FEDERATED NATIONAL HOLDING CO
Form 10-K
March 17, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

x Annual Report under Section 13 or 15(d) of the Securities Act of 1934
For the fiscal year ended December 31, 2013
or
o Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period of _____________to_______________
Commission file number: 0-2500111

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

Florida	65-0248866
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employern Identification No)

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

Registrant's telephone number, including area code (954) 581-9993

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

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

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

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o 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 o 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 o

Indicate by check mark whether the registrant has electronically submitted and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes x No o

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

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

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

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

The aggregate market value of the Registrant’s common stock held by non-affiliates was $72,651,131 on June 30, 2013, computed on the basis of the closing sale price of the Registrant’s common stock on that date.

As of March 11, 2014, the total number of common shares outstanding of Registrant's common stock was 11,264,864.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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PART I

CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS

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

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

ITEM 1 BUSINESS

GENERAL

Federated National Holding Company ("FNHC", "Company", "we", "us"), formerly known as 21st Century Holding 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. We changed our name on September 11, 2012, pursuant to approval received at our annual shareholders' meeting, from 21st Century Holding Company so that our parent company and other subsidiary companies' names are consistent with our primary insurance subsidiary and the name under which we have been writing insurance for more than 22 years.

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

Our insurance subsidiary is Federated National Insurance Company ("FNIC"). FNIC is licensed as an admitted carrier in Florida. An admitted carrier is an insurance company that has received a license from the state department of insurance giving the company the authority to write specific lines of insurance in that state. These companies are also bound by rate and form regulations, and are strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud. Admitted carriers are also required to financially contribute to the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders. Through contractual relationships with a network of approximately 3,600 independent agents, of which approximately 1,800 actively sell and service our products, FNIC is authorized to underwrite homeowners', commercial general liability, fire, allied lines and personal and commercial automobile insurance in Florida. FNIC is licensed as an admitted carrier in Alabama, Louisiana, Georgia and Texas and underwrites commercial general liability insurance in those states, homeowners' insurance in Louisiana and personal automobile insurance in Georgia and Texas.

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

In January 2011, we merged FNIC and our other wholly owned insurance subsidiary, American Vehicle Insurance Company ("American Vehicle"), with FNIC continuing the operations of both entities. In connection with this merger, the Company, FNIC and American Vehicle entered into a Consent Order with the Florida Office of Insurance Regulation ("Florida OIR") pursuant to which we agreed to certain restrictions on our business operations. The Consent Order was amended in February 2013 to lessen or eliminate certain of the original requirements, due to FNIC's statutory underwriting profit during 2012. See "Regulation– Consent Order."

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

Until June 2011, we offered premium financing to our own and third-party insureds through our wholly owned subsidiary, Federated Premium Finance, Inc. ("Federated Premium").

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

FNU earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. FNU earns a $25 per policy fee, and traditionally a 6% commission fee from its affiliate, FNIC. During the fourth quarter of 2010, FNU, pursuant to the Consent Order as discussed above, reduced its fee to earn amounts varying between 2% and 4%, which we anticipate will return to 6% at an unknown future date with approval from the Florida OIR. A formal agreement reflecting this fee modification was executed during January 2011.

The homeowner policy provides FNU the right to cancel any policy within a period of 90 days from the policy's inception with 25 days' notice, or after 90 days from policy inception with 95 days' notice, even if the risk falls within our underwriting criteria.

Although we are authorized to underwrite the various lines described above, our business is primarily underwriting homeowners' policies. During 2013, 89.6%, 4.3%, 2.6% and 3.5% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and personal automobile insurance, respectively. During 2013, $29.7 million or 13.6% of the $218.3 million of homeowners' premiums we underwrote were produced under an agency agreement with Ivantage Select Agency, Inc. ("ISA"), an affiliate of Allstate Insurance Company, that grants Allstate agents the authority to offer certain FNU products. The $29.7 million of homeowners' premiums produced under this agreement with ISA represents 25.5% of the total increase in the sale of homeowners' policies during 2013, compared with 2012. This network of agents began writing for FNIC in March 2013. During 2012, 85.3%, 7.8%, 4.4% and 2.5% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and personal automobile insurance, respectively.

During the years ended December 31, 2013, 2012 or 2011, we did not experience any weather-related catastrophic events such as the hurricanes that occurred in Florida during 2005 and 2004. We are not able to predict how hurricanes or other insurable events will affect our future results of operations and liquidity. Losses and LAE are affected by a number of factors, many of which are partially or entirely beyond our control, including the following.

