expenses ("LAE") 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, the Company believes that the liability and LAE reserve is adequate. The Company reviews and evaluates its estimates and assumptions regularly and makes adjustments, reflected in current operations, as necessary, on an ongoing basis.

Business Combinations

We use the acquisition method of accounting for all business combination transactions, and accordingly, recognize the fair values of assets acquired, liabilities assumed and any non-controlling interests in our consolidated financial statements. The allocation of fair values may be subject to adjustment after the initial allocation for up to a one-year period as more information becomes available relative to the fair values as of the acquisition date. The consolidated financial statements include the results of operations of any acquired company since the acquisition date.

Fair Value

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 pay 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. Refer to Note 4 below for additional information regarding fair value.

Investments

Investments consist of debt and equity securities. Debt securities consist of securities with an initial fixed maturity of more than three months, including 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.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Held-to-maturity debt securities are recorded at the amortized cost, reflecting the ability and intent to hold the securities to maturity. All other debt securities are 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 (loss) as a separate component of shareholders' equity. Prior to January 1, 2020, if a decline in fair value was deemed to be other-than-temporary, the investment was 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 operations. As the result of the adoption of Accounting Standards Update ("ASU") 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instrument* ("ASU 2016-13") beginning on January 1, 2020, we instead record an allowance for credit loss. Refer to Note 7 below for additional information regarding allowances for credit loss. Any portion of the market decline related to debt securities that is believed to arise from factors other than credit is recorded as a component of other comprehensive income (loss) rather than against income. Equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) are measured at fair value with changes in fair value recognized in net income (loss).

When we invest in certain companies, such as limited partnerships and limited liability companies, and if we determine we are not the primary beneficiary, we account for them using the equity method to determine the carry value, which is included in other assets on our Consolidated Balance Sheets. Our maximum exposure to loss is limited to the capital we invest.

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.

Refer to Note 5 below for additional information regarding investments.

Cash and Cash Equivalents

Cash and cash equivalents consist of all deposit or deposit in transit balances with a bank that are available for withdrawal. The Company considers all highly liquid investments with an original maturity of three months or less at the date of the purchase to be cash equivalents.

Premiums and Unearned Premiums

The Company recognizes premiums as revenue on a pro-rata basis over the term of the insurance policy.

Unearned premiums represent the portion of gross premiums written, related to the unexpired terms of such coverage.

Premium receivable balances, which include any outstanding receivable from the SageSure profit sharing agreement, 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. Refer to Note 7 below for additional information regarding allowances for credit loss.

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. Refer to Note 7 below for additional information regarding allowances for credit loss.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

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 and other underwriting expenses and ceded losses incurred reduce net losses and LAE 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 Company records adjustments to the premiums or ceding commission in the period that changes in the estimated losses are determined.

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. Reinsurance payable and funds withheld liabilities represents the unpaid reinsurance premiums or reinstatement premiums due to reinsurers, or in the case of certain reinsurance agreements amounts withheld as collateral by us.

Refer to Note 6 below for additional information regarding reinsurance.

Deferred Acquisition Costs and Value of Business Acquired

Deferred acquisition costs 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 deferred acquisition costs generally include agent or broker commissions, referral fees, 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 twelve months for homeowners policies. Deferred acquisition cost balances are 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 deferred acquisition costs. The Company assesses the recoverability of deferred acquisition costs on an annual basis or more frequently if circumstances indicate impairment may have occurred.

Value of business acquired ("VOBA") is an asset that reflects the estimated fair value of in-force contracts in an acquisition and represents the portion of the purchase price that is allocated to the value of the right to receive future cash flows from the business in-force at the acquisition date. VOBA is amortized over the period in which the related premiums written are earned, generally twelve months or less for property insurance business. VOBA amortization is reported within commissions and other underwriting expenses on our consolidated statements of operations. VOBA is reviewed to ensure that the unamortized portion does not exceed the expected recoverable amount as of October 1 and more frequently if circumstances indicate impairment may have occurred.

Goodwill

We recognize the excess of the purchase price, plus the fair value of any non-controlling interest in the acquiree, over the fair value of identifiable net assets acquired at the acquisition date as goodwill. Goodwill is not amortized but is reviewed for impairment annually as of October 1 and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. We perform a quantitative goodwill impairment test where the fair value of the reporting unit is determined and compared to the carrying value of the reporting unit. If the fair value of the reporting unit is greater than the reporting unit's carrying value, then the carrying value of the reporting unit is deemed to be recoverable. If the carrying value of the reporting unit is greater than the reporting unit's fair value, goodwill is impaired and written down to the reporting unit's fair value; and a charge is reported in impairment of intangibles on our consolidated statements of operations. Refer to Note 8 below for additional information regarding goodwill.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Other Assets

Other assets consist primarily of identifiable intangible assets, property and equipment owned, right-of-use assets for our long-term leases, receivables resulting from sales of securities that had not yet settled as of the balance sheet date and prepaid expenses.

Property and equipment is stated at cost, net of accumulated depreciation and amortization. Depreciation is calculated using a straight-line method over the estimated useful lives, ranging from 3 to 15 years. Repairs and maintenance are charged to expense as incurred.

The Company accounts for internal-use software development costs in accordance with accounting guidelines which state that software costs, including internal payroll costs, incurred in connection with the development or acquisition of software for internal use is charged to expense as incurred until the project enters the application development phase. Costs incurred in the application development phase are capitalized and are depreciated using the straight-line method over an estimated useful life of 3 years, beginning when the software is ready for use.

We recognize the estimated fair value of identifiable intangibles such as trade names and non-compete agreements acquired through a business combination at the acquisition date. Identifiable intangible assets are amortized on a straight-line basis over their identified useful life, if applicable. The carrying values of identifiable intangible assets are reviewed at least annually for indicators of impairment in value that are other-than-temporary, including unexpected or adverse changes in the following: the economic or competitive environments in which the company operates; profitability analysis; cash flow analysis; and the fair value of the relevant business operation. If there is an indication of impairment, then the discounted cash flow method would be used to measure the impairment, and the carrying value would be adjusted as necessary and reported in impairment of intangibles on our consolidated statements of operations. Refer to Note 8 below for additional information regarding identifiable intangible assets.

Direct Written Policy Fees

Policy fees represent a non-refundable application fee for insurance coverage. These policy fees are deferred over the related policy term in a manner consistent with how the related premiums are earned.

Other Income

Other income represents brokerage, commission related income from the Company's agency operations, fees generated from the exited personal automobile line of business as well as recognition of equity method investment results. Brokerage income is recognized over the term of the reinsurance period, typically one year. Commission income from agency operations are recognized up-front upon policy inception. In applying the equity method, the Company records its initial investment at cost, and subsequently increases or decreases the carrying amount of the investment by its proportionate share of the net earnings or losses with any dividends or distributions received are recorded as a decrease in the carrying value of the investment.

Losses and Loss Adjustment Expenses

The reserves for losses and LAE represent management's best estimate of the ultimate cost of all reported and unreported losses incurred through the balance sheet date. Such liabilities are determined based upon the Company's assessment of claims pending and the development of prior years' loss liability, including liabilities based upon individual case estimates for reported losses and LAE and estimates of such amounts that are incurred but not yet reported ("IBNR"). Changes in the estimated liability are charged or credited to operations as the losses and LAE are settled.

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, the Company 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 the results of operations in the period in which they are made and the liabilities may deviate substantially from prior estimates.

Refer to Note 9 below for additional information regarding reserves for losses and LAE.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Long-Term Debt, Net of Deferred Financing Costs

The Company records long-term debt, net in the consolidated balance sheets at carrying value.

The Company incurs specific incremental costs, other than those paid to lenders, in connection with the issuance of the Company's debt instruments. These deferred financing costs include loan origination costs, issue costs and other direct costs payable to third parties and are recorded as a direct deduction from the carrying value of the associated debt liability in the consolidated balance sheets, when the debt liability is recorded. The Company amortizes the deferred financing costs as interest expense over the term of the related debt using the effective interest method in the consolidated statements of operations.

Refer to Note 10 below for additional information regarding long-term debt.

Income Taxes

The Company applies the asset and liability method of accounting for income taxes. 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 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. The Company will establish a valuation allowance if management determines, based on available information, that it is more likely than not that deferred income tax assets will not be realized. Significant judgment is required in determining whether valuation allowances should be established and the amount of such allowances.

The Company's management makes assumptions, estimates and judgments, which are subject to change, in accounting for income taxes. The Company's management also considers events and transactions on an on-going basis and the laws enacted as of the Company's reporting date.

Refer to Note 11 below for further information regarding income taxes.

Share-Based Compensation

We expense the fair value of stock awards included in our stock incentive compensation plans. The Company grants awards and amortizes them on a straight-line over the vesting term using the straight-line basis for service awards and over successive one-year requisite service periods for performance based awards. For all restricted stock awards ("RSAs"), excluding grants based on relative total shareholder return ("TSR"), the fair value is determined based on the closing market price on the date of grant. For grants based on TSR, grant date fair value is determined using a Monte Carlo simulation and, unlike the performance condition awards, the expense is not reversed if the performance condition is not met. Non-employee directors are treated as employees for accounting purposes. The non-cash share-based compensation expense is reflected in commissions and other underwriting and general and administrative expense on our Consolidated Statements of Operations and is recognized as an increase to additional paid-in capital on our Consolidated Balance Sheets.

Basic and Diluted Net Income (Loss) per Share

Basic net income per share is computed by dividing net income available to common shareholders by the weighted average number of common shares, while diluted net income per share is computed by dividing net income available to common shareholders by the weighted average number of such common shares and dilutive share equivalents result from the assumed exercise of employee stock options and vesting of restricted common stock and are calculated using the treasury stock method.

Recently Issued Accounting Pronouncements, Adopted

In January 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-01, which addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. In February 2018, the FASB issued ASU 2018-03, *Technical Corrections and Improvements to Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. Most notably, the combined new guidance required 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

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

value recognized in net income. The Company adopted the guidance effective January 1, 2018, by reflecting a cumulative adjustment, which increased retained earnings (deficit) and decreased accumulated other comprehensive income (loss) by \$1.0 million. This adjustment represented the level of net unrealized gains and losses associated with our equity investments with readily determinable market values as of January 1, 2018. The adoption also resulted in the recognition of \$(1.2) million in our consolidated statements of operations and statements of comprehensive income (loss), which represented the change in net unrealized gains and losses on our equity securities for 2018. This new guidance increases our earnings volatility compared to the prior accounting rules.

In February 2018, the FASB issued ASU 2018-02, *Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The update allowed a reclassification from accumulated other comprehensive income (loss) to retained earnings (deficit) for stranded tax effects resulting from the Tax Cuts and Job Act of 2017 ("Tax Act"). Guidance had previously required the effect of a change in tax laws or rates on deferred tax balances to be reported in income from continuing operations in the accounting period that includes the period of enactment, even if the related income tax effects were originally charged or credited directly to accumulated other comprehensive income. The Company adopted the guidance effective January 1, 2018, by reflecting a cumulative effect adjustment to retained earnings (deficit) with an off-setting adjustment to accumulated other comprehensive income (loss) for less than \$0.1 million.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The update superseded the prior lease guidance in Topic 840, *Leases* and lessees were 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. Additionally, lessees are 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. The Company adopted the guidance effective January 1, 2019, by reflecting a \$6.1 million right-of-use asset, after-tax, and \$6.1 million lease liability, after-tax, on our consolidated balance sheets for our leases in existence as of that date. All of the Company's leases were classified as operating leases and we elected the practical expedient, therefore no adjustment to comparative prior periods presented have been made. The provisions of this ASU did not have an impact on our pattern of lease expense recognition on our consolidated statements of operations. Refer to Note 12 below for additional information regarding leases.

In June 2016, the FASB issued ASU 2016-13, which significantly changes the measurement of credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. The update requires entities to record allowances for available-for-sale debt securities rather than reduce the carrying amount, as currently performed under the other-than-temporary impairment ("OTTI") model. The update also requires enhanced disclosures for financial assets measured at amortized cost and available-for-sale debt securities to help the financial statement users better understand significant judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity's portfolio. The Company adopted the guidance effective January 1, 2020, by reflecting a cumulative effect adjustment of less than \$0.1 million, after-tax, which decreased retained earnings (deficit), held-to-maturity debt securities and reinsurance recoverable. Refer to Note 7 for additional information regarding allowances for credit loss.

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment*. ASU 2017-04 eliminated the requirement to perform Step 2 of the goodwill impairment test in favor of only applying a quantitative test (referred to in previous guidance as Step 1). As part of the quantitative test, the fair value of the reporting unit is compared with its carrying value, and an impairment charge is recognized when the carrying value exceeds the reporting unit's fair value. An entity still has the option to first perform a qualitative assessment of an individual reporting unit to determine if the quantitative assessment is necessary. The Company adopted the guidance effective January 1, 2020. Refer to Note 8 for information regarding our goodwill impairment assessment.

In August 2018, the FASB issued ASU 2018-15, *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. ASU 2018-15 requires a customer in a cloud computing arrangement that is a service contract to follow the internal-use software guidance in Accounting Standards Codification 350-40 to determine which implementation costs to defer and recognize as an asset. The Company adopted the guidance effective January 1, 2020, which did not have any impact on the Company's consolidated financial condition or results of operations.

Recently Issued Accounting Pronouncements, Not Yet Adopted

In January 2020, the FASB issued ASU 2020-1, *Accounting for Equity Securities and Equity Investments*, which clarifies the interaction between accounting standards related to equity securities (Topic 321), equity method investments (Topic 323), and certain derivatives (Topic 815). The update clarifies that an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting for the purposes of applying the measurement alternative in accordance with Topic 321 immediately before applying or upon discontinuing the equity method. The update is effective for interim and annual reporting periods beginning

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

after December 15, 2021, with early adoption permitted. The Company is in the early stage of evaluating the impact that the update will have on the Company's consolidated financial position or results of operations.

3. ACQUISITION

On December 2, 2019, the Company completed its acquisition of the insurance operations of 1347 Property Insurance Holdings, Inc. ("PIH"). Specifically, the Company purchased from PIH all of the outstanding equity of MIC, Maison Managers, Inc., and ClaimCor LLC (collectively, the "Maison Companies"). The Maison Companies provide multi-peril and wind/hail only coverage to personal residential dwellings and manufactured/mobile homes in Louisiana, Texas and Florida. The acquisition enables us to increase geographic diversification of our book of business outside Florida and generate additional business with operating synergies and general and administrative expense savings.

The purchase price was \$51.0 million, which includes \$25.5 million in cash and shares of the Company's common stock equal to \$25.5 million, which amounted to 1,773,102 shares of the Company's common stock. The number of shares was determined by the closing price of 20 trading days immediately preceding the closing date, December 2, 2019. The resale of these shares was registered and are subject to a standstill agreement. We recognized the fair value of the shares as of the acquisition date, net of issuance costs, by increasing shareholders' equity by \$24.4 million

In addition to the purchase price, PIH received five-year right of first refusal to provide reinsurance of up to 7.5% of any layer in FNHC's catastrophe reinsurance program. PIH also agreed to a non-compete for five years following the closing with respect to residential property insurance in Alabama, Florida, Georgia, Louisiana, South Carolina and Texas.

Subsequent to the effective acquisition date, the revenues and net income of the business acquired were \$4.4 million and \$1.4 million, respectively, for the year ended December 31, 2019. We recognized \$1.3 million of acquisition-related costs, pre-tax, for the twelve months ended December 31, 2019. These costs are included in the general and administrative expenses line item of the consolidated statement of operations. We also capitalized \$0.5 million in application development costs to property and equipment included in the other asset line item on the consolidated balance sheet.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

The acquisition date fair values of certain assets and liabilities, including VOBA and intangible assets, were not adjusted during the one year following the December 2, 2019 acquisition date. The following presents (in thousands) the acquisition date fair values of the net assets acquired related to the Maison Companies as of December 2, 2019:

	<u>Fair Value</u>
Assets:	
Debt securities, available-for-sale	\$ 56,929
Cash and cash equivalents	35,968
Prepaid reinsurance premium	25,279
Premiums receivable	2,977
Reinsurance recoverable	7,603
Deferred acquisition costs and value of business acquired, net	8,721
Other assets	3,507
Total assets acquired	<u>140,984</u>
Liabilities:	
Loss and adjustment expense reserves	16,660
Unearned premiums	50,513
Reinsurance payable	24,071
Income taxes, net	1,778
Deferred revenue	1,515
Other liabilities	7,487
Total liabilities assumed	<u>102,024</u>
Net specifically identifiable assets acquired	38,960
Goodwill	10,997
Net assets acquired	<u>\$ 49,957</u>

All the gross contractual amounts of acquired receivables have been fully collected.

The entire \$8.7 million acquired VOBA balance was fully amortized as of December 31, 2020.

The goodwill recorded as part of the acquisition included the expected synergies and other benefits that resulted from the acquisition including reinsurance savings and reduction in operating and general and administrative expenses. Refer to Note 8 below for additional information regarding goodwill and identifiable intangible assets.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Pro Forma Financial Information

The following unaudited pro forma condensed consolidated statements of operations of the Company assume that the acquisition of the Maison Companies was completed on January 1, 2018:

	Year Ended December 31,	
	2019	2018
	(In thousands)	
Revenue	\$ 471,438	\$ 454,469
Net income (loss)	(9,025)	17,432

Pro forma adjustments include the revenue and net income (loss) of the Maison Companies for each period as well as estimates for amortization of identifiable intangible assets acquired and fair value adjustments associated with investments, VOBA (different than deferred acquisition costs) and reinsurance recoverable. Other pro forma adjustments include the incremental increase to interest expense attributable to financing the acquisition and the impact of reflecting acquisition and integration costs in 2018, instead of 2019.

4. FAIR VALUE

Fair Value Disclosures of Financial Instruments

The Company accounts for financial instruments at fair value or the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. 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 recorded at fair value are classified and disclosed in one of the following three categories:

- **Level 1** — Quoted market prices (unadjusted) for identical assets or liabilities in active markets 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, or observable inputs;
- **Level 2** — Quoted market prices for similar assets or liabilities and valuations, using models or other valuation techniques using observable market data. Significant other observable that can be corroborated by observable market data; and
- **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.

If the inputs used to measure fair value fall within different levels of the hierarchy, the category level is based on the lowest priority level input that is significant to the fair value measurement of the instrument.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

The Company's financial instruments measured at fair value on a recurring basis and the level of the fair value hierarchy of inputs used consisted of the following:

	December 31, 2020			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Debt securities - available-for-sale, at fair value:				
United States government obligations and authorities	\$ 38,511	\$ 133,264	\$ —	\$ 171,775
Obligations of states and political subdivisions	—	22,264	—	22,264
Corporate securities	—	266,528	—	266,528
International securities	—	27,643	—	27,643
Debt securities, at fair value	38,511	449,699	—	488,210
Equity securities, at fair value	1,881	1,276	—	3,157
Total investments, at fair value	\$ 40,392	\$ 450,975	\$ —	\$ 491,367

	December 31, 2019			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Debt securities - available-for-sale, at fair value:				
United States government obligations and authorities	\$ 83,764	\$ 110,429	\$ —	\$ 194,193
Obligations of states and political subdivisions	—	24,020	—	24,020
Corporate securities	—	278,302	—	278,302
International securities	—	29,750	—	29,750
Debt securities, at fair value	83,764	442,501	—	526,265
Equity securities, at fair value	17,361	2,678	—	20,039
Total investments, at fair value	\$ 101,125	\$ 445,179	\$ —	\$ 546,304

Held-to-maturity debt securities reported on the consolidated balance sheets at amortized cost and disclosed at fair value below (and in Note 5) and the level of fair value hierarchy of inputs used consisted of the following:

	Level 1	Level 2	Level 3	Total
	(In thousands)			
December 31, 2020	\$ —	\$ —	\$ —	\$ —
December 31, 2019	3,453	878	—	4,331

We measure the fair value of our securities based on assumptions used by market participants in pricing the security. The most appropriate valuation methodology is selected based on the specific characteristics of the security, and we consistently apply the valuation methodology to measure the security's fair value. Our fair value measurement is based on a market approach that utilizes prices and other relevant information generated by market transactions involving identical or comparable securities. We review the third party pricing methodologies on a quarterly basis and validate the fair value prices to a separate independent data service and ensure there are no material differences. Additionally, market indicators, industry and economic events are monitored.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

A summary of the significant valuation techniques and market inputs for each financial instrument carried at fair value includes the following:

- *United States Government Obligations and Authorities:* In determining the fair value for United States government securities in Level 1, the Company uses quoted prices (unadjusted) in active markets for identical or similar assets. In determining the fair value for United States government securities in Level 2, the Company uses the market approach utilizing primary valuation inputs including reported trades, dealer quotes for identical or similar assets in markets that are not active, benchmark yields, credit spreads, reference data and industry and economic events.
- *Obligations of States and Political Subdivisions:* In determining the fair value for state and municipal securities, the Company uses the market approach utilizing primary valuation inputs including reported trades, dealer quotes for identical or similar assets in markets that are not active, benchmark yields, credit spreads, reference data and industry and economic events.
- *Corporate and International Securities:* In determining the fair value for corporate securities the Company uses the market approach utilizing primary valuation inputs including reported trades, dealer quotes for identical or similar assets in markets that are not active, benchmark yields, credit spreads (for investment grade securities), observations of equity and credit default swap curves (for high-yield corporates), reference data and industry and economic events.
- *Equity Securities:* In determining the fair value for equity securities in Level 1, the Company uses quoted prices (unadjusted) in active markets for identical or similar assets. In determining the fair value for equity securities in Level 2, the Company uses the market approach utilizing primary valuation inputs including reported trades, dealer quotes for identical or similar assets in markets that are not active, benchmark yields, credit spreads, reference data and industry and economic events.

We did not have securities trading in less liquid or illiquid markets with limited or no pricing information, therefore we did not use unobservable inputs to measure fair value as of December 31, 2020 and 2019. Additionally, we did not have any assets or liabilities measured at fair value on a nonrecurring basis as of December 31, 2020 and 2019, and we noted no significant changes in our valuation methodologies between those periods.

There were no changes to the Company's valuation methodology and the Company is not aware of any events or circumstances that would have a significant adverse effect on the carrying value of its assets and liabilities measured at fair value as of December 31, 2020 and 2019. There were no transfers between the fair value hierarchy levels during the years ended December 31, 2020, 2019 and 2018.

5. INVESTMENTS

Unrealized Gains and Losses

The difference between amortized cost or cost and estimated fair value and gross unrealized gains and losses, by major investment category, consisted of the following:

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
December 31, 2020				
Debt securities - available-for-sale:				
United States government obligations and authorities	\$ 169,947	\$ 1,866	\$ 38	\$ 171,775
Obligations of states and political subdivisions	21,560	704	—	22,264
Corporate	254,618	11,989	79	266,528
International	27,001	659	17	27,643
	<u>\$ 473,126</u>	<u>\$ 15,218</u>	<u>\$ 134</u>	<u>\$ 488,210</u>

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

	<u>Amortized Cost or Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(In thousands)			
December 31, 2019				
Debt securities - available-for-sale:				
United States government obligations and authorities	\$ 191,546	\$ 3,073	\$ 426	\$ 194,193
Obligations of states and political subdivisions	23,748	294	22	24,020
Corporate	268,182	10,252	132	278,302
International	29,169	593	12	29,750
	<u>512,645</u>	<u>14,212</u>	<u>592</u>	<u>526,265</u>
Debt securities - held-to-maturity:				
United States government obligations and authorities	3,585	12	39	3,558
Corporate	697	20	—	717
International	55	1	—	56
	<u>4,337</u>	<u>33</u>	<u>39</u>	<u>4,331</u>
Total investments, excluding equity securities	<u>\$ 516,982</u>	<u>\$ 14,245</u>	<u>\$ 631</u>	<u>\$ 530,596</u>

Net Realized and Unrealized Gains and Losses

The Company calculates the gain or loss realized on the sale of investments by comparing the sales price (fair value) to the cost or amortized cost of the security sold. Net realized gains and losses on investments are determined in accordance with the specific identification method.

Net realized and unrealized gains (losses) recognized in earnings, by major investment category, consisted of the following:

	<u>Year Ended December 31,</u>		
	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(In thousands)		
Gross realized and unrealized gains:			
Debt securities	\$ 20,470	\$ 2,829	\$ 423
Equity securities	8,587	5,928	2,374
Total gross realized and unrealized gains	<u>29,057</u>	<u>8,757</u>	<u>2,797</u>
Gross realized and unrealized losses:			
Debt securities	(2,879)	(664)	(3,990)
Equity securities	(8,146)	(1,009)	(2,951)
Total gross realized and unrealized losses	<u>(11,025)</u>	<u>(1,673)</u>	<u>(6,941)</u>
Net realized and unrealized gains (losses) on investments	<u>\$ 18,032</u>	<u>\$ 7,084</u>	<u>\$ (4,144)</u>

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

The above line item, net realized and unrealized gains (losses) on investments, includes the following equity securities gains (losses) recognized in earnings:

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Net gains (losses) on equity securities:			
Realized	\$ 4,555	\$ 803	\$ 591
Unrealized	(4,114)	4,116	(1,168)
	<u>441</u>	<u>4,919</u>	<u>(577)</u>
Less:			
Net realized and unrealized gains (losses) on securities sold	<u>309</u>	<u>672</u>	<u>732</u>
Net unrealized gains (losses) still held as of the end-of-period	<u>\$ 132</u>	<u>\$ 4,247</u>	<u>\$ (1,309)</u>

Contractual Maturity

Actual maturities may differ from contractual maturities because issuers may have the right to call or pre-pay obligations.

Amortized cost and estimated fair value of debt securities, by contractual maturity, consisted of the following:

	December 31, 2020	
	Amortized	
	Cost	Fair Value
	(In thousands)	
Securities with Maturity Dates		
Debt securities, available-for-sale:		
One year or less	\$ 21,454	\$ 21,573
Over one through five years	137,378	142,457
Over five through ten years	144,296	149,674
Over ten years	169,998	174,506
Total	<u>\$ 473,126</u>	<u>\$ 488,210</u>

Net Investment Income

Net investment income consisted of the following:

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Interest income	\$ 11,563	\$ 15,605	\$ 12,253
Dividends income	223	296	207
Net investment income	<u>\$ 11,786</u>	<u>\$ 15,901</u>	<u>\$ 12,460</u>

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Aging of Gross Unrealized Losses

Gross unrealized losses and related fair values for debt securities, grouped by duration of time in a continuous unrealized loss position, consisted of the following:

Less than 12 months		12 months or longer		Total	
Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses

(In thousands)

December 31, 2020

Debt securities - available-for-sale:

United States government obligations and authorities	\$ 25,521	\$ 38	\$ —	\$ —	\$ 25,521	\$ 38
Corporate	7,989	79	—	—	7,989	79
International	2,175	16	132	1	2,307	17
	\$ 35,685	\$ 133	\$ 132	\$ 1	\$ 35,817	\$ 134

Less than 12 months		12 months or longer		Total	
Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses

(In thousands)

December 31, 2019

Debt securities - available-for-sale:

United States government obligations and authorities	\$ 49,833	\$ 409	\$ 2,218	\$ 17	\$ 52,051	\$ 426
Obligations of states and political subdivisions	6,810	22	—	—	6,810	22
Corporate	15,872	94	7,694	38	23,566	132
International	3,856	10	179	2	4,035	12
	76,371	535	10,091	57	86,462	592

Debt securities, held-to-maturity:

United States government obligations and authorities	—	—	2,287	39	2,287	39
	—	—	2,287	39	2,287	39
Total investments, excluding equity securities	\$ 76,371	\$ 535	\$ 12,378	\$ 96	\$ 88,749	\$ 631

As of December 31, 2020, the Company held a total of 47 debt securities that were in an unrealized loss position, of which 2 securities were in an unrealized loss position continuously for 12 months or more. As of December 31, 2019, the Company held a total of 203 debt securities that were in an unrealized loss position, of which 24 securities were in an unrealized loss position continuously for 12 months or more. The unrealized losses associated with these securities consisted primarily of losses related to corporate securities. The Company did not have any OTTI losses on its available-for-sale securities for the years ended December 31, 2020, 2019 and 2018, respectively. Refer to Note 7 below for information regarding allowances for credit loss.

Collateral Deposits

Cash and cash equivalents and investments, the majority of which were debt securities, with fair values of \$11.5 million and \$11.2 million were deposited with governmental authorities and into custodial bank accounts as required by law or contractual obligations, as of December 31, 2020 and 2019, respectively.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Reclassification of Held-to-Maturity Securities to Available-for-Sale

The Company sold held-to-maturity securities with a carrying value of \$70 thousand and realized a loss of less than \$1 thousand during the second quarter of 2020 due to credit concerns for certain securities. The Company, as of the date of the aforementioned sales, reclassified its remaining held-to-maturity securities to available-for-sale. The held-to-maturity securities transferred had an amortized cost of \$4.2 million and fair value of \$4.3 million and resulted in \$58 thousand of unrealized gains, pre-tax, recognized in other comprehensive income (loss) in the year ended December 31, 2020.

6. REINSURANCE

Overview

Reinsurance is used to mitigate the exposure to losses, manage capacity and protect capital resources. The Company reinsures (cedes) a portion of written premiums on an excess of loss or a quota-share basis in order to limit the Company's loss exposure. To the extent that reinsuring companies are unable to meet their obligations assumed under these reinsurance agreements, the Company remains primarily liable to its policyholders.

The Company is selective in choosing reinsurers and considers numerous factors, the most important of which is 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 the Company's exposure to the insolvency of a reinsurer, the Company evaluates the acceptability and review the financial condition of the reinsurer at least annually with the assistance of the Company's reinsurance broker.

Significant Reinsurance Contracts

2019-2020 Catastrophe Excess of Loss Reinsurance Program

Given the December 2, 2019 acquisition of the Maison Companies, the Company and PIH agreed to combine FNIC, MIC and MNIC under a single reinsurance program allowing the carriers to capitalize on efficiencies, spread of risk and scale.

The combined reinsurance treaties provide approximately \$1.3 billion of single-event reinsurance coverage in excess of a \$27 million retention for catastrophic losses on the first event (and \$15 million on the second and third events), including hurricanes, and aggregate coverage of \$1.9 billion, at an approximate total cost of \$224.3 million.

The combined FNIC, MIC and MNIC private market excess of loss treaties, covering both Florida and non-Florida exposures, became effective July 1, 2019 and all private layers have prepaid automatic reinstatement protection, which affords the carriers additional coverage for subsequent events. This private market excess of loss treaty structure breaks coverage into layers, with a cascading feature such that substantially all layers attach after \$20 million in losses for FNIC, \$2 million in losses for MNIC and \$5 million in losses for MIC. For FNIC and MNIC, the second and third event attaches at \$10 million per event, on a combined basis. 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. The overall reinsurance program is with reinsurers that currently have an A.M. Best Company or Standard & Poor's rating of "A-" or better, or have fully collateralized their maximum potential obligations in dedicated trusts.