- the nature and severity of the loss;
- weather-related patterns;
- the availability, cost and terms of reinsurance;
- underlying settlement costs, including medical and legal costs;
- legal and political factors such as legislative initiatives and public opinion;
- macroeconomic issues.

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

We have entered into a Coexistence Agreement effective August 30, 2013 (the "Coexistence Agreement") with Federated Mutual Insurance Company ("Federated Mutual") in response to correspondence received from Federated Mutual's counsel alleging that our use of the name "Federated" infringed certain federal trademarks held by Federated Mutual. Although we believe that we have meritorious defenses to this allegation, we sought to avoid litigation and therefore negotiated and entered into the Coexistence Agreement. Under the Coexistence Agreement, among other things, we may continue to use "Federated" until at least August 30, 2020, after which time we have agreed to either cease using "Federated" in commerce or otherwise adopt and use trade names that are not confusingly similar to Federated Mutual's trademarks. During this period, we continue to develop our brand under the "FedNat" name, which is the name by which agents generally know us.

Our goal in our reinsurance strategy is to equalize the liquidity requirements imposed by most severe insurable events and by all other insurable events we manage in the normal course of business. Please see "Reinsurance Agreements" under "Item 1. Business" for a more detailed description of our reinsurance agreements and strategy.

Our executive offices are located at 14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323 and our telephone number is (954) 581-9993.

Our internet web site is FedNat.com for policy holders, agents and investors. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports are available, free of charge, through our website as soon as reasonably practicable after we electronically file or furnish such material to the Securities and Exchange Commission ("SEC"). Further, a copy of this annual report on Form 10-K is located at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding our filings at www.sec.gov.

RECENT DEVELOPMENTS

We sold 2,781,395 shares of our common stock in a November 19, 2013 capital raise offering, which represented approximately 25.0% of our outstanding shares of common stock on that date after giving effect to this offering.

BUSINESS STRATEGY

We expect that in 2014 we will capitalize on our operational efficiencies and business practices through:

- improved property analytical qualities such as a broader geographical dispersion of risks throughout the state of Florida and avoiding risks that do not yield an underwriting profit;

- continued territorial expansion of our homeowners', commercial general liability and private passenger automobile insurance products into additional states;

- employing our business practices developed and used in Florida in our expansion to other selected states;

- maintaining a commitment to provide high quality customer service to our agents and insureds;
- expansion of our marketing efforts by retaining key personnel and implementing direct marketing technologies;
- offering attractive incentives to our agents to place a high volume of quality business with our companies;
- offering our employees continuing education classes appropriate to the respective discipline employed within this organization;
- assumption of existing risks from other carriers; and
- additional strategies that may include possible acquisitions or dispositions of assets, and development of procedures to improve claims history and mitigate losses from claims.

We expect that in 2014 these strategies have poised us to accelerate the 2013 results trajectory in 2014 and beyond. There can be no assurances, however, that any of the foregoing strategies will be developed or successfully implemented or, if implemented, that they will positively affect our results of operations.

INSURANCE OPERATIONS AND RELATED SERVICES

Overview of Premium Growth

Gross premiums written increased $123.9 million, or 103.7%, to $243.4 million for 2013, compared with $119.5 million for 2012. Florida homeowners' represents 94% and Texas private passenger automobile represents the remaining 6% of the increased premium volume. We believe that our growth in 2013 reflects management's efforts over several years. Our success today reflects our goal to be an agent-friendly carrier that provides exceptional service. We have invested in our agent relationships and our staff, have created easy to use systems for the agent, and increased our relevance to the agents' operations by providing insurance products that meet their market needs.

Our homeowner business contributed $116.5 million or 94.0% of the increased gross written premiums during the year ended December 31, 2013. This increase was the result of:

- policyholders continuing to renew their FNIC homeowners' policy,
- a "flight to quality" in the market by agents who seek quality carriers to place their business,
- and supporting a marketing team dedicated to promoting the quality and quantity of products and services that we offer.

During 2013, approximately 85% of our policyholders renewed their policies. This high retention rate reflects the confidence that the policyholder and his agent have in our financial stability and strength. Additionally, policyholders have told agents that our professional staff adjusts claims quickly and fairly.

Overview of Insurance Lines of Business

The following tables set forth the amount and percentages of our consolidated gross premiums written, premiums ceded to reinsurers and net premiums written by line of business for the periods indicated.

	Years Ended December 31,					
	2013		2012		2011	
	Premium	Percent	Premium	Percent	Premium	Percent
	(Dollars in Thousands)					
Gross written premiums:						
Automobile	$8,449	3.5 %	$2,996	2.5 %	$3,274	3.3 %
Federal Flood	6,213	2.6 %	5,293	4.4 %	4,468	4.5 %
Homeowners'	218,350	89.6 %	101,832	85.3 %	80,403	81.9 %
Commercial General Liability	10,362	4.3 %	9,338	7.8 %	10,125	10.3 %
Total gross written premiums	$243,374	100.0 %	$119,459	100.0 %	$98,270	100.0 %
Ceded premiums:						
Automobile	$6,337	7.7 %	$2,021	4.0 %	$1,541	3.3 %
Federal Flood	6,213	7.5 %	5,293	10.4 %	4,468	9.7 %
Homeowners'	69,721	84.3 %	43,331	84.7 %	40,273	87.0 %
Commercial General Liability	438	0.5 %	440	0.9 %	12	0.0 %

Total ceded premiums	$82,709	100.0 %	$51,085	100.0 %	$46,294	100.0 %
Net written premiums						
Automobile	$2,112	1.3 %	$975	1.4 %	$1,733	3.3 %
Federal Flood	-	0.0 %	-	0.0 %	-	0.0 %
Homeowners'	148,629	92.5 %	58,501	85.6 %	40,130	77.2 %
Commercial General Liability	9,924	6.2 %	8,898	13.0 %	10,113	19.5 %
Total net written premiums	$160,665	100.0 %	$68,374	100.0 %	$51,976	100.0 %

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Homeowners' Property and Casualty Insurance

FNIC underwrites homeowners' insurance in Florida and Louisiana. Homeowners' insurance generally protects an owner of real and personal property against covered causes of loss to that property. The number of Louisiana homeowner policies in-force totaled approximately 400 at December 31, 2013. The table that follows reflects the number of Florida homeowner policies in-force by county and reflects our concentrations of risk from catastrophic events.

	In-Force Policy Count Years Ended December 31,					
	2013		2012		2011	
County	Amount	Percentage	Amount	Percentage	Amount	Percentage
Palm Beach	13,874	11.9 %	7,270	11.7 %	8,203	19.0 %
Brevard	8,947	7.7 %	4,508	7.4 %	2,900	6.6 %
Collier	7,420	6.4 %	3,422	5.6 %	1,583	3.6 %
Lee	6,870	5.9 %	5,175	8.5 %	3,133	7.2 %
Hillsborough	6,350	5.5 %	2,682	4.4 %	2,984	6.8 %
Pinellas	6,139	5.3 %	4,034	6.6 %	3,788	8.6 %
Broward	5,498	4.7 %	3,700	6.1 %	4,386	10.0 %
Saint Lucie	4,957	4.3 %	3,151	5.2 %	1,757	4.0 %
Indian River	4,704	4.0 %	2,436	4.0 %	903	2.1 %
Okaloosa	4,668	4.0 %	1,966	3.2 %	372	0.8 %
Martin	4,444	3.8 %	2,052	3.4 %	984	2.2 %
Orange	4,083	3.5 %	1,654	2.7 %	1,012	2.3 %
Sarasota	3,936	3.4 %	2,759	4.5 %	2,689	6.1 %
Charlotte	3,129	2.7 %	2,059	3.4 %	1,680	3.8 %
Escambia	3,038	2.6 %	1,227	2.0 %	158	0.4 %
Walton	3,021	2.6 %	1,210	2.0 %	193	0.4 %
Santa Rosa	2,939	2.5 %	1,305	2.1 %	131	0.3 %
Bay	2,785	2.4 %	792	1.3 %	118	0.3 %
Duval	2,249	1.9 %	911	1.5 %	546	1.2 %
Volusia	1,990	1.7 %	881	1.4 %	863	2.0 %
Miami-Dade	1,883	1.6 %	1,616	2.6 %	1,944	4.4 %
Manatee	1,859	1.6 %	1,560	2.6 %	1,548	3.5 %
Seminole	1,665	1.4 %	788	1.3 %	367	0.8 %
Saint Johns	1,639	1.4 %	547	0.9 %	165	0.4 %
Flagler	1,267	1.1 %	543	0.9 %	66	0.2 %
All others	7,047	6.1 %	2,854	4.7 %	1,320	3.0 %
Total	116,401	100.0 %	61,102	100.0 %	43,793	100.0 %

Our homeowner insurance products provide maximum dwelling coverage in the amount of approximately $3.0 million, with the aggregate maximum policy limit being approximately $5.0 million. We currently offer dwelling coverage "A" up to $3.0 million with an aggregate total insured value of $5.0 million. We continually subject these limits to review; though there were no material changes during 2013. The approximate average premium on the policies currently in-force is $1,857, as compared with $1,675 for 2012. 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 homeowner 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 nor inadequate). Premium rates are regulated and approved by the Florida OIR. In 2013 our voluntary program rate indications did not indicate the need for adjustment. In 2012 we were approved for a 4.8% and 0.9% rate increase on our voluntary property book of homeowners' business. In 2011 our voluntary rate increase of 20% was approved.