As indicated above, FNIC, MIC and MNIC's combined 2019-2020 reinsurance program is estimated to cost \$224.3 million. This amount includes approximately \$178.5 million for private reinsurance for the carriers' exposure described above, including prepaid automatic premium reinstatement protection, along with approximately \$45.8 million payable to the FHCF. The combination of private and FHCF reinsurance treaties affords FNIC, MIC and MNIC approximately \$1.9 billion of aggregate coverage with a maximum single event coverage totaling approximately \$1.3 billion, exclusive of retentions. Each carrier will pay directly its allocated portion of the aggregate reinsurance ceded premium cost. The allocation methodology by which FNIC, MIC and MNIC determines their share of the premium and distribution of reinsurance recoveries under the combined reinsurance tower is based on catastrophe loss modeling of the separate books of business. Each carrier shares the combined program cost in proportion to its contribution to the total expected loss in each reinsurance layer. Each carrier's reinsurance recoveries will be based on that carrier's contributing share of a given event's total loss. Both FNIC and MNIC maintained their FHCF participation at 75% for the 2019 hurricane season, and MIC increased its FHCF participation to 90%.

FNIC's non-Florida excess of loss reinsurance treaty affords us an additional \$18 million of coverage for a second event, which applies to hurricane losses only. The result is a non-Florida retention of \$20 million for FNIC for the first event and \$2 million for the second

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

event, although these retentions are reduced to \$10 million and \$1 million after taking into account the profit-sharing agreement that FNIC has with the non-affiliated managing general underwriter that writes FNIC's non-Florida property business. FNIC's non-Florida reinsurance program cost for the above specific coverage approximates \$1.8 million for this private reinsurance.

The insurance carriers' cost and amounts of reinsurance are based on current analysis of exposure to catastrophic risk. The data is subjected to exposure level analysis at various dates through December 31, 2019. This analysis of the carriers' exposure level in relation to the total exposures to the FHCF and excess of loss treaties may produce changes in retentions, limits and reinsurance premiums in total, and by carrier, as a result of increases or decreases in the carriers' exposure levels.

2020-2021 Catastrophe Excess of Loss Reinsurance Program

The Company's excess of loss catastrophe reinsurance program for 2020-2021 (the "Program"), which covers the Company and its wholly-owned insurance subsidiaries, FNIC, MIC and MNIC was renewed effective July 1, 2020. FNIC, MIC and MNIC are collectively referred to herein as the "carriers". The Program provides up to approximately \$1.3 billion of single-event reinsurance coverage in excess of up to a \$31 million retention for catastrophic losses, including hurricanes, and aggregate coverage up to \$1.9 billion, at an approximate total cost of \$286.0 million, subject to adjustments based on actual exposure or premium of policies at different points in time in the coming months. The Company will retain 100% of the first \$25 million retention on each event plus up to an additional \$6 million in retention on the first event by retaining an approximate 9.1% co-participation of the next \$70 million of limit after the first \$25 million. More specifically, the Program includes up to approximately \$1.3 billion in aggregate private reinsurance for coverage in all states in which the Company operates, of which up to approximately \$650 million is limited to any one event, plus an additional \$650 million of reinsurance provided by the Florida Hurricane Catastrophe Fund ("FHCF"), that responds on both a per occurrence and in the aggregate basis, and which coverage is exclusive to the state of Florida.

The private layers of the Program, covering both Florida and non-Florida exposures have prepaid automatic reinstatement protection, which affords the carriers additional coverage for subsequent events. The private reinsurance market continued to harden this year due to a number of factors, including issues unique to the U.S. coastal catastrophe reinsurance marketplace generally and the Florida market specifically. These factors resulted in more restrictive terms by some of our individual reinsurers. The change in terms from the prior year's program includes some portion of the program having a single aggregate retention for our carriers taken as a whole, versus each carrier's own individual retention, plus some portions of the program not "cascading", which provides less broad coverage for multiple event scenarios generating gaps in coverage that need to be filled with additional post renewal reinsurance protection or be retained net by the Company. As of December 31, 2020, the overall reinsurance Program was placed with reinsurers with an A.M. Best Company or Standard & Poor's rating of "A-" or better, or that have fully collateralized their maximum potential obligations in dedicated trusts. For the purpose of debt covenant compliance, if any reinsurer on the program is not collateralized or has a rating lower than "A-" by A.M. Best Company or Standard & Poor's then the Company treats that reinsurer's participation as if it was part of the Company's net retention. Refer to "Part II, Item 1A., Risk Factors" for more information.

The total Program cost includes approximately \$238.2 million for private reinsurance for the carriers' exposure described above, including prepaid automatic reinstatement premium protection, along with approximately \$47.8 million payable to the FHCF. The combination of private and FHCF reinsurance treaties will afford the carriers up to approximately \$1.9 billion of aggregate coverage within Florida and \$1.3 billion in states outside Florida with a maximum single event coverage totaling up to approximately \$1.3 billion within Florida and approximately \$650 million outside Florida, exclusive of retentions.

Each carrier will share the combined program cost in proportion to its contribution to the total expected loss in each reinsurance layer. Each carrier's reinsurance recoveries will be based on that carrier's contributing share of a given event's total loss and each carrier will be responsible for its portion of the Program's \$25 million per event retention (\$31 million for the first event only) based on a specific allocation formula. Both FNIC and MNIC increased their FHCF participation to 90% for the 2020 hurricane season, and MIC maintained its FHCF participation at 90%.

In addition, the Company purchased subsequent event reinsurance coverage that has a lower retention than the first event. Under the Program, FNIC's non-Florida book of business as written by SageSure has excess of loss reinsurance treaties which afford this specific book of business additional protection through an additional \$16 million of coverage for a second event, which applies to hurricane losses only. This additional reinsurance coverage is specific to FNIC's non-Florida business and does not afford coverage to MIC's non-Florida business. The result is a retention of approximately \$18 million for FNIC's book with SageSure for the first event and approximately \$2 million for the second event, although these retentions are reduced to approximately \$9 million and approximately \$1 million after taking into account the quota-share reinsurance agreement that FNIC has with Anchor Re, Inc. ("Anchor Re"). Furthermore, for Florida only losses, the carriers purchased second and third event coverage of 71.5% of \$15 million excess of \$10 million that reduces the second and third event retention for the carriers, from \$25 million to \$14.3 million per event, on a

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

combined basis, which could be reduced further by an additional 28.5% placed on a parametric basis with an Excess and Surplus lines carrier that will provide coverage for the second and third Florida hurricane loss, if the first event loss criteria has been satisfied to the carriers after the inception of treaty. The amount of recovery with the parametric product is based on the magnitude of the hurricane and the proximity of the individual insured risk to the hurricane path. This coverage terminates on May 31, 2021.

Furthermore, on September 3, 2020, the Company secured \$39.2 million of reinsurance limit at an approximate cost of \$11.2 million. This limit is available for Hurricane Delta and any subsequent events that occur during the remainder of the current treaty year. In addition, on October 13, 2020, the Company secured 50% of \$10 million excess of \$8 million of reinsurance limit at an approximate cost of \$875 thousand to lower its retention and further protect FNIC's non-Florida book of business written by SageSure. This limit was available for any named storm event during the remainder of 2020. On November 4, 2020, the Company secured an additional \$13.5 million of reinsurance limit at an approximate cost of \$2.0 million. This limit was available for any subsequent events that occurred for the remainder of 2020, except for Hurricane Eta.

Effective January 1, 2021, the Company entered into a new aggregate excess of loss agreement on its MIC book of business. This new agreement provides reinsurance coverage on non-named storms, of 65% of \$15 million excess of \$10 million with a \$0.9 million occurrence deductible and a \$4.2 million occurrence limit at an approximate cost of \$2.3 million.

The carriers' cost and amounts of reinsurance are based on current analysis of exposure to catastrophic risk. The data is subjected to exposure level analysis at various dates through December 31, 2020. This analysis of the carriers' exposure levels in relation to the total exposures to the FHCF and excess of loss treaties may produce changes in retentions, limits and reinsurance premiums in total, and by carrier, as a result of increases or decreases in the carriers' exposure levels.

Quota-Share Reinsurance Programs

FNIC's reinsurance programs also include quota-share treaties. One such treaty for 30% became effective July 1, 2014, and another for 10% became effective on July 1, 2015 with each running for two years. The combined treaties provided up to a 40% quota-share reinsurance on covered losses for the homeowners' property and liability 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% quota-share treaty expired on a cut-off basis, which means as of that date the Company retained an incremental 30% of its unearned premiums and losses. On July 1, 2017, the 10% quota-share treaty expired on a cut-off basis, which means as of that date we retained an incremental 10% of the underlying unearned premiums and losses. The reinsurers remain liable for the paid losses occurring during the terms of the treaties, until each treaty is commuted.

On July 1, 2017, FNIC bound a 10% quota-share on its Florida homeowners book of business, which excluded named storms, subject to certain limitations. This treaty is not subject to accounting as a retrospectively rated contract. This treaty expired on July 1, 2018 on a cut-off basis, meaning that the reinsurer will not be liable (under this agreement) for losses as a result of occurrences taking place after the date of termination, and the unearned premium previously ceded was returned to FNIC.

On July 1, 2018, FNIC renewed the quota-share treaty on its Florida homeowners book of business, on an in-force, new and renewal basis, excluding named storms, which was initially set at a 2% cession, and is subject to certain limitations. In addition, this quota-share allowed FNIC to prospectively increase or decrease the cession percentage up to three times during the term of the agreement. Effective October 1, 2018, FNIC elected to increase the cession percentage from 2% to 10% on an in-force, new and renewal basis. The treaty expired on July 1, 2019 on a cut-off basis, meaning that the reinsurer will not be liable (under this agreement) for losses as a result of occurrences taking place after the date of termination, and the unearned premium previously ceded was returned to FNIC.

On July 1, 2019, FNIC renewed the quota-share treaty on its Florida homeowners book of business, on an in-force, new and renewal basis, excluding named storms, which was set at a 10% cession and is subject to certain limitations. In addition, this quota-share allows FNIC the flexibility to prospectively increase or decrease the cession percentage up to three times during the term of the agreement. The treaty expired on July 1, 2020 on a cut-off basis, meaning that the reinsurer will not be liable (under this agreement) for losses as a result of occurrences taking place after the date of termination, and the unearned premium previously ceded was returned to FNIC.

On July 1, 2020, FNIC renewed the quota-share treaty on its Florida homeowners book of business, on an in-force, new and renewal basis, excluding named storms, which was set at a 10% cession and is subject to certain limitations. In addition, this quota-share allows FNIC the flexibility to prospectively increase or decrease the cession percentage up to three times during the term of the agreement.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

On July 1, 2020, FNIC entered into a quota-share treaty on its non-Florida homeowners book of business with Anchor Re, an Arizona captive reinsurance entity that is an affiliate of SageSure. The treaty provides 50% quota-share reinsurance protection on claims incurred subsequent to July 1, 2020 on in-force, new and renewal business through June 30, 2021, subject to certain limitations, which include limits on the net losses that Anchor Re can realize during the treaty year. The treaty arrangement is fully collateralized through Anchor Re. The financial economics of this treaty substantially mirror the 50% profit-sharing arrangement that was previously in place. Thus, this treaty is not expected to have any impact on the pre-tax operating results of the Company, though the components of the combined ratio will be affected by the ceding of premiums, claims and commissions. On November 3, 2020, FNIC, with the agreement of Anchor Re, increased its cession percentage in this treaty from 50% to 80%, effective December 1, 2020, on claims incurred subsequent to December 1, 2020 on in-force, new and renewal basis.

Effective October 1, 2020, FNIC, with the agreement of Swiss Re, increased its cession percentage on this treaty from 10% to 20% on an in-force, new and renewal basis. This treaty excludes named storms and includes a cap on non-named storm catastrophe losses (as discussed above).

Effective November 15, 2020, FNIC entered into a new 10% quota-share reinsurance treaty through November 15, 2021 on its Florida homeowners book of business on an in-force, new and renewal basis. This treaty excludes all catastrophe losses and provides coverage only on attritional losses and is subject to certain limitations.

Effective December 31, 2020, FNIC entered into an additional new 10% quota-share reinsurance treaty through December 31, 2021 on its Florida homeowners book of business on an in-force, new and renewal basis. This treaty excludes named storms, but otherwise contains no caps with respect to non-named storm catastrophe losses.

As a result of these three actions, the Company now has 40% quota-share coverage in place through June 30, 2021, at which point 20% of this coverage will be up for renewal. It is the Company's current intent to seek such renewal.

Associated Trust Agreements

Certain reinsurance agreements require FNIC to secure the credit, regulatory and business risk. Fully funded trust agreements securing these risks totaled less than \$0.1 million as of December 31, 2020 and 2019.

Reinsurance Recoverable, Net

Amounts recoverable from reinsurers are recognized in a manner consistent with the claims liabilities associated with the reinsurance placement and presented on the consolidated balance sheet as reinsurance recoverable. Reinsurance recoverable, net consisted of the following:

	December 31,	
	2020	2019
	(In thousands)	
Reinsurance recoverable on paid losses	\$ 54,898	\$ 45,186
Reinsurance recoverable on unpaid losses	358,193	164,429
Allowance for credit loss	(65)	—
Reinsurance recoverable, net	\$ 413,026	\$ 209,615

As of December 31, 2020 and 2019, the Company had reinsurance recoverable of \$304.3 million (as a result of Hurricanes Irma, Laura, Sally, Michael and Delta) and \$163.7 million (as a result of Hurricanes Irma and Michael). Hurricane Delta made landfall in Louisiana on October 9, 2020 as a Category 2 hurricane impacting both Texas and Louisiana. Hurricane Sally made landfall in Alabama on September 16, 2020 as a Category 2 hurricane impacting both Alabama and the Florida panhandle. Hurricane Laura made landfall in Louisiana on August 27, 2020 as a Category 4 hurricane impacting both Louisiana and eastern Texas.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Net Premiums Written and Net Premiums Earned

Net premiums written and net premiums earned consisted of the following:

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Net Premiums Written			
Direct	\$ 726,885	\$ 610,608	\$ 567,764
Ceded	(490,262)	(232,729)	(202,732)
	<u>\$ 236,623</u>	<u>\$ 377,879</u>	<u>\$ 365,032</u>
Net Premiums Earned			
Direct	\$ 720,967	\$ 582,334	\$ 580,020
Ceded	(356,833)	(218,682)	(224,763)
	<u>\$ 364,134</u>	<u>\$ 363,652</u>	<u>\$ 355,257</u>

7. ALLOWANCES FOR CREDIT LOSS

Overview

There is significant risk and judgment involved in determining estimates of our allowances for credit loss, which reduce the amortized cost of an asset to produce an estimate of the net amount that will be collected over the asset's contractual life. Longer time horizons generally present more uncertainty in expected cash flow. We evaluate the expected credit loss of assets on an individual basis, except in cases where assets collectively share similar risk characteristics where we pool them together. We evaluate and estimate our allowances for credit loss by considering reasonable, relevant and supportable available information.

Activity in the allowances for credit loss, by asset line item on the consolidated balance sheet, is summarized as follows:

	Debt Securities Held-to- Maturity	Premiums Receivable	Reinsurance Recoverable, Net	Total
	(In thousands)			
Balance as of December 31, 2019	\$ —	\$ 159	\$ —	\$ 159
Cumulative effect of new accounting standard (1)	1	—	32	33
Credit loss expense (recovery) (2)	(1)	74	33	106
Balance as of December 31, 2020	<u>\$ —</u>	<u>\$ 233</u>	<u>\$ 65</u>	<u>\$ 298</u>

(1) Refer to Note 2 above about our adoption of ASU 2016-13 on January 1, 2020.