Similarly, for the policies we assumed from Citizens Property Insurance Corporation ("Citizens") in 2009, we received approval for a 14.8% increase in 2013 and a 14.1% rate increase in 2012. In 2011 we received approval for a 13.9% increase. Our voluntary program was 97.7%, 90.0%, and 79.2% of the total homeowner program, for the years ending December 31, 2013, 2012, and 2011, respectively.

For a further discussion regarding Homeowners' Property and Casualty Insurance, see "Recent Developments", above.

Commercial General Liability

We underwrite commercial general liability insurance for approximately 380 classes of artisan (excluding home-builders and developers) and mercantile trades (such as owners, landlords and tenants). The limits of liability range from $100,000 per occurrence with a $200,000 policy aggregate to $1.0 million per occurrence with a $2.0 million policy aggregate. We continually subject these limits to review, though there were no changes during 2013. We market the commercial general liability insurance products through independent agents and a limited number of general agencies unaffiliated with the Company. The average annual premium on policies currently in-force during 2013 is approximately $773, as compared with $569 in 2012.

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

	Years Ended December 31,								
	2013			2012			2011		
	Amount	Percentage		Amount	Percentage		Amount	Percentage	
	(Dollars in Thousands)								
State									
Florida	$9,572	92.37	%	$8,639	92.52	%	$8,606	84.99	%
Louisiana	150	1.45	%	217	2.32	%	916	9.05	%
Texas	547	5.28	%	426	4.56	%	534	5.28	%
Other	93	0.90	%	56	0.60	%	69	0.68	%
Total	$10,362	100.00	%	$9,338	100.00	%	$10,125	100.00	%

Personal Automobile

Personal automobile insurance markets can be divided into two categories, standard automobile and nonstandard automobile. Standard personal automobile insurance is principally provided to insureds who present an average risk profile in terms of driving record, vehicle type and other factors. Nonstandard personal automobile insurance is principally provided to insureds that are unable to obtain standard insurance coverage because of their driving record, age, vehicle type or other factors, including market conditions. The average nonstandard personal automobile insurance policy currently in-force is approximately $987 for a twelve month policy in Florida and approximately $158 for a three month policy in Texas.

The maximum exposures for the nonstandard policy in Florida are $10,000 per individual, $20,000 per accident for bodily injury, $10,000 per accident for property damage, and predominantly $50,000 for comprehensive and collision. Beginning in late 2010 we underwrote nonstandard personal automobile insurance in Georgia, where the maximum exposures are $25,000 per individual, $50,000 per accident for bodily injury, $25,000 per accident for property damage, and predominantly $50,000 for comprehensive and collision. In addition, we write commercial automobile insurance in Florida. The maximum exposure is predominantly $30,000 on a combined single limit basis.

Flood

FNIC writes flood insurance through the National Flood Insurance Program ("NFIP") on a direct and ceded basis. We write the policy for the NFIP, which assumes 100% of the flood risk while we retain a commission for our service. The average flood policy premium is approximately $504 with limits up to $250,000. Commissions in connection with this program totaled $0.4 million, $0.3 million and $0.2 million in 2013, 2012 and 2011, respectively.

Managing General Agent Services

FNU, a wholly owned subsidiary of the Company, acts as FNIC's exclusive managing general agent in Florida and is also licensed as a managing general agent in the States of Alabama, Georgia, Louisiana, Mississippi, Missouri, North Carolina, Nevada, South Carolina, Texas and Virginia. FNU has contracted with several unaffiliated insurance companies to sell commercial general liability, workers compensation, personal umbrella, inland marine and other various lines of insurance through FNU's existing network of agents.

FNU earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. FNU earns a $25 per policy fee, and traditionally a 6% commission fee from its affiliate, FNIC. During the fourth quarter of 2010, FNU, pursuant to the Consent Order as discussed above, reduced its fee to earn amounts varying between 2% and 4%, which we anticipate will return to 6% at an unknown future date with approval from the Florida OIR. A formal agreement reflecting this fee modification was executed during January 2011.

Claims Adjusting

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

Premium Finance

Until June 2011, our wholly owned subsidiary, Federated Premium, offered premium financing to our own and third-party insureds. Premium financing was marketed through our distribution network of general agents and independent agents.