(2) Reflected in commissions and other underwriting expenses on the consolidated statements of comprehensive income (loss).

Accrued investment income is included in other assets on the consolidated balance sheet. We immediately write-off accrued investment income if it becomes uncollectible, therefore we do not measure or record an allowance for credit losses.

Investments

Our investment policy is established by the Board of Directors' Investment Committee and is reviewed on a regular basis. This policy currently 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. We do not use any swaps, options, futures or forward contracts to hedge or enhance our investment portfolio.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Our investment portfolio has inherent risks because it contains volatility associated with market pricing and interest rate sensitive instruments, such as bonds, which may be adversely affected by changes in interest rates or credit worthiness. The effects of market volatility, declining economic conditions, such as a U.S. or global economic slowdown, whether due to COVID-19, or other factors, could adversely impact the credit quality of securities in our portfolio and may have unforeseen consequences on the liquidity and financial stability of the issuers of securities we hold.

Our debt securities portfolio includes securities that:

- Are explicitly guaranteed by a sovereign entity that can print its own currency;
- The currency is routinely held by central banks, used in international commerce and commonly viewed as a reserve currency; and
- Have experienced a consistent high credit rating by rating agencies and a long history with no credit losses.

We believe if these governments were to technically default it is reasonable to assume an expectation of immaterial losses, even in the current strained market conditions. Refer to Note 5 above for the balances of these sovereign debt securities, which are reported in the following investment categories:

- United States government obligations and authorities;
- Obligations of states and political subdivisions; and
- International.

For our debt securities, available-for-sale, the fact that a security's fair value is below its amortized cost is not a decisive indicator of credit loss. In many cases, a security's fair value may decline due to factors that are unrelated to the issuer's ability to pay. For this reason, we consider the extent to which fair value is below amortized cost in determining whether a credit-related loss exists. The Company also considers the credit quality rating of the security, with a special emphasis on securities downgraded below investment grade. A comparison is made between the present value of expected future cash flows for a security and its amortized cost. If the present value of future expected cash flows is less than amortized cost, a credit loss is presumed to exist and an allowance for credit loss is established. Management may conclude that a qualitative analysis is sufficient to support its conclusion that the present value of the expected cash flows equals or exceeds a security's amortized cost. As a result of this review, management concluded that there were no credit-related impairments of our available-for-sale securities as of January 1, 2020, and December 31, 2020. Management does not intend to sell available-for-sale securities in an unrealized loss position, and it is not "more likely than not" that the Company will be required to sell these securities before a recovery in their value to their amortized cost basis occurs.

Our equity investments are measured at fair value through net income (loss), therefore they do not require an allowance for credit loss.

Premiums Receivable

We do have collectability risk, but our homeowners policy terms are one year or less and our policyholders are dispersed throughout the southeast United States, although the majority of our policyholders are located in Florida.

We write-off premiums receivable if the individual policy becomes uncollectible. Because collectively our premiums receivable share similar risk characteristics, we pool them to measure our valuation allowance for credit losses using an aging method approach. This method applies historical loss rates to levels of delinquency for our policy terms that are one year or less. Based upon historical collectability, adjusted for current and future economic conditions, we have measured and recorded our valuation allowances for premiums receivable.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

The aging of our premiums receivable and associated allowance for credit loss as of December 31, 2020 was as follows:

	Current	Days Past Due				Total
		1-29	30-59	60-89	90 plus	
(In thousands)						
Amortized cost	\$ 46,376	\$ 4,253	\$ 159	\$ 94	\$ 154	\$ 51,036
Allowance for credit loss	—	(43)	(8)	(28)	(154)	(233)
Net	\$ 46,376	\$ 4,210	\$ 151	\$ 66	\$ —	\$ 50,803

Reinsurance Recoverable

Refer to Note 6 above for details of our efforts to minimize our exposure to losses from a reinsurer's inability to pay.

We measure and record our valuation allowances for credit losses on our reinsurance recoverables asset by multiplying the probability the asset would default within a given timeframe ("PD") by the percentage of the asset not expected to be collected upon default, or loss given default ("LGD") and multiplying the result by the amortized cost of the asset. We use market observable data for our PD and LGD assumptions, and in cases where we are unable to observe LGD, we assume it is 100%.

8. GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS

The changes in carrying amount of goodwill were as follows:

	Gross Goodwill as of Beginning-of-Year	Accumulated Impairment as of Beginning-of-Year	Acquisition Accounting Adjustments	Impairment	Net Goodwill as of End-of-Year
(In thousands)					

For the year ended December 31,;

2019	\$ —	\$ —	\$ 10,997	\$ —	\$ 10,997
2020	10,997	—	—	(10,997)	—

Related to our annual quantitative goodwill impairment assessment performed on October 1, our reporting unit is defined as consolidated FNHC. The fair value of the reporting unit, which we consider a Level 3 fair value estimate, is comprised of the value of in-force (i.e., existing) business and the value of new business. Specifically, new business is representative of cash flows and profitability associated with policies or contracts we expect to issue in the future, reflecting our forecasts of volume and product mix over a 10-year period. To determine the value of in-force and new business, we use a discounted cash flows technique that applies a discount rate reflecting the market expected, weighted-average rate of return adjusted for the risk factors associated with our operations to the projected future cash flow for our reporting unit.

Coinciding with the preparation of the financial statements for the year ended December 31, 2020, the Company's annual goodwill impairment testing has resulted in the conclusion that the goodwill intangible asset established in conjunction with the acquisition of the Maison Companies in December 2019 is impaired. Therefore, during the fourth quarter of 2020, we recorded a non-cash impairment charge of \$11.0 million, against which there is no tax offset, representing the write-off of the full amount of our goodwill asset. The Company's impairment analysis considered the earnings and share price of the Company and comparable companies, as well as projected cash flows. Continued adverse storm activity, higher excess of loss catastrophe reinsurance costs and the continued unfavorable claims environment in the state of Florida reduced the previously modeled fair value of the Company. These impacts, along with other information relevant to the estimated fair value of the Company, including the trading price of our shares, resulted in the impairment conclusion.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

The gross carrying amounts and accumulated amortization for each major specifically identifiable intangible asset class were as follows:

	December 31, 2020		December 31, 2019		Weighted-Average- Amortization Period
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	
	(In thousands)				
Trade name (1)	\$ 1,100	\$ —	\$ 1,800	\$ —	0
Non-compete agreements (2)	300	162	300	13	2
Insurance licenses (3)	180	—	182	—	0
Total	\$ 1,580	\$ 162	\$ 2,282	\$ 13	

- (1) This intangible has an indefinite useful life. We recorded impairment of \$0.7 million in the year ended December 31, 2020, due primarily to a higher discount rate, which lowered the fair value.
- (2) Will become fully amortized during the year ended December 31, 2021.
- (3) This intangible has an indefinite useful life. We recorded impairment of \$2 thousand for the year ended December 31, 2020, due primarily to a higher discount rate, which lowered the fair value.

9. LOSS AND LOSS ADJUSTMENT RESERVES

The liability for loss and LAE reserves is determined on an individual-case basis for all claims 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:

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Gross reserves, beginning-of-period	\$ 324,362	\$ 296,230	\$ 230,515
Less: reinsurance recoverable (1)	(164,429)	(166,396)	(98,345)
Net reserves, beginning-of-period	159,933	129,834	132,170
Net reserves from the Maison Companies acquisition	—	11,825	—
Incurring loss, net of reinsurance, related to:			
Current year	358,952	262,118	231,133
Prior year loss development (redundancy) (2)	18,367	13,460	2,166
Ceded losses subject to offsetting experience account adjustments (3)	(816)	(2,489)	(4,883)
Prior years	17,551	10,971	(2,717)
Amortization of acquisition fair value adjustment	(54)	(9)	—
Total incurred loss and LAE, net of reinsurance	376,449	273,080	228,416
Paid loss, net of reinsurance, related to:			
Current year	253,344	173,313	155,462
Prior years	100,799	81,493	75,290
Total paid loss and LAE, net of reinsurance	354,143	254,806	230,752
Net reserves, end-of-period	182,239	159,933	129,834
Plus: reinsurance recoverable (1)	358,128	164,429	166,396
Gross reserves, end-of-period	\$ 540,367	\$ 324,362	\$ 296,230

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

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

- (2) Reflects loss development from prior accident years impacting pre-tax net income. Excludes losses ceded under retrospective reinsurance treaties to the extent there is an offsetting experience account adjustment.
- (3) Reflects losses ceded under retrospective reinsurance treaties to the extent there is an offsetting experience account adjustment, such that there is no impact on pre-tax net income (loss).

The establishment of loss reserves is an inherently uncertain process and changes in loss reserve estimates are expected as such estimates are subject to the outcome of future events. The factors influencing changes in claim costs are often difficult to isolate or quantify and developments in paid and incurred losses from historical trends are frequently subject to multiple interpretations. Changes in estimates, or differences between estimates and amounts ultimately paid, are reflected in the operating results of the period during which such adjustments are made.

During the year ended December 31, 2020, the Company experienced \$18.4 million of net unfavorable loss and LAE reserve development on prior accident years, primarily in its commercial general liability line of business as a result of higher than expected late reported claims across a number of accident years during 2020.

During the year ended December 31, 2019, the Company experienced \$13.5 million of net unfavorable loss and LAE reserve development on prior accident years, primarily in its personal automobile and commercial general liability lines of business. The development in commercial general liability was driven by late reported claims as well as large losses that drove up the overall severity metrics. Additionally, the unfavorable automobile development primarily related to 2017 accident year from our auto programs in the states of Georgia and Texas, and was driven by claims reopening and higher severity.

During the year ended December 31, 2018, the Company experienced \$2.2 million of net unfavorable loss and LAE reserve development on prior accident years, primarily driven by net development in our personal automobile line of business, partially offset by net redundancy in our homeowners line of business. The unfavorable development on automobile primarily related to the 2016 accident year in the state of Georgia. The favorable net redundancy on homeowners was primarily driven by lower LAE expenses associated with Hurricane Irma, partially offset by continued adverse impact from assignment of benefits (“AOB”) and related litigation costs in the state of Florida.

As previously disclosed, the Company entered into 30% and 10% retrospectively-rated Florida-only property quota-share treaties, which ended on July 1, 2016 and 2017, respectively. These agreements included a profit share (experience account) provision, under which the Company will receive ceded premium adjustments at the end of the treaty to the extent there is a positive balance in the experience account. This experience account is based on paid losses rather than incurred losses. Due to the retrospectively-rated nature of this treaty, when the experience account is positive we cede losses under these treaties as the claims are paid with an equal and offsetting adjustment to ceded premiums (in recognition of the related change to the experience account receivable), with no impact on net income. Conversely, when the experience account is negative, the Company cedes losses on an incurred basis with no offsetting adjustment to ceded premiums, which impacts net income. Loss development can be either favorable or unfavorable regardless of whether the experience account is in a positive or negative position.

AOB is a legal construct that allows a third party to step into the shoes of the insured and is then paid directly by an insurance company for services rendered on behalf of the insured for a covered loss. Absent an AOB, the insured would pay the third party and those costs would be reimbursed by the insurance company to the insured. AOB is commonly used when a homeowner experiences a water loss, for example a leaky pipe, an overflow from a sink, or a damaged appliance, and contacts a contractor or water remediation company.

Misuse of this legal construct has led to contractors over inflating costs of claims and/or submitting improper claims, causing insurance companies to have to either pay the overinflated claim, fight the claim in court, or both. In all cases, AOB claims cost the insurance company, on average, more than five times the cost to settle non-AOB claims, which has been a primary driver the increase to our overall loss and loss adjustment in comparison to historical severity averages.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

The following tables provide incurred losses and allocated LAE ("ALAE") and cumulative paid losses and ALAE, net of reinsurance, for the prior 10 accident years, and the total of IBNR reserves plus expected development on reported claims and the cumulative number of reported claims (in thousands, except number of reported claims), as of the most recent reporting period, by the Company's significant lines of business, which are homeowners, commercial general liability and automobile.

Accident Year	Homeowners Incurred Losses and ALAE, Net of Reinsurance											IBNR & Expected	Cumulative
	For the Years Ended December 31,											Development on	Number of
	(Unaudited)											Reported Claims	Reported Claims (1)
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020		2020	
2011	\$ 20,492	\$ 21,344	\$ 23,007	\$ 23,932	\$ 24,582	\$ 25,957	\$ 26,143	\$ 26,394	\$ 26,394	\$ 26,375	\$	12	2,428
2012		23,032	23,301	24,186	24,468	25,889	26,356	26,836	26,951	26,984		85	2,694
2013			43,807	42,021	35,834	35,859	37,185	37,880	37,978	38,088		15	3,431
2014				64,312	63,300	61,770	62,206	61,817	62,043	62,535		378	7,606
2015					99,497	92,411	95,129	94,760	94,703	96,144		1,522	13,038
2016						171,264	162,043	158,764	157,880	156,316		1,394	22,614
2017							202,844	192,769	188,548	179,327		47,728	67,165
2018								210,158	213,128	216,570		20,849	35,817
2019									257,644	261,541		23,909	19,661
2020										342,119		236,080	35,117
										Total	\$	<u>1,405,999</u>	

(1) The cumulative number of reported claims is measured by individual claimant at a coverage level.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Homeowners Cumulative Paid Losses and ALAE, Net of Reinsurance

For the Years Ended December 31,

(Unaudited)

Accident Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
2011	\$ 11,119	\$ 19,250	\$ 21,323	\$ 22,723	\$ 24,047	\$ 25,580	\$ 25,982	\$ 26,287	\$ 26,340	\$ 26,342
2012		13,693	20,728	23,120	23,923	25,186	26,113	26,777	26,861	26,901
2013			19,986	31,606	33,867	35,123	35,803	37,473	37,688	37,915
2014				37,033	53,831	57,891	59,722	60,555	61,441	61,692
2015					52,214	79,359	86,647	90,415	92,327	93,405
2016						102,556	142,716	148,274	152,258	153,997
2017							135,589	176,580	179,327	178,013
2018								141,173	194,160	206,133
2019									157,768	236,090
2020										236,197
										\$ 1,256,685
										—
										\$ 149,314

All outstanding liabilities for unpaid claims and ALAE prior to 2011, net of reinsurance

Total outstanding liabilities for unpaid claims and ALAE, net of reinsurance

The following table provides supplementary information about the average annual percentage payout of incurred losses and ALAE, net of reinsurance, for homeowners policies, as of December 31, 2020:

Average Annual Payout of Losses and ALAE, Net of Reinsurance

(Unaudited)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Homeowners	62.0 %	25.6 %	4.6 %	1.9 %	1.8 %	2.3 %	1.0 %	0.6 %	0.2 %	— %

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Accident Year	Commercial General Liability Incurred Losses and ALAE, Net of Reinsurance										IBNR & Expected	Cumulative
	For the Years Ended December 31,										Development on	Number of
	(Unaudited)										Reported Claims	Reported Claims
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2020	2020
2011	\$ 6,436	\$ 5,854	\$ 4,749	\$ 4,603	\$ 4,760	\$ 5,409	\$ 6,254	\$ 6,828	\$ 7,817	\$ 9,394	\$ 1,572	1,367
2012		5,279	4,952	4,801	4,700	4,658	4,346	4,509	5,109	6,431	1,209	817
2013			7,095	5,069	5,221	5,502	5,704	5,580	5,984	7,588	1,245	759
2014				7,475	7,709	6,384	6,620	6,348	6,697	9,028	1,549	1,016
2015					8,082	7,008	6,020	5,377	7,947	9,141	2,043	877
2016						10,727	5,809	6,561	8,502	12,267	3,086	845
2017							8,289	7,853	6,558	8,519	3,369	639
2018								6,553	6,233	7,280	4,281	420
2019									1,604	2,535	1,826	114
2020										37	—	6
										Total	\$ 72,220	