The Company anticipates continued use of the direct bill feature associated with our homeowners' and commercial general liability programs. Direct billing is when the insurance company accepts from the insured, as a receivable, a promise to pay the premium, as opposed to requiring payment of the full amount of the policy. The advantage of direct billing a policyholder by the insurance company is that we are not reliant on a credit facility, but remain able to charge and collect interest from the policyholder. Underwriting criteria are designed with down payment requirements and monthly payments that create policyholder equity in the insurance policy. The equity in the policy is collateral for the extension of credit to the insured.

Through our monitoring systems, we track delinquent payments and, in accordance with the terms of the extension of credit, cancel if payment is not made. If any excess premium remains after cancellation of the policy and deduction of applicable penalties, this excess is refunded to the policyholder. The direct bill program enables us to closely manage our risk while providing credit to our insureds.

Independent Insurance Agency

Insure-Link, Inc. ("Insure-Link") was formed in March 2008 to serve as an independent insurance agency. The insurance agency markets direct to the public to provide a variety of insurance products and services to individual clients, as well as business clients, by offering a full line of insurance products including, but not limited to, homeowners', flood, personal and commercial automobile, commercial general liability and workers' compensation insurance through their agency appointments with over thirty different carriers.

MARKETING AND DISTRIBUTION

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

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

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

We believe that the management of our distribution system now centers on our ability to capture and maintain relevant data by producing agents. We believe that information management of agent production, coupled with loss experience, will enable us to maximize profitability.

REINSURANCE AGREEMENTS

Financing risk generally involves a combination of risk retention and risk transfer techniques. “Retention”, similar to a deductible, involves financing losses by funds internally generated. “Transfer” involves the existence of a contractual arrangement designed to shift financial responsibility to another party in exchange for premium. Secondary to the primary risk-transfer agreements, we use reinsurance agreements to transfer a portion of the risks insured under our policies to other companies through the purchase of reinsurance. We utilize reinsurance to reduce exposure to catastrophic and non-catastrophic risks and to help manage the cost of capital. Reinsurance techniques are designed to lessen earnings volatility, improve shareholder return, and to support the required statutory surplus requirements. We also use reinsurance to realize an arbitrage of premium rates, benefit from the availability of our reinsurers’ expertise, and benefit from the management of a profitable portfolio of insureds by way of enhanced analytical capacities. Our primary property line that is subject to catastrophic reinsurance is Homeowners’ Multiple Peril. FNIC cedes these risks to domestic and foreign reinsurance participants from Bermuda and Europe as well as to the Florida Hurricane Catastrophe Fund (“FHCF”).

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

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

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

For the 2013–2014 hurricane season, the excess of loss and FHCF treaties insured the property lines for approximately $562.7 million of aggregate catastrophic losses and LAE with a maximum single event coverage totaling approximately $420.4 million, with the Company retaining the first $7.0 million of losses and LAE for each event.

The reinsurance program includes coverage purchased from the private market, which affords optional reinstatement premium protection that provides coverage beyond the first event, along with any remaining coverage from the FHCF. Coverage afforded by the FHCF totals approximately $278.1 million, or 49.4 % of the $562.7 million of aggregate catastrophic losses and LAE. The FHCF affords coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event.

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

The 2013-2014 private reinsurance companies and their respective A.M. Best Company ("A.M. Best") and Standard and Poor's ("S&P") ratings are listed in the table as follows.

Reinsurer	A.M. Best Rating	S&P Rating
UNITED STATES		
American Agricultural Insurance Company	A-	NR
Everest Reinsurance Company	A+	A+
Houston Casualty Company, UK Branch	A	A+
Odyssey Reinsurance Company	A	A-
BERMUDA		
ACE Tempest Reinsurance Limited	A+	AA-
Allied World Assurance Company Limited, Bermuda	A	A
Arch Reinsurance Limited	A+	A+
Argo Reinsurance Limited	A	NR
Ariel Reinsurance Bermuda Ltd for and on Behalf of Ariel Syndicate 1910 (ARE)	A-	NR
DaVinci Reinsurance Ltd	A	A+
Endurance Specialty Insurance Limited	A	A
JC Re Ltd. (aka Pillar Capital and fka Juniperus & Actua Re Ltd.)	NR *	** NR
Partner Reinsurance Company Limited	A+	A+
Platinum Underwriters Bermuda Limited	A	A-
Renaissance Reinsurance Ltd	A+	AA-
S.A.C. Re, Ltd.	A-	NR
XL Re Limited	A	A
UNITED KINGDOM		
A.F. Beazley Syndicate No. 623 (AFB)	A	A+
A.F. Beazley Syndicate No. 2623 (AFB)	A	A+
Amlin Syndicate No. 2001 (AML)	A	A+
Ariel Syndicate No. 1910 (ARE)	A	A+
ARK Syndicate No. 3902 (NOA)	A	A+
Ascot Syndicate No. 1414 (ASC)	A	A+
Barbican Syndication No. 1955 (BAR)	A	A+
Canopius Syndicate No. 958 (CNP)	A	A+
Canopius Syndicate No. 4444 (CNP)	A	A+
Cathederal Syndicate No. 2010 (MMX)	A	A+
Kiln Syndicate No. 510 (KLN)	A	A+
Liberty Syndicates Services Limited, Paris for and on behalf of Lloyd's Syndicate No. 4472 (LIB)	NR	A+
MAP Underwriting Syndicate No. 2791 (MAP)	A	A+
MAP Underwriting Syndicate No. 2791 (Parallel) (MAP)	A	A+
Novae Syndicate No. 2007 (NVA)	A	A+
Pembroke Syndicate No. 4000 (PEM)	A	A+
Tokio Marine Kiln Syndicate No. 1880 (TMK)	A	A+
EUROPE		