Accident Year	Commercial General Liability Cumulative Paid Losses and ALAE, Net of Reinsurance												
	For the Years Ended December 31,												
	(Unaudited)												
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020			
2011	\$ 764	\$ 2,763	\$ 3,366	\$ 3,673	\$ 4,246	\$ 4,866	\$ 5,831	\$ 6,349	\$ 7,365	\$ 7,693			
2012		871	1,714	2,632	3,342	3,686	3,841	4,098	4,521	4,790			
2013			882	2,233	3,366	3,867	4,606	5,033	5,467	5,847			
2014				717	2,593	3,855	4,375	5,130	6,270	6,901			
2015					798	2,296	3,249	3,827	5,866	6,566			
2016						1,515	3,657	5,088	6,606	8,382			
2017							1,592	2,478	3,293	4,225			
2018								963	1,554	2,604			
2019									147	424			
2020										5			
									Total	\$ 47,437			
												All outstanding liabilities for unpaid claims and ALAE prior to 2011, net of reinsurance	3,545
												Total outstanding liabilities for unpaid claims and ALAE, net of reinsurance	\$ 28,328

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

The following table provides supplementary information about the average annual percentage payout of incurred losses and ALAE, net of reinsurance, for commercial general liability policies, as of December 31, 2020:

Average Annual Payout of Losses and ALAE, Net of Reinsurance
(Unaudited)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Commercial general liability	10.2 %	14.1 %	10.4 %	7.2 %	10.3 %	6.5 %	6.3 %	5.0 %	7.2 %	4.7 %

Automobile Incurred Losses and ALAE, Net of Reinsurance
For the Years Ended December 31,

Accident Year	(Unaudited)										IBNR & Expected	Cumulative
											Development on	Number of
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Reported Claims	Reported Claims
2011	\$ 3,580	\$ 3,350	\$ 2,954	\$ 2,912	\$ 2,762	\$ 2,848	\$ 2,796	\$ 2,756	\$ 2,762	\$ 2,760	\$ —	789
2012		1,735	1,741	1,717	1,424	1,455	1,491	1,448	1,444	1,448	4	824
2013			1,517	1,863	1,826	1,829	2,161	2,123	2,127	2,127	6	3,471
2014				2,038	3,213	3,551	4,315	4,379	4,417	4,413	4	6,019
2015					3,045	2,882	2,781	2,878	2,915	2,944	14	6,553
2016						13,414	20,205	24,346	25,918	25,923	251	67,655
2017							20,411	22,472	24,579	24,669	740	52,885
2018								3,513	4,623	4,439	887	9,604
2019									(3)	—	2	101
2020										—	—	1
										Total	\$ 68,723	

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Automobile Cumulative Paid Losses and ALAE, Net of Reinsurance

For the Years Ended December 31,

(Unaudited)

Accident Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
2011	\$ 1,417	\$ 2,381	\$ 2,562	\$ 2,644	\$ 2,726	\$ 2,755	\$ 2,755	\$ 2,755	\$ 2,755	\$ 2,755
2012		867	1,293	1,333	1,384	1,393	1,430	1,444	1,447	1,449
2013			907	1,609	1,906	2,069	2,109	2,112	2,116	2,116
2014				1,455	3,120	3,678	4,122	4,291	4,383	4,396
2015					1,393	2,293	2,670	2,807	2,890	2,897
2016						8,084	17,258	23,053	25,582	26,132
2017							12,821	20,762	23,860	24,468
2018								2,331	3,626	3,137
2019									(5)	—
2020										—
									Total	\$ 67,350
										All outstanding liabilities for unpaid claims and ALAE prior to 2011, net of reinsurance
										15
										Total outstanding liabilities for unpaid claims and ALAE, net of reinsurance
										<u>\$ 1,388</u>

The following table provides supplementary information about the average annual percentage payout of incurred losses and ALAE, net of reinsurance, for automobile policies, as of December 31, 2020:

Average Annual Payout of Losses and ALAE, Net of Reinsurance

(Unaudited)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Automobile	42.3 %	33.5 %	14.2 %	6.2 %	2.3 %	1.2 %	0.3 %	— %	— %	— %

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

The reconciliation of the net incurred and paid development tables to the liability for unpaid losses and LAE in the consolidated balance sheets is as follows:

	December 31,	
	2020	2019
	(In thousands)	
Liabilities for unpaid losses and ALAE:		
Homeowners	\$ 149,314	\$ 137,168
Commercial general liability	28,328	17,014
Automobile	1,388	2,142
Flood	—	—
Total liabilities for unpaid losses and ALAE, net of reinsurance	179,030	156,324
Reinsurance recoverables:		
Homeowners	353,741	160,578
Commercial general liability	—	500
Automobile	1,424	3,228
Flood	2,963	123
Total reinsurance recoverables	358,128	164,429
Unallocated loss adjustment expenses	3,209	3,609
Gross liability for unpaid losses and LAE	\$ 540,367	\$ 324,362

Management establishes a liability on an aggregate basis to provide for the estimated 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.

Various actuarial methods are utilized to determine the reserves that are booked to our financial statements. Weightings of tests and methods at a detailed level may change from evaluation to evaluation based on a number of observations, measures and time elements. On an overall basis, changes to methods and/or assumptions underlying reserve estimations and selections as of December 31, 2020 and 2019, were not considered material, except for our commercial general liability line of business. For this line of business, we updated our actuarial assumptions to reflect the new, emerging trend relating to the increased level of new claims being reported related to construction defects, as the new development patterns are different than the historical patterns.

IBNR reserves are established for the quarter and year-end based on a quarterly reserve analysis by our actuarial staff. Various standard actuarial tests are applied to subsets of the business at a line of business and coverage basis. Included in the analyses are the following:

- *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
- *Bornbuetter-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.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

10. LONG-TERM DEBT

Long-term debt consisted of the following:

	December 31,	
	2020	2019
	(In thousands)	
Senior unsecured fixed rate notes, due March 15, 2029, net of deferred financing costs of \$1,317 and \$1,478, respectively	\$ 98,683	\$ 98,522
Total long-term debt, net	\$ 98,683	\$ 98,522

As of December 31, 2020, the Company's estimated annual aggregate amount of debt maturities includes the following:

For the Years Ending December 31,	Aggregate Debt Maturities
	(In thousands)
2021	\$ —
2022	—
2023	—
2024	—
2025	—
Thereafter	100,000
Total debt maturities	100,000
Less: deferred financing costs	1,317
Total debt maturities, net	\$ 98,683

Senior Unsecured Notes

On March 5, 2019, the Company completed a private placement offering and issued \$100.0 million in principal amount of Senior Unsecured Fixed Rate Notes due 2029 (the "Notes"), pursuant to an indenture dated as of March 5, 2029 (the "Indenture"). The Notes mature on March 15, 2029 and bear interest at a fixed rate of 7.5% per year, payable semi-annually in arrears, subject to increases in the interest rate payable in the event of a downgrade below "BBB-" in the credit rating assigned to the Notes. The Notes are not convertible or exchangeable for any equity securities, other securities or assets of the Company or any subsidiary. A portion of the cash from the offering was used to redeem all \$45.0 million of the Company's Senior Unsecured Fixed Rate Notes Due 2022 and the Company's Senior Notes Due 2027. We recognized \$3.6 million as interest expense in our consolidated statements of operations for the year ended 2019, for prepayment fees, including the write-off unamortized debt issuance costs on the repayment.

The Company may redeem the Notes under certain circumstances as set forth in the Indenture. Prior to March 15, 2024, the Company may redeem the Notes, in whole or in part, at a redemption price equal to 100.00% of the principal amount of the Notes to be redeemed, plus the "Applicable Premium," plus accrued and unpaid interest on such Notes, if any, on the Notes redeemed, to the applicable redemption date. The "Applicable Premium" is defined in the Indenture to mean, with respect to any Note on any applicable redemption date, the greater of (1) 1.0% of the then-outstanding principal amount of such Note and (2) the excess (if any) of: (A) the present value at such redemption date of (i) the applicable redemption price of such Note at March 15, 2024 (excluding any accrued but unpaid interest), plus (ii) all required interest payments due on such Note through March 15, 2024 (excluding accrued but unpaid interest), computed using a discount rate equal to the Treasury Rate (as defined in the Indenture) on such redemption date plus 50 basis points; over (B) the then-outstanding principal amount of such Note.

On and after March 15, 2024, the Company may redeem the Notes, in whole or in part, at 103.750% in 2024, 101.875% in 2025, and 100% in 2026 and thereafter, together with any accrued and unpaid interest on the Notes being redeemed to but excluding the date of redemption.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

If a change in control of the Company, as defined in the Indenture, occurs, the holders of the Notes will have the right to require the Company to purchase all or a portion of their Notes at a price in cash equal to 101% of the principal amount thereof, plus any accrued but unpaid interest.

The Notes are senior unsecured obligations of the Company and will rank equally with all of the Company's other future senior unsecured indebtedness. The Indenture includes customary covenants and events of default. Among other things, the covenants restrict the ability of the Company and its subsidiaries to incur additional indebtedness or make restricted payments, including dividends, and under certain circumstances, the Company is required to maintain certain levels of reinsurance coverage while the Notes remain outstanding, and maintain certain other financial covenants. These covenants are subject to important exceptions and qualifications set forth in the Indenture. Principal and interest on the Notes are subject to acceleration in the event of certain events of default, including automatic acceleration upon certain bankruptcy-related events. The Company's debt to capital ratio exceeds 35%, therefore the Company is precluded from incurring additional debt, repurchasing shares of our common stock or paying common stock dividends. No acceleration of the related debt is mandated due to the fact that catastrophic weather events drove the ratio over 35% rather than specific actions taken by the Company. The Company's actual debt to capital ratio as of December 31, 2020 was approximately 38.4%.

11. INCOME TAXES

The components of income tax expense (benefit) include the following:

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Federal:			
Current	\$ (29,449)	\$ (982)	\$ 5,162
Deferred	(3,494)	567	(751)
Federal income tax expense (benefit)	<u>(32,943)</u>	<u>(415)</u>	<u>4,411</u>
State:			
Current	(403)	241	1,383
Deferred	(150)	(124)	(296)
State income tax expense (benefit)	<u>(553)</u>	<u>117</u>	<u>1,087</u>
Total income tax expense (benefit)	<u>\$ (33,496)</u>	<u>\$ (298)</u>	<u>\$ 5,498</u>

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

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

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Computed expected tax expense provision, at federal rate	\$ (23,447)	\$ 150	\$ 4,244
State tax, net of federal tax benefit	(3,157)	(122)	761
Tax-exempt interest	(5)	(3)	(134)
Income subject to dividends-received deduction	(26)	(34)	(13)
Goodwill impairment	2,309	—	—
Return to provision	(3,407)	(307)	158
Executive compensation	41	230	436
Meals and entertainment	13	43	28
Uncertain tax position	(179)	(203)	—
Rate difference on NOL carryback	(8,785)	(113)	—
Change in valuation allowance	2,968	—	—
Other	179	61	18
Total income tax expense (benefit)	<u>\$ (33,496)</u>	<u>\$ (298)</u>	<u>\$ 5,498</u>

In response to COVID-19, the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) was signed into law on March 27, 2020. The CARES Act contains several relief provisions for corporations and lifts certain deduction limitations originally imposed by the U.S. Tax Cuts and Jobs Act of 2017 (the “Tax Act”) signed into law on December 22, 2017. The CARES Act, among other things, includes temporary changes regarding the prior and future utilization of net operating losses (“NOL”), temporary changes to the prior and future limitations on interest deductions, temporary suspension of certain payment requirements for the employer portion of Social Security taxes and the creation of certain refundable employee retention credits. The Company utilized the NOL provision in the current year.

Our effective income tax rate is the ratio of income tax expense (benefit) over our income (loss) before income taxes. For the years ended December 31, 2020, 2019 and 2018, the effective income tax rate was 30.0%, (41.8)% and 27.2%, respectively. Differences in the effective tax and the statutory Federal income tax rate of 21% in 2020, 2019 and 2018, are driven by state income taxes and anticipated annual permanent differences, including estimates for tax-exempt interest, dividends received deduction, executive compensation as well as the NOL provision in the current year, as discussed above.

As of December 31, 2020, we had NOL carryforwards for Federal tax purposes of \$11.1 million. As of December 31, 2020, we had NOL carryforwards for state tax purposes of \$73.0 million expiring between 2037 and 2040 and \$12.0 million that do not expire. The amount and timing of realizing these NOL carryforwards depend on future taxable income and limitations imposed by tax laws.

The Company has a valuation allowance of \$3.0 million and \$0 on its deferred income tax asset as of December 31, 2020 and 2019, respectively.

We recognize accrued interest and penalties related to unrecognized tax benefits in income tax expense (benefit) in the consolidated statements of operations and statements of comprehensive income (loss). A reconciliation of these uncertain tax positions was as follows:

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Balance at January 1	\$ 382	\$ 585	\$ 585
Increases/(decreases) for uncertain tax positions taken during the prior years	(179)	(203)	—
Balance at December 31	<u>\$ 203</u>	<u>\$ 382</u>	<u>\$ 585</u>

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred income tax asset (liability), net include the following:

	As of December 31,	
	2020	2019
	(In thousands)	
Deferred income tax assets:		
Unearned premiums	\$ 5,611	\$ 10,232
Unpaid losses and loss adjustment expenses	581	1,596
Accrued expenses	236	216
Net operating loss carryforwards	5,350	2,095
Share-based compensation	232	161
Depreciation and amortization	412	—
Lease liability	1,783	1,655
Other	69	23
Gross deferred income tax assets	14,274	15,978
Valuation allowance	(2,968)	—
Total deferred income tax assets	11,306	15,978
Deferred income tax liabilities:		
Deferred acquisition costs and other	(6,387)	(12,703)
Depreciation and amortization	—	(1,679)
Unrealized gains on investment securities	(2,865)	(3,270)
Lease asset	(1,783)	(1,655)
Other	(213)	(257)
Total deferred income tax liabilities	(11,248)	(19,564)
Deferred income tax asset (liability), net	\$ 58	\$ (3,586)

The deferred income tax asset (liability), net along with income tax receivable, net is included in current and deferred income taxes, net on our Consolidated Balance Sheets.

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 2015 and 2017 - 2019 are open for review by the Internal Revenue Service and other state taxing authorities.

12. COMMITMENTS AND CONTINGENCIES

Litigation and Legal Proceedings

In the ordinary course of 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 LAE reserves. The Company's management believes 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 the Company's consolidated financial statements. The Company is also occasionally involved in other legal and regulatory proceedings, some of which may assert claims for substantial amounts, making the Company party to individual actions in which extra contractual damages, punitive damages or penalties, such as claims alleging bad faith in the handling of insurance claims, are sought.