Amlin Bermuda (Branch of Amlin AG)	A	A
SCOR Global P&C SE	A	A

* Reinstatement Premium Protection Program Participants

** Participant will fund a trust agreement for their exposure with cash and U.S. Government obligations of American institutions at fair market value.

For the 2012–2013 hurricane season, the excess of loss and FHCF treaties insured the property lines for approximately $328.3 million of aggregate catastrophic losses and LAE with a maximum single event coverage totaling approximately $246.5 million, with the Company retaining the first $8.0 million of losses and LAE for each event. The reinsurance program includes coverage purchased from the private market, which affords optional reinstatement premium protection that provides coverage beyond the first event, along with any remaining coverage from the FHCF. Coverage afforded by the FHCF totals approximately $144.7 million, or 44.1% of the $328.3 million of aggregate catastrophic losses and LAE. The FHCF affords coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event.

The estimated cost to the Company for the excess of loss reinsurance products for the 2012-2013 hurricane season, inclusive of approximately $11.2 million payable to the FHCF and the prepaid automatic premium reinstatement protection, is approximately $43.1 million.

The 2012-2013 private reinsurance companies and their respective A.M. Best and S&P ratings are listed in the table as follows.

Reinsurer	A.M. Best Rating		S&P Rating
UNITED STATES			
American Agricultural Insurance Company	A-		NR
Everest Reinsurance Company	A+		A+
Houston Casualty Company, (UK Branch)	A+	*	AA
Munich Reinsurance America, Inc.	A+		AA-
Odyssey Reinsurance Company	A		A-
BERMUDA			
ACE Tempest Reinsurance Limited	A+	*	AA-
Arch Reinsurance Limited	A+	*	A+
Ariel Reinsurance Bermuda Limited for and on Behalf of Ariel Syndicate 1910 (ARE)	A-	*	NR
DaVinci Reinsurance Limited	A	*	A+
JC Re Limited (Juniperus & fka Actua Re Limited)	NR	* **	NR
Montpelier Reinsurance Limited	A-		A-
Nephila (via Allianz Risk Transfer AG, Bermuda Branch)	NR		AA-
Platinum Underwriters Bermuda Limited	A	*	A-
Renaissance Reinsurance Limited	A+	*	AA-
UNITED KINGDOM			
Amlin Syndicate No. 2001 (AML)	A		A+
Ariel Syndicate No. 1910 (ARE)	A	*	A+
ARK Syndicate No. 3902 (NOA)	A		A+
Barbican Syndication No. 1955 (BAR)	A		A+
Kiln Syndicate No. 510 (KLN)	A		A+
Liberty Syndicates Services Limited Paris, for and on Behalf of Lloyd's Syndicate No. 4472 (LIB)	NR		A+
MAP Underwriting Syndicate No. 2791 (Parallel) (MAP)	A		A+
Novae Syndicate No. 2007 (NVA)	A		A+

Tokio Marine Kiln Syndicate No. 1880 (TMK)	A	A+
Torus Syndicate No. 1301 (TUL)	A	A+
EUROPE		
Amlin Bermuda (Branch of Amlin AG)	A	A
SCOR Global P&C Zurich Branch	A	A

* Reinstatement Premium Protection Program Participants

** Participant will fund a trust agreement for their exposure with cash and U.S. Government obligations of American institutions at fair market value.