The Company reviews the outstanding matters, if any, on a quarterly basis. The Company accrues for estimated losses and contingent obligations in the consolidated financial statements if and when the obligation or potential loss from any litigation, legal proceeding or claim is considered probable and the amount of the potential exposure is reasonably estimable. The Company records such probable and estimable losses, through the establishment of legal expense reserves. As events evolve, facts concerning litigation and contingencies become known and as additional information becomes available, the Company's management reassesses its potential

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

liabilities related to pending claims and litigation and may revise its previous estimates and make appropriate adjustment to the financial statements. Estimates that require judgment are subject to change and are based on management's assessment, including the advice of legal counsel, the expected outcome of litigation and legal proceedings or other dispute resolution proceedings or the expected resolution of contingencies. The Company's management believes that the Company's accruals for probable and estimable losses are reasonable and that the amounts accrued do not have a material effect on the Company's consolidated financial statements.

Regarding the matter involving the Co-Existence Agreement effective as of August 30, 2013 with Federated Mutual Insurance Company ("Mutual") and the related arbitration (please see Note 9 of our 2018 Form 10-K for more information), the Company and Mutual have exchanged releases and all remaining pending proceedings have been resolved by an agreed order entered by the U.S. District Court for the Northern District of Illinois on November 22, 2019.

Assessment Related Activity

The Company operates 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: Florida Insurance Guaranty Association ("FIGA"), Citizens Property Insurance Corporation ("Citizens"), FHCF, Georgia Insurers Insolvency Pool ("GIIP"), Special Insurance Fraud Fund ("SIIF"), Fair Access to Insurance Requirements Plan ("FAIRP"), Property Insurance Association of Louisiana ("PIAL"), South Carolina Property & Casualty Insurance Guaranty Association ("SCPCIGA"), Texas Property and Casualty Insurance Guaranty Association ("TPCIGA"), Texas Windstorm Insurance Association ("TWIA"), Alabama Insurance Guaranty Association ("AIGA"), and Alabama Insurance Underwriters Association ("AIUA"). As a direct premium writer, we are required to participate in certain insurer solvency associations under the applicable laws in the states which we do business. One form of assessment requires us to collect the assessment from our policyholders and then remit the collected amounts to the assessing entity, which does not have any impact on our financial results. We are also subject to assessments that require us to pay the full amount of the assessment to the assessing entity and then we are permitted to make rate filings to allow us to recoup the amount of the assessment from our policyholders over time.

In connection with its automobile line of business, which is currently winding down, FNIC is also required to participate in an insurance apportionment plan under Florida law, 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. There were no material assessments by the JUA Plan as of December 31, 2020. Future assessments by the JUA and the JUA Plan are indeterminable at this time.

Leases

The Company is committed under various operating lease agreements for office space. FNHC and its subsidiaries lease certain facilities, furniture and equipment under long-term lease agreements. Rental expense for the years ended December 31, 2020, 2019 and 2018 was \$1.1 million, \$1.0 million and \$0.7 million, respectively.

Future minimum lease payments under these agreements are as follows:

Year Ended December 31,	Aggregate Minimum Lease Payments
	(In thousands)
2021	\$ 1,066
2022	1,098
2023	1,131
2024	1,164
2025	1,115
Thereafter	3,318
Total	\$ 8,892

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

The right-of-use asset is reflected in other assets and the lease liability is reflected in other liabilities on our consolidated balance sheets. Lease expense, net of sublease income is reflected in general and administrative expenses on our consolidated statements of operations.

Additional information related to our operating lease agreement for office space consisted of the following:

	December 31,	
	2020	2019
	(In thousands)	
Right-of-use asset	\$ 7,430	\$ 8,096
Accrued rent	(259)	(317)
Right-of-use asset, net	<u>\$ 7,171</u>	<u>\$ 7,779</u>
Lease liability	\$ 7,430	\$ 8,096
Weighted average discount rate	4.70 %	4.70 %
Weighted average remaining years of lease term	7.7	8.7

	Year Ended December 31,	
	2020	2019
	(In thousands)	
Lease expense	\$ 1,118	\$ 1,046
Sublease income	(466)	(229)
Lease expense, net	<u>\$ 652</u>	<u>\$ 817</u>
Net cash provided by (used in) operating activities	\$ (555)	\$ (573)

The interest rates implicit in our leases were not known, therefore the weighted-average discount rate above was determined by what FedNat would have had to pay to borrow the lease payments in a similar economic environment that existed at inception of our leases while considering our general credit and the theoretical collateral of the office space. In the event of a change to lease term, the Company would re-evaluate all inputs and assumptions, including the discount rate.

Refer to Note 2 above for additional information regarding the implementation of new lease accounting rules on January 1, 2019.

13. SHAREHOLDERS' EQUITY

Common Stock Repurchases

The Company has previously repurchased shares of its common stock in open market transactions complying with Rules 10b-18 and 10b5-1 under the Exchange Act. These repurchases were based on assessments of the Company's capital needs at the time, the market prices of the Company's common stock, and general market conditions. The amount and timing of such repurchases were subject to market conditions, applicable legal requirements and other factors. At the present time, the Company is prohibited from undertaking any share repurchases under the terms of its senior note indenture.

In December 2017, the Company's Board of Directors authorized an additional share repurchase program under which the Company may repurchase up to \$10.0 million (plus \$0.8 million remaining from previous authorization which was fully expended as of March 31, 2018) of its outstanding shares of common stock through December 31, 2018. The unused portion of this authorization expired on December 31, 2018.

In December 2018, the Company's Board of Directors authorized an additional share repurchase program under which the Company may repurchase up to \$10.0 million of its outstanding shares of common stock through December 31, 2019. During the year ended

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

December 31, 2019, the Company repurchased 237,647 shares of its common stock at a total cost of \$3.9 million, which is an average price per share of \$16.27. The unused portion of this authorization expired on December 31, 2019.

In December 2019, the Company's Board of Directors authorized a new share repurchase program under which the Company may repurchase up to \$10 million of its outstanding shares of common stock from January 1, 2020 through December 31, 2020. In March 2020, the Company's Board of Directors authorized an additional \$10.0 million increase to the share repurchase program. This increased authorization allowed the Company to purchase up to \$20 million of shares outstanding through December 31, 2020. During the year ended December 31, 2020, the Company repurchased 800,235 shares of its common stock at a total cost of \$10.0 million, which is an average price per share of \$12.50. The unused portion of this authorization expired on December 31, 2020.

Securities Offerings

In June 2018, the Company filed with the Securities and Exchange Commission ("SEC") on Form S-3, a shelf registration statement enabling the Company to offer and sell, from time to time, up to an aggregate of \$150.0 million of securities. Refer to Note 18 for information on securities that were recently sold under this registration statement.

Stock Compensation Plan

In June 2018, the Company filed with the SEC on Form S-8, a registration statement registering 800,000 shares of common stock reserved for issuance under the Company's 2018 Omnibus Incentive Compensation Plan (the "2018 Plan"). The 2018 Plan, which was approved by the Company's shareholders at the 2018 annual meeting is an equity compensation plan that may be used for our employees, non-employee directors, consultants and advisors.

Share-Based Compensation Expense

Share-based compensation arrangements include the following:

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Restricted stock	\$ 1,409	\$ 1,841	\$ 2,134
Performance stock	171	335	233
Total share-based compensation expense	<u>\$ 1,580</u>	<u>\$ 2,176</u>	<u>\$ 2,367</u>
Recognized tax benefit	\$ 634	\$ 534	\$ 600
Intrinsic value of options exercised	110	2	229
Fair value of restricted stock vested	1,659	1,977	2,360

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 \$3.4 million as of December 31, 2020, which will be recognized over the remaining weighted average vesting period of approximately 1.96 years.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Stock Option Awards

A summary of the Company's stock option activity includes the following:

	Number of Shares	Weighted Average Option Exercise Price
Outstanding at January 1, 2018	50,351	\$ 3.72
Granted	—	—
Exercised	(10,834)	3.47
Cancelled	(500)	2.45
Outstanding at December 31, 2018	39,017	3.80
Granted	—	—
Exercised	(167)	2.45
Cancelled	—	—
Outstanding at December 31, 2019	38,850	3.80
Granted	—	—
Exercised	(13,433)	3.16
Cancelled	—	—
Outstanding at December 31, 2020	25,417	\$ 4.01

Stock options outstanding and exercisable in a select price range is as follows:

Options Outstanding and Exercisable				
Range of Exercise Price	Shares Outstanding and Exercisable	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Aggregate Intrinsic Value
\$2.45 - \$4.40	25,417	1.14	\$4.01	48,546

Restricted Stock Awards

The Company recognizes share-based compensation expense for all RSAs held by the Company's directors, executives and other key employees. For all RSA awards, excluding grants based on total relative shareholder return ("TSR"), the accounting charge is measured at the grant date as the fair value of FNHC common stock and expensed as non-cash compensation over the vesting term using the straight-line basis for service awards and over successive one-year requisite service periods for performance-based awards. Our expense for our performance awards depends on achievement of specified results; therefore the ultimate expense can range from 0% to 250% of target. Our TSR-based cliff vesting awards contain performance criteria which are tied to the achievement of certain market conditions. The TSR grant date fair value was determined using a Monte Carlo simulation and, unlike the performance condition awards, the expense is not reversed if the performance condition is not met. This value is recognized as expense over the requisite service period using the straight-line recognition method.

During the years ended December 31, 2020 and 2019, the Board of Directors granted 210,272 and 140,156 RSAs, respectively, vesting over three or five years, to the Company's directors, executives and other key employees.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

RSA activity includes the following:

	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2018	297,543	\$ 20.54
Granted	133,060	16.31
Vested	(112,071)	21.06
Cancelled	(56,198)	17.87
Outstanding at December 31, 2018	262,334	18.78
Granted	140,156	18.03
Vested	(94,755)	20.87
Cancelled	(52,390)	17.66
Outstanding at December 31, 2019	255,345	17.82
Granted	210,272	11.82
Vested	(89,889)	18.46
Cancelled	—	—
Outstanding at December 31, 2020	<u>375,728</u>	<u>\$ 14.32</u>

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

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) associated with debt securities - available-for-sale consisted of the following:

	Year Ended December 31,					
	2020			2019		
	Before Tax	Income Tax	Net	Before Tax	Income Tax	Net
	(In thousands)					
Accumulated other comprehensive income (loss), beginning-of-period	\$ 13,621	\$ (3,340)	\$ 10,281	\$ (5,023)	\$ 1,273	\$ (3,750)
Other comprehensive income (loss) due to debt securities - held to maturity reclassified to available-for-sale	(58)	14	(44)	—	—	—
Other comprehensive income (loss) before reclassification	19,114	(4,688)	14,426	20,809	(5,144)	15,665
Reclassification adjustment for realized losses (gains) included in net income	(17,591)	4,314	(13,277)	(2,165)	531	(1,634)
	<u>1,523</u>	<u>(374)</u>	<u>1,149</u>	<u>18,644</u>	<u>(4,613)</u>	<u>14,031</u>
Accumulated other comprehensive income (loss), end-of-period	<u>\$ 15,086</u>	<u>\$ (3,700)</u>	<u>\$ 11,386</u>	<u>\$ 13,621</u>	<u>\$ (3,340)</u>	<u>\$ 10,281</u>

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

14. EMPLOYEE BENEFIT PLAN

The Company sponsors a profit sharing plan under Section 401(K) of the Internal Revenue Code, which is a defined contribution plan that allows employees to defer compensation through contributions to the 401(K) Plan. This plan covers substantially all employees who meet specified service requirements and includes a 100% match up to the first 6% of an employee's salary, not to exceed statutory limits. Additionally, the Company may make additional profit-sharing contributions.

For the years ended December 31, 2020, 2019 and 2018, the Company made no additional profit-sharing contribution.

The Company's total contributions to the 401(K) Plan were \$1.2 million, \$0.9 million and \$1.0 million for the years ended December 31, 2020, 2019 and 2018, respectively.

15. RELATED PARTY TRANSACTIONS

Related to an equity method investment in Southeast Catastrophe Consulting Company, LLC, based in Mobile, Alabama, the Company recorded pre-tax claims adjustment service fees and other expenses of \$6.7 million for the year ended December 31, 2018. Additionally, the Company recognized other income in the consolidated statements of operations, of \$2.2 million, \$0.3 million, \$0.3 million for the years ended December 31, 2020, 2019 and 2018, respectively.

16. EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed by dividing net income by the weighted average number of common shares outstanding for the period, including vested restricted stock awards during the period. Diluted EPS is computed by dividing net income by the weighted average number of shares outstanding, noted above, adjusted for the dilutive effect of stock options and unvested restricted stock awards. Dilutive securities are common stock equivalents that are freely exercisable into common stock at less than market prices or otherwise dilute earnings if converted. The net effect of common stock equivalents is based on the incremental common stock that would be issued upon the assumed exercise of common stock options and the vesting of RSAs using the treasury stock method. Common stock equivalents are not included in diluted earnings per share when their inclusion is antidilutive.

The following table presents the calculation of basic and diluted EPS:

	Year Ended December 31,		
	2020	2019	2018
	(In thousands, except per share data)		
Net income (loss) attributable to FedNat Holding Company shareholders	\$ (78,158)	\$ 1,011	\$ 14,928
Weighted average number of common shares outstanding - basic	13,846	12,977	12,775
Net income (loss) per common share - basic	<u>(\$5.64)</u>	<u>\$0.08</u>	<u>\$1.17</u>
Weighted average number of common shares outstanding - basic	13,846	12,977	12,775
Dilutive effect of stock compensation plans	—	46	92
Weighted average number of common shares outstanding - diluted	<u>13,846</u>	<u>13,023</u>	<u>12,867</u>
Net income (loss) per common share - diluted	<u>\$ (5.64)</u>	<u>\$ 0.08</u>	<u>\$ 1.16</u>
Dividends per share	<u>\$ 0.36</u>	<u>\$ 0.33</u>	<u>\$ 0.24</u>

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Dividends Declared

In February 2020, our Board of Directors declared a \$0.09 per common share dividend, payable in March 2020, to shareholders of record on February 14, 2020, amounting to \$1.3 million.

In April 2020, our Board of Directors declared a \$0.09 per common share dividend, payable in June 2020, to shareholders of record on May 15, 2020, amounting to \$1.3 million.

In July 2020, our Board of Directors declared a \$0.09 per common share dividend, payable in September 2020, to shareholders of record on August 14, 2020, amounting to \$1.2 million.

In November 2020, our Board of Directors declared a \$0.09 per common share dividend, payable in December 2020, to shareholders of record on November 16, 2020, amounting to \$1.3 million.

17. STATUTORY ACCOUNTING AND DIVIDEND RESTRICTIONS

The Company's insurance companies are subject to regulations and standards of the Florida Office of Insurance Regulation (the "Florida OIR") and Louisiana Department of Insurance (the "LDI"). These standards require that insurance companies prepare statutory-basis financial statements in accordance with the National Association of Insurance Commissioners ("NAIC") Accounting Practices and Procedures Manual. The Company did not use any prescribed or permitted statutory accounting practices that differed from the NAIC's statutory accounting practices as of December 31, 2020.

The Company's insurance companies are required to report their risk-based capital ("RBC") each December 31. Failure to maintain an adequate RBC could subject the Company to regulatory action and could restrict the payment of dividends. As of December 31, 2020, the RBC levels of the Company's insurance companies did not subject them to any regulatory action.