Annually, the cost and amounts of reinsurance are based on management's analysis of FNIC's exposure to catastrophic risk as of June 30 and estimated to September 30. Our data is then subjected to actual exposure level analysis as of September 30. This analysis of our exposure level in relation to the total exposures to the FHCF and excess of loss treaties may produce changes in limits and reinsurance premiums as a result of the reconciliation of estimated to actual exposure level. The September 30, 2013 change to total limits was an increase of $8.7 billion of total insured value or 25.3% and the change to reinsurance premiums was an increase of $8.3 million or 13.8%. The September 30, 2012 change to total limits was an increase of $2.1 billion of total insured value or 12.5% and the change to reinsurance premiums was an increase of $2.4 million or 6.0%. These adjustments are amortized over the remaining underlying policy term.

To date, we have made no claims asserted against our reinsurers in connection with the 2013–2014 and 2012–2013 excess of loss and FHCF treaties.

The quota share retrocessionaire reinsurance agreements require FNIC to securitize credit, regulatory and business risk. Fully funded trust agreements totaled $4.9 million and $4.8 million as of December 31, 2013 and 2012, respectively.

We are selective in choosing reinsurers and consider numerous factors, the most important of which are the financial stability of the reinsurer, their history of responding to claims and their 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.

LIABILITY FOR UNPAID LOSSES AND LAE

We are directly liable for loss and LAE payments under the terms of the insurance policies that we write. 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, other than personal automobile, involving a probable loss is reported, we establish a liability for the estimated amount of our ultimate losses and LAE payments. The estimate of the amount of the ultimate loss is based upon such factors as the type of loss, jurisdiction of the occurrence, knowledge of the circumstances surrounding the claim, severity of injury or damage, potential for ultimate exposure, estimate of liability on the part of the insured, past experience with similar claims and the applicable policy provisions.

All newly reported claims received with respect to personal automobile policies are set up with an initial average liability. The average liability for these claims is determined by dividing the number of reported claims into the total amount paid during the same period. If a claim is open more than 45 days, that open case liability is evaluated and the liability is adjusted upward or downward according to the facts and circumstances of that particular claim.

In addition, management provides for a liability on an aggregate basis to provide for incurred but not yet reported (“IBNR”). We utilize independent actuaries to help establish liability for unpaid losses and LAE. We do not discount the liability for unpaid losses and LAE for financial statement purposes.

The estimates of the liability for unpaid losses and LAE 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 unpaid losses and LAE. Adjustments are reflected in results of operations in the period in which they are made and the liabilities may deviate substantially from prior estimates.

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

There can be no assurance that our liability for unpaid losses and LAE will be adequate to cover actual losses. If our liability for unpaid losses and LAE proves to be inadequate, we will be required to increase the liability with a corresponding reduction in our net income in the period in which the deficiency is identified. Future loss experience substantially in excess of established liability for unpaid losses and LAE could have a material adverse effect on our business, results of operations and financial condition.

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The following table sets forth a reconciliation of beginning and ending liability for unpaid losses and LAE as shown in our consolidated financial statements for the periods indicated.

	Years Ended December 31,		
	2013	2012	2011
	(Dollars in Thousands)		
Balance at January 1	$49,908	$59,983	$66,529
Less reinsurance recoverables	(3,503)	(2,088)	(6,809)
Net balance at January 1	$46,405	$57,895	$59,720
Incurred related to			
Current year	$56,209	$31,636	$31,893
Prior years	201	(1,427)	(997)
Total incurred	$56,410	$30,209	$30,896
Paid related to			
Current year	$22,695	$15,892	$13,672
Prior years	21,846	25,807	19,048
Total paid	$44,541	$41,699	$32,720
Net balance at period end	$58,274	$46,405	$57,896
Plus reinsurance recoverables	2,742	3,503	2,087
Balance at period end	$61,016	$49,908	$59,983

As shown above, and as a result of review of liability for losses and LAE, which includes a re-evaluation of the adequacy of reserve levels for prior year’s claims, we increased the liability for losses and LAE for claims occurring in prior years by $0.2 million for the year ended December 31, 2013 and decreased the liability for losses and LAE for claims occurring in prior years by $1.4 million and $1.0 million for the years ended December 31, 2012 and 2011, respectively.

The liability for losses and LAE increased by $18.6 million and $0.9 million for our homeowners’ and automobile lines, and decreased by $8.4 million for our commercial general liability lines, respectively, during 2013. These changes are due to management's continued efforts to manage the claims life cycle more efficiently. Additionally, our underwriting processes are designed to quickly gather the true primary and secondary risk characteristics and provide a profitable quote to the policyholder. This approach helps to reduce the overall frequency and severity of the loss portfolio.