Additionally, Florida Statutes require the Company's Florida domiciled insurance companies to maintain specified levels of statutory capital and restrict the timing and amount of dividends and other distributions that may be paid to the parent company. These standards require dividends to be paid only from statutory unassigned surplus. The maximum dividend that may be paid by the Company's insurance companies to their parent company, without prior regulatory approval is limited to the lesser of statutory net income from operations of the preceding calendar year, not including realized capital gains, plus a 2 years carryforward or 10% of statutory unassigned surplus as of the preceding year end. A dividend may also be taken without prior regulatory approval if (a) the dividend is equal to or less than the greater of (i) 10% of the insurer's surplus as to policyholders derived from realized net operating profits on its business and net realized capital gains; or (ii) the insurer's entire net operating profits and realized net capital gains derived during the immediately preceding calendar year; (b) the insurer will have surplus as to policyholders equal to or exceeding 115 percent of the minimum required statutory surplus as to policyholders after the dividend or distribution is made; and (c) the insurer has filed notice with the Florida OIR at least 10 business days prior to the dividend payment or distribution, or such shorter period of time as approved by the Florida OIR on a case-by-case basis. These dividends are referred to as "ordinary dividends." However, if a dividend, together with other dividends paid within the preceding 12 months, exceeds this statutory limit or is paid from sources other than earned surplus, the entire dividend is generally considered an "extraordinary dividend" and must receive prior regulatory approval before such dividend can be paid.

With respect to the Company's Louisiana domiciled insurer, Louisiana law restricts a domestic insurer from declaring and paying any dividends to its stockholders unless its capital is fully paid in cash and is unimpaired and it has a surplus beyond its capital stock and the initial minimum surplus required and all other liabilities equal to fifteen percent of its capital stock, provided that this restriction shall not apply when an insurer's paid-in capital and surplus exceeds the minimum required by Louisiana law by one hundred percent or more. No extraordinary dividend or other extraordinary distribution to its shareholders may be made until 30 days after the commissioner of insurance has received notice of the declaration thereof and has not within that period disapproved the payment, or has approved the payment within the thirty-day period. An extraordinary dividend or distribution includes any dividend or distribution of cash or other property, whose fair market value together with that of other dividends or distributions made within the preceding twelve months exceeds the lesser of (a) 10% percent of the insurer's surplus as regards policyholders as of the 31st day of December next preceding; or (b) the net income, not including realized capital gains, for the twelve-month period ending the 31st day of December next preceding, but shall not include pro rata distributions of any class of the insurer's own securities. In determining whether a dividend or distribution is extraordinary, an insurer may carry forward net income from the previous two calendar years that has not already been paid out as dividends. This carryforward shall be computed by taking the net income from the second and third preceding calendar years, not including realized capital gains, less dividends paid in the second and immediate preceding calendar years.

FedNat Holding Company and Subsidiaries
Notes to Consolidated Statements (Continued)
December 31, 2020

Notwithstanding the foregoing, an insurer may declare an extraordinary dividend or distribution which is conditional upon regulatory approval and the declaration shall confer no rights upon shareholders until either the payment is approved or has not been disapproved within the 30-day period referred to above. As noted above, authorization to issue dividends from the insurance companies is based on achieving certain financial results and regulatory approvals. Due to the financial results, we have neither applied for regulatory approval nor are we authorized to issue dividends from the insurance carriers at this time.

As of December 31, 2020 and 2019, on a combined statutory basis, the capital and surplus of the Company's insurance companies was \$145.2 million and \$192.5 million, respectively. Combined statutory operational results of the Company's insurance companies was a net loss of \$57.5 million, net loss of \$36.8 million and net income of \$2.9 million for the years ended December 31, 2020, 2019 and 2018, respectively. Statutory capital and surplus exceeds amounts necessary to satisfy regulatory requirements.

18. SUBSEQUENT EVENTS

Rate Increases

The Company applied for and was approved by the LDI for a state-wide average rate increase of 9.9% for FNIC's Louisiana homeowners multiple-peril insurance policies, which became effective for new and renewal policies in January 2021.

The Company applied for and was approved by the Texas Department of Insurance for a state-wide average rate increase of 12.3% for MIC's Texas homeowners multiple-peril insurance policies, which became effective for new and renewal policies in February 2021.

The Company applied for and was approved by the Florida OIR for a state-wide average rate increase of 6.7% for Florida homeowners multiple-peril insurance policies, which is expected to become effective for new and renewal policies in March 2021.

The Company applied for a "use and file" rate filing with the Florida OIR to implement a state-wide average increase of 7.0% for Florida homeowners multiple-peril insurance policies and 6.0% for dwelling fire insurance policies, which is expected to become effective for new and renewal policies in April 2021. The revised rates are not deemed approved or final until so affirmed by the Florida OIR, at their discretion.

Reinsurance

Effective January 1, 2021, the Company secured a new aggregate excess of loss reinsurance for calendar year 2021 for MIC, which provides non-named storm coverage of 65% of \$15 million excess of \$10 million with a \$0.9 million occurrence deductible and a \$4.2 million occurrence limit at an approximate annual cost of \$2.3 million. Refer to Note 6 above for further information.

Effective March 1, 2021, the Company secured additional reinsurance limit of 50% of \$70 million excess of \$25 million and 100% of \$15 million excess of \$10 million at an approximate cost of \$13 million. This limit is available for any subsequent events through May 31, 2021 for all carriers and all states, with a portion excluding named storms.

Winter Storm Uri

On approximately February 13, 2021, Winter Storm Uri ("Uri") hit the Southern Plains causing heavy residential damage in Texas, primarily associated with freezing temperatures causing widespread instances of burst water pipes. The Company expects to incur claims in excess of its aggregate reinsurance retention, which is approximately \$23 million for this event. In addition, the Company has a co-participation within its reinsurance tower which arose in early February 2021 when, in conjunction with year end 2020 financial reporting, we strengthened ultimate loss and LAE reserves for the five hurricane events that occurred in 2020. Due to this increase in hurricane reserves, the Company has a co-participation of approximately \$18 million in excess of \$61 million, which results from the portion of our reinsurance program that does not embody the cascading feature where unused limit drops down for subsequent events. Combined with the \$23 million retention, the Company's total exposure to Uri including reinstatement premium is currently estimated to be \$41 million, pre-tax, before anticipated quota share recoveries.

Capital Raise

On March 15, 2021, the Company closed an underwritten public offering of 3,500,000 shares of its common stock at a price of \$4.75 per share for gross proceeds of \$16.6 million. The offering generates net proceeds to the Company of approximately \$15.2 million, after deducting the underwriter's discount and estimated offering expenses payable by the Company.

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of
FedNat Holding Company

Opinion on Internal Control over Financial Reporting

We have audited FedNat Holding Company and subsidiaries' internal control over financial reporting as of December 31, 2020, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, because of the effect of the material weakness described below on the achievement of the objectives of the control criteria, FedNat Holding Company and subsidiaries (the Company) has not maintained effective internal control over financial reporting as of December 31, 2020, based on the COSO criteria.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment. Management has identified certain design and operating effectiveness deficiencies in the Company's internal controls, which when evaluated collectively, aggregated to a material weakness in internal control. The deficiencies in the Company's internal controls included deficiencies related to management's controls over the calculation of reinsurance related balances and a profit share arrangement with the same third party.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2020 and 2019, the related consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2020, and the related notes and the financial statement schedules listed in the index at Item 15. This material weakness was considered in determining the nature, timing and extent of audit tests applied in our audit of the 2020 consolidated financial statements, and this report does not affect our report dated March 29, 2021 which expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible 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 Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

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 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.

/s/ Ernst & Young LLP

Charlotte, North Carolina
March 29, 2021

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of December 31, 2020.

Notwithstanding the identified material weakness described further below, we believe the consolidated financial statements included in this Form 10-K fairly represent in all material respects the financial condition, results of operations and cash flows of the Company for the periods presented.

Management's Report on Internal Control over Financial Reporting

Because of its inherent limitations, internal controls 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 condition, or that the degree of compliance with the policies or procedures may deteriorate.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control — Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

A material weakness is a deficiency, or combination of deficiencies, in internal controls over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. The Company's management, with the oversight of the Audit Committee of our Board of Directors, concluded that the deficiency described below rises to the level of a material weakness, as it had the potential to allow for a material dollar amount of misstatement to our financial statements being made without being detected.

Based on the results of this evaluation, our management has concluded that our internal control over financial reporting was not effective as of December 31, 2020 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with GAAP. Management has identified certain design and operating effectiveness deficiencies in the Company's internal controls, which when evaluated collectively, aggregated to a material weakness in internal control. The deficiencies in the Company's internal controls included deficiencies related to management's controls over the calculation of reinsurance related balances and a profit share arrangement with the same third party. Our independent registered public accounting firm that audited the consolidated financial statements included in this Annual Report, Ernst & Young LLP, has issued an attestation report on the effectiveness of our internal control over financial reporting which appears in Part II, Item 8, "Financial Statements and Supplementary Data" included in this Annual Report.

Changes in Internal Control over Financial Reporting

To remediate the material weakness, we are implementing additional reconciliation procedures and enhancing and strengthening our documentation and review procedures relating to unique, new, changing or unusual transactions. While management believes the implementation of the additional reconciliation procedures and other controls along with plans to add to staffing will remediate this item, the material weakness cannot be considered remediated until the applicable controls operate for a sufficient period of time and

management has concluded, through testing, that these controls are operating effectively. We expect that the remediation of this material weakness will be completed by the end of the fiscal year 2021.

Except as noted above, there were no changes in our internal control over financial reporting that occurred during the year ended December 31, 2020 that has materially affected, or is reasonable likely to materially affect, our internal control over financial reporting.

Limitations on Effectiveness

Our management and our audit committee do not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all errors or all instances of fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of the control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control gaps and instances of fraud have been detected. These inherent limitations include the realities that judgments and decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 is incorporated herein by reference to the applicable information in the Proxy Statement for our 2021 Annual Meeting of Shareholders to be filed with the Commission not later than 120 days after the close of the fiscal year.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated herein by reference to the applicable information in the Proxy Statement for our 2021 Annual Meeting of Shareholders to be filed with the Commission not later than 120 days after the close of the fiscal year.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 12 is incorporated herein by reference to the applicable information in our Proxy Statement for our 2021 Annual Meeting of Shareholders to be filed with the Commission not later than 120 days after the close of the fiscal year.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 is incorporated herein by reference to the applicable information in the Proxy Statement for the 2021 Annual Meeting of Shareholders to be filed with the Commission not later than 120 days after the close of the fiscal year.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by Item 14 is incorporated herein by reference to the applicable information in the Proxy Statement for the 2021 Annual Meeting of Shareholders to be filed with the Commission not later than 120 days after the close of the fiscal year.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 10-K

(a) The following documents are filed as part of this report.

(1) Financial Statements

The following consolidated financial statements of the Company and the reports of independent auditors thereon are filed with this report:

Independent Auditor's Reports

Consolidated Balance Sheets as of December 31, 2020 and 2019

Consolidated Statements of Operations for the years ended December 31, 2020, 2019 and 2018.

Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2020, 2019 and 2018.

Consolidated Statements of Shareholders' Equity for the years ended December 31, 2020, 2019 and 2018.

Consolidated Statements of Cash Flows for the years ended December 31, 2020, 2019 and 2018.

Notes to Consolidated Financial Statements for the years ended December 31, 2020, 2019 and 2018.

(2) Financial Statement Schedules.

The following are included herein under Item 8, Financial Statements and Supplementary Data:

Schedule II, Condensed Financial Information of Registrant

Schedule V, Valuation and Qualifying Accounts

Schedule VI, Supplemental Information Concerning Insurance Operations

- (3) Exhibits.

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Exhibit	Filing Date	
3.1	Second Restated Articles of Incorporation of FedNat Holding Company	10-Q	3.1	November 7, 2018	
3.2	Second Amended and Restated Bylaws of FedNat Holding Company	10-Q	3.2	November 7, 2018	
4.1	Description of Registrant's Securities				X
4.2	Indenture dated March 5, 2019 between FedNat Holding Company and The Bank of New York Mellon, as Trustee, Paying Agent, and Registrar	8-K	4.1	March 6, 2019	
4.3	First Supplemental Indenture by and between FedNat Holding Company and The Bank of New York Mellon, as trustee	8-K	4.1	March 5, 2020	
4.4	Form of 7.50% Senior Unsecured Note due 2029 of FedNat Holding Company	S-4	4.5	January 16, 2020	
10.1*	FHCF Supplement Layer Reinsurance Contract effective June 1, 2020 between FedNat Insurance Company and subscribing reinsurers	10-Q	10.1	May 6, 2020	
10.2*	Form of Reimbursement Contract effective June 1, 2020 between the State Board of Administration of the State of Florida, as administrator of the Florida Hurricane Catastrophe Fund, and each of FedNat Insurance Company; Monarch National Insurance Company; and Maison Insurance Company	10-Q	10.2	May 6, 2020	
10.3*	Non-Florida Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and between FedNat Insurance Company and subscribing reinsurers	10-Q	10.1	November 9, 2020	
10.4*	Non-Reinstatable Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.2	November 9, 2020	
10.5*	Third-Fifth Cascading Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.3	November 9, 2020	
10.6*	Fourth Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.4	November 9, 2020	
10.7*	First, Second and Fifth Cascading Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.5	November 9, 2020	
10.8*	Private Single Retention Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.6	November 9, 2020	
10.9*	Second-Fifth Cascading Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.7	November 9, 2020	

10.10*	<u>Third-Fifth Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.8	November 9, 2020
10.11*	<u>Second-Fifth Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.9	November 9, 2020
10.12*	<u>Third-Fifth Cascading Reinstatement Premium Protection Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.10	November 9, 2020
10.13*	<u>First-Third Cascading Reinstatement Premium Protection Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.11	November 9, 2020
10.14*	<u>Second Single Retention Reinstatement Premium Protection Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.12	November 9, 2020
10.15*	<u>Second Reinstatement Premium Protection Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.13	November 9, 2020
10.16*	<u>First Reinstatement Premium Protection Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.14	November 9, 2020
10.17*	<u>Private Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.15	November 9, 2020
10.18*	<u>Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.16	November 9, 2020
10.19*	<u>Reinstatement Premium Protection Reinsurance Contract effective July 1, 2020, by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.17	November 9, 2020
10.20*	<u>Private Second-Fifth Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.18	November 9, 2020
10.21*	<u>Non-Florida Second Event Property Catastrophe Excess of Loss Reinsurance Contract effective July 1, 2020 by and between FedNat Insurance Company and subscribing reinsurers</u>	10-Q	10.19	November 9, 2020
10.22*	<u>First-Third Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.20	November 9, 2020
10.23*	<u>Second-Fourth Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch national Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.21	November 9, 2020
10.24*	<u>Private Third-Fifth Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers</u>	10-Q	10.22	November 9, 2020

10.25*	First-Third Single Retention Cascading Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.23	November 9, 2020	
10.26*	Second and Third Event Excess Catastrophe Reinsurance Contract effective July 1, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.24	November 9, 2020	
10.27*	Supplemental Excess Catastrophe Reinsurance Contract effective July 28, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.25	November 9, 2020	
10.28*	Main Supplemental Excess Catastrophe Reinsurance Contract effective September 3, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.26	November 9, 2020	
10.29*	Supplemental Excess Catastrophe Reinsurance Contract effective September 3, 2020 by and among FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.27	November 9, 2020	
10.30*	Private Supplemental Excess Catastrophe Reinsurance Contract effective September 3, 2020 by and between FedNat Insurance Company, Monarch National Insurance Company, Maison Insurance Company and subscribing reinsurers	10-Q	10.28	November 9, 2020	
10.31*	Net Quota Share Reinsurance Agreement effective July 1, 2020 by and between FedNat Insurance Company and Swiss Reinsurance America Corporation	10-Q	10.29	November 9, 2020	
10.32*	Non-Florida Property Quota Share Reinsurance Contract effective July 1, 2020 by and between FedNat Insurance Company and SageSure Anchor Re, Inc	10-Q	10.30	November 9, 2020	
10.32.A*	Addendum 1, effective December 1, 2020, to Non-Florida Property Quota Share Reinsurance Contract effective July 1, 2020 by and between FedNat Insurance Company and SageSure Anchor Re, Inc.				X
10.33*	Quota Share Reinsurance Contract effective December 31, 2020 by and between FedNat Insurance Company and subscribing reinsurers				X
10.34*	Administrator Agreement, effective July 1, 2013, between Federated National Insurance Company and SageSure Insurance Managers LLC, as amended	10-K	10.9	March 6, 2020	
10.34.A*	Sixth Amendment, entered into November 4, 2020, to Administrator Agreement, effective July 1, 2013, between Federated National Insurance Company and SageSure Insurance Managers LLC, as amended				X
10.35	Administrative Services Agreement dated November 1, 2015 between FedNat Underwriters Inc. and SageSure Insurance Managers LLC	10-K	10.10	March 6, 2020	
10.36.A	Insurance Agency Master Agreement dated February 4, 2013 between Ivantage Select Agency, Inc. and Federated National Underwriters, Inc.	10-Q	10.5	November 6, 2013	
10.36.B	First Amendment to Insurance Agency Master Agreement dated February 12, 2013 between Ivantage Select Agency, Inc. and Federated National Underwriters, Inc.	10-Q	10.6	November 6, 2013	
10.36.C	Second Amendment to Insurance Agency Master Agreement dated February 12, 2013 between Ivantage Select Agency, Inc. and Federated National Underwriters, Inc.	10-Q	10.6	May 11, 2015	
10.36.D*	Third Amendment to Insurance Agency Master Agreement dated August 10, 2018 between Ivantage Select Agency, Inc. and FedNat Underwriters, Inc.	10-K	10.14	March 6, 2020	

10.37+	Confidential Information, Non-Solicitation and Non-Competition Agreement dated as of April 17, 2017 between the Company and Ronald Jordan	10-Q	10.3	May 10, 2017	
10.38+	Confidential Information, Non-Solicitation and Non-Competition Agreement dated as of August 22, 2020 between the Company and Patrick McCahill	10-Q	10.32	November 9, 2020	
10.39+	2018 Omnibus Incentive Compensation Plan	DEF 14A	Annex B	April 13, 2018	
10.40+	Form of Restricted Stock Grant Summary of the Company (Time-Based Vesting)	8-K	99.2	January 14, 2019	
10.41+	Form of Restricted Stock Grant Summary Agreement of the Company (Performance-Based Vesting)	8-K	99.3	January 14, 2019	
10.42+	Form of Indemnification Agreement between the Company and its directors and executive officers	10-K	10.14	March 17, 2008	
10.43+	Form of Amended and Restated Non-Competition, Non-Disclosure and Non-Solicitation Agreement between the Company and certain employees of the Company	8-K	10.1	August 7, 2013	
10.44+	Second Amended and Restated Employment Agreement dated January 18, 2012 between the Company and Michael H. Braun	8-K	10.1	January 20, 2012	
10.45+	Amendment to Employment Agreement and Restrictive Covenant Agreement effective as of March 17, 2015 between Monarch Delaware Holdings LLC and Michael H. Braun	10-Q	10.3	May 11, 2015	
10.46+	Non-Competition, Non-Disclosure and Non-Solicitation Agreement effective as of March 17, 2015 between Monarch Delaware Holdings LLC and Michael H. Braun	10-Q	10.4	May 11, 2015	
10.47.A+	Employment Agreement dated January 8, 2019 between the Company and Ronald A. Jordan	8-K	99.1	January 14, 2019	
10.47.B+	First Amendment dated November 4, 2020 to Employment Agreement dated January 8, 2019 between the Company and Ronald A. Jordan				X
10.48+	Employment Agreement dated August 22, 2020 between the Company and Patrick McCahill	10-Q	10.31	November 9, 2020	
10.49	Standstill Agreement dated December 2, 2019 between FedNat Holding Company and 1347 Property Insurance Holdings, Inc.	8-K	10.2	December 2, 2019	
10.50	Reinsurance Capacity Right of First Refusal Agreement dated December 2, 2019 between FedNat Holding Company and 1347 Property Insurance Holdings, Inc.	8-K	10.3	December 2, 2019	
10.51	Investment Advisory Agreement dated December 2, 2019 between Fundamental Global Advisors LLC and FedNat Holding Company	8-K	10.4	December 2, 2019	
10.52	Consent Order dated August 7, 2019 among the Florida Office of Insurance Regulation, FedNat Holding Company, 1347 Property Insurance Holdings, Inc., and Maison Insurance Company.	8-K	10.1	August 13, 2019	
10.53	Consent Agreement dated August 9, 2019 among the Louisiana Department of Insurance, FedNat Holding Company and Maison Insurance Company.	8-K	10.2	August 13, 2019	
21.1	Subsidiaries of the Company				X
23.1	Consent of Independent Registered Public Accounting Firm				X
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act				X
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act				X
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act				X
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act				X
101.INS**	Inline XBRL Instance Document.				X

101.SCH**	Inline XBRL Taxonomy Extension Schema Document.	X
101.CAL**	Inline XBRL Taxonomy Extension Calculation Linkbase Document.	X
101.DEF**	Inline XBRL Taxonomy Extension Definition Linkbase Document	X
101.LAB**	Inline XBRL Taxonomy Extension Label Linkbase Document.	X
101.PRE**	Inline XBRL Taxonomy Extension Presentation Linkbase Document.	X
104	Cover Page Interactive Data File (formatted in Inline XBRL and contained in Exhibit 101)	X

+ Indicates a Management Compensation Plan or Arrangement

* Portions of this exhibit have been omitted from this exhibit in accordance with and as permitted by Item 601(b)(10)(iv) of Regulation S-K.

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

Index to Financial Statement Schedules

	PAGE
Schedule II Condensed Financial Information of Registrant	113
Schedule V Valuation and Qualifying Accounts	117
Schedule VI Supplemental Information Concerning Insurance Operations	118

ITEM 16. FORM 10-K SUMMARY

Not applicable.

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this Form 10-K report to be signed on its behalf by the undersigned, thereto duly authorized.

FEDNAT HOLDING COMPANY

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

Date: March 29, 2021

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons on behalf of the registrant and in the capacities and on the date indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Michael H. Braun</u> Michael H. Braun	Chief Executive Officer, President and Director (Principal Executive Officer)	March 29, 2021
<u>/s/ Ronald A. Jordan</u> Ronald A. Jordan	Chief Financial Officer (Principal Financial Officer)	March 29, 2021
<u>/s/ Erick A. Fernandez</u> Erick A. Fernandez	Chief Accounting Officer (Principal Accounting Officer)	March 29, 2021
<u>/s/ Bruce F. Simberg</u> Bruce F. Simberg	Chairman of the Board and Director	March 29, 2021
<u>/s/ Jenifer G. Kimbrough</u> Jenifer G. Kimbrough	Director	March 29, 2021
<u>/s/ Thomas A. Rogers</u> Thomas A. Rogers	Director	March 29, 2021
<u>/s/ William G. Stewart</u> William G. Stewart	Director	March 29, 2021
<u>/s/ Richard W. Wilcox, Jr.</u> Richard W. Wilcox, Jr.	Director	March 29, 2021
<u>/s/ Roberta N. Young</u> Roberta N. Young	Director	March 29, 2021
<u>/s/ David W. Michelson</u> David W. Michelson	Director	March 29, 2021
<u>/s/ David K. Patterson</u> David K. Patterson	Director	March 29, 2021

Schedule II – Condensed Financial Information of Registrant
Condensed Balance Sheets
FEDNAT HOLDING COMPANY (Parent Company Only)
December 31, 2020 and 2019

	December 31,	
	2020	2019
	(In thousands)	
ASSETS		
Investments in subsidiaries (1)	\$ 225,568	\$ 268,767
Investment securities, available-for-sale, at fair value	20,646	24,951
Equity securities, at fair value	1,881	1,751
Cash and cash equivalents	18,170	21,031
Deferred income taxes, net	868	1,940
Income taxes receivable	7,969	13,850
Note receivable and accrued interest to subsidiary (1)	19,517	18,107
Right-of-use assets	7,108	7,716
Other assets	1,991	2,878
Total assets	<u>\$ 303,718</u>	<u>\$ 360,991</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Due to subsidiaries, net (1)	\$ 31,686	\$ 1,779
Long-term debt	98,683	98,522
Lease liabilities	7,108	7,716
Other liabilities	8,081	4,281
Total liabilities	<u>145,558</u>	<u>112,298</u>
Shareholders' Equity		
Preferred stock	—	—
Common stock	137	144
Additional paid-in capital	169,298	167,677
Accumulated other comprehensive income (loss)	11,386	10,281
Retained earnings (deficit)	(22,661)	70,591
Total shareholders' equity	<u>158,160</u>	<u>248,693</u>
Total liabilities and shareholders' equity	<u>\$ 303,718</u>	<u>\$ 360,991</u>

(1) Eliminated in consolidation.

The accompanying note is an integral part of the condensed financial statements.

Schedule II – Condensed Financial Information of Registrant (Continued)

Condensed Statements of Earnings

FEDNAT HOLDING COMPANY (Parent Company Only)

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Revenues:			
Management fees (1)	\$ 2,660	\$ 2,160	\$ 2,608
Interest from subsidiaries (1)	1,410	107	—
Net investment income	477	1,757	843
Net realized and unrealized investment gains (losses)	972	448	(765)
Equity in income (loss) of consolidated subsidiaries	(94,363)	20,909	30,895
Total revenue	(88,844)	25,381	33,581
Costs and expenses:			
General and administrative expenses	15,149	13,892	9,296
Interest expense	7,661	10,776	4,077
Total costs and expenses	22,810	24,668	13,373
Income (loss) before income taxes	(111,654)	713	20,208
Income tax expense (benefit)	(33,496)	(298)	5,498
Net income (loss)	(78,158)	1,011	14,710
Net income (loss) attributable to non-controlling interest	—	—	(218)
Net income (loss) attributable to FedNat Holding Company shareholders	\$ (78,158)	\$ 1,011	\$ 14,928

(1) Eliminated in consolidation.

The accompanying note is an integral part of the condensed financial statements.

Schedule II – Condensed Financial Information of Registrant (Continued)

Condensed Statements of Cash Flows

FEDNAT HOLDING COMPANY (Parent Company Only)

	Year Ended December 31,		
	2020	2019	2018
	(In thousands)		
Cash flow from operating activities:			
Net income (loss)	\$ (78,158)	\$ 1,011	\$ 14,710
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Net realized and unrealized investment (gains) losses	(972)	(448)	765
Equity in undistributed income (loss) of consolidated subsidiaries (1)	94,363	(20,909)	(30,895)
Amortization of investment premium or discount, depreciation and amortization	430	369	141
Loss (gain) on early extinguishment of debt	—	3,575	—
Share-based compensation	790	1,050	1,183
Changes in operating assets and liabilities:			
Income taxes, net	6,900	(5,379)	(2,371)
Due to subsidiaries, net (1)	(21,891)	3,044	(9,317)
Other, net	3,564	998	1,497
Net cash provided by (used in) operating activities	5,026	(16,689)	(24,287)
Cash flow from investing activities:			
Capital contributions to consolidated subsidiaries (1)	(11,000)	—	(30,000)
Sales, maturities and redemptions of investments securities	31,300	11,276	54,543
Purchases of investment securities	(25,089)	(15,617)	(61,009)
Payment for acquisition	—	(25,566)	—
Issuance of note receivable to subsidiary (1)	—	(18,000)	—
Purchases of property and equipment	(21)	(289)	(639)
Net cash provided by (used in) investing activities	(4,810)	(48,196)	(37,105)
Cash flow from financing activities:			
Proceeds from issuance of long-term debt, net of issuance costs	—	98,390	—
Payment of long-term debt and prepayment penalties	—	(48,000)	—
Issuance of common stock for share-based awards	42	1	39
Purchases of FedNat Holding Company common stock	(10,418)	(3,449)	(5,061)
Dividends from consolidated subsidiaries	12,376	39,174	27,990
Dividends paid	(5,077)	(4,309)	(4,184)
Net cash provided by (used in) financing activities	(3,077)	81,807	18,784
Net increase (decrease) in cash and cash equivalents	(2,861)	16,922	(42,608)
Cash and cash equivalents at beginning of period	21,031	4,109	46,717
Cash and cash equivalents at end of period	\$ 18,170	\$ 21,031	\$ 4,109

(1) Eliminated in consolidation.

The accompanying note is an integral part of the condensed financial statements.

Schedule II – Condensed Financial Information of Registrant (Continued)

Note to Condensed Financial Statements

FEDNAT HOLDING COMPANY (Parent Company Only)

(1) ORGANIZATION AND BASIS OF PRESENTATION

FedNat Holding Company (“FNHC”), the Parent Company, 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.

The accompanying condensed financial statements include the activity of the Parent Company and on an equity basis, its consolidated subsidiaries. Accordingly, these condensed financial statements have been presented for the parent company only. These condensed financial statements should be read in conjunction with the consolidated financial statements and related notes of FNHC and subsidiaries set forth in Part II, Item 8 Financial Statements and Supplemental Data of this Annual Report.

In applying the equity method to our consolidated subsidiaries, we record the investment at cost and subsequently adjust for additional capital contributions, distributions and proportionate share of earnings or losses.

Schedule V – Valuation and Qualifying Accounts
FEDNAT HOLDING COMPANY AND SUBSIDIARIES

Year	Description	Balance at January 1,	Charged to		Balance at December 31,
			Costs and Expenses	Deductions	
(in thousands)					
2020	Allowance for uncollectible reinsurance recoverable	\$ —	\$ 65	\$ —	\$ 65
	Allowance for uncollectible premiums receivable	\$ 159	\$ 74	\$ —	\$ 233
2019	Allowance for uncollectible reinsurance recoverable	\$ —	\$ —	\$ —	\$ —
	Allowance for uncollectible premiums receivable	\$ 77	\$ 82	\$ —	\$ 159
2018	Allowance for uncollectible reinsurance recoverable	\$ —	\$ —	\$ —	\$ —
	Allowance for uncollectible premiums receivable	\$ 70	\$ 7	\$ —	\$ 77

Schedule VI – Supplemental Information Concerning Insurance Operations
FEDNAT HOLDING COMPANY AND SUBSIDIARIES

Year	Line of Business	December 31,			Year Ended December 31,						
		Deferred Acquisition Cost	Loss and Loss Adjustment Expense Reserves	Unearned Premiums	Earned Premiums	Net Investment Income	Claim and Claim Adjustment Expenses Incurred Related to		Amortization of Deferred Acquisition Costs	Paid Claims and Claim Adjustment Expenses	Net Premiums Written
		Cost	Reserves	Premiums	Premiums	Income	Current Year	Prior Year	Costs	Expenses	Written
(In thousands)											
2020	Property and Casualty Insurance	\$ 25,405	\$ 540,367	\$ 366,789	\$ 364,134	\$ 11,786	\$ 358,898	\$ 17,551	\$ 121,524	\$ 354,143	\$ 236,623
2019	Property and Casualty Insurance	\$ 56,136	\$ 324,362	\$ 360,870	\$ 363,652	\$ 15,901	\$ 262,109	\$ 10,971	\$ 96,885	\$ 254,806	\$ 377,879
2018	Property and Casualty Insurance	\$ 39,436	\$ 296,230	\$ 281,992	\$ 355,257	\$ 12,460	\$ 231,133	\$ (2,717)	\$ 97,873	\$ 230,752	\$ 365,032