Based upon discussions with our independent actuarial consultants and their statements of opinion on losses and LAE, we believe that the liability for unpaid losses and LAE is currently adequate to cover all claims and related expenses which may arise from incidents reported and IBNR as of December 31, 2013. There can be no assurance concerning future adjustments of reserves, positive or negative, for claims incurred through December 31, 2013.

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Federated National Holding Company

The following table presents total unpaid losses and LAE, net, and total reinsurance recoverable due from our catastrophic reinsurers as shown in our consolidated financial statements.

	As of December 31,	
	2013	2012
	(Dollars in Thousands)	
Catastrophe Excess of Loss (various participants) and FHCF		
Reinsurance recoverable on paid losses and LAE	$ 29	$ 47
Unpaid losses and LAE	25	94
	$ 54	$ 141
Amounts due from (to) reinsurers consisted of amounts related to:		
Unpaid losses and LAE	$ 25	$ 94
Reinsurance recoverable on paid LAE	29	47
Reinsurance payable	-	-
	$ 54	$ 141

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Federated National Holding Company

The following table presents the liability for unpaid losses and LAE for the years ended December 31, 2004 through 2013 and does not distinguish between catastrophic and non-catastrophic events. The top line of the table shows the estimated liability for unpaid losses and LAE at the balance sheet date for each of the periods indicated. These figures represent the estimated amount of unpaid losses and LAE for claims arising in all prior years that were unpaid at the balance sheet date, including losses that had been IBNR. The portion of the table labeled "Cumulative paid as of" shows the cumulative payments for losses and LAE made in succeeding years for losses incurred prior to the balance sheet date. The lower portion of the table shows the re-estimated amount of the previously recorded liability based on experience as of the end of each succeeding year.

	Years Ended December 31, (Dollars in Thousands)									
	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
Unpaid losses and LAE, net	$61,016	$49,908	$59,983	$66,529	$70,611	64,775	$59,685	$39,615	$154,039	$46,5
Cumulative paid as of:										
One year later		24,329	16,527	20,774	29,202	26,431	30,570	36,058	170,825	68,0
Two years later			31,676	26,667	40,493	45,264	48,409	58,002	196,080	88,2
Three years later				38,703	42,577	52,761	64,014	72,752	215,297	96,6
Four years later					50,096	53,689	68,865	86,110	228,805	103,
Five years later						60,075	68,880	89,006	240,171	107,
Six years later							73,235	87,555	242,383	110,
Seven years later								90,910	244,405	107,
Eight years later									246,286	229,
Nine years later										230,
Re-estimated net liability as of:										
End of year	61,016	49,908	59,983	66,529	70,611	64,775	59,685	39,615	154,039	46,5
One year later		46,245	58,389	62,756	73,122	75,646	69,383	71,907	193,068	80,0
Two years later			58,711	51,266	70,709	80,606	82,890	80,383	223,005	94,7
				51,936	59,276	78,132	88,159	97,174	231,761	102,

Three years later									
Four years later				58,223	68,119	85,532	102,571	248,116	108,
Five years later					69,226	77,294	99,710	252,365	112,
Six years later						78,541	93,878	249,744	111,
Seven years later							96,514	248,211	114,
Eight years later								251,217	110,
Nine years later									113,
Cumulative redundancy (deficiency)	3,662	1,272	14,593	12,388	(4,451)	(18,856)	(56,899)	(97,178)	(67,3
Cumulative redundancy (-) deficiency as a % of reserves originally established	7.3 %	2.1 %	21.9 %	17.5 %	-6.9 %	-31.6 %	-143.6 %	-63.1 %	-144

The cumulative redundancy or deficiency represents the aggregate change in the estimates over all prior years. A deficiency indicates that the latest estimate of the liability for losses and LAE is higher than the liability that was originally estimated and a redundancy indicates that such estimate is lower. It should be emphasized that the table presents a run-off of balance sheet liability for the periods indicated rather than accident or policy loss development for those periods. Therefore, each amount in the table includes the cumulative effects of changes in liability for all prior periods. Conditions and trends that have affected liabilities in the past may not necessarily occur in the future.
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As noted above, we have since experienced $3.7 million and $1.3 million cumulative redundancies in connection with the re-estimation of all losses that occurred in 2012 and 2011, respectively.

The table below sets forth the differences between loss and LAE reserves as disclosed for Generally Accepted Accounting Principles ("GAAP") basis compared with Statutory Accounting Principles ("SAP") basis of presentation for the years ended 2013, 2012 and 2011.

	Years Ended December 31,		
	2013	2012	2011
	(Dollars in Thousands)		
GAAP basis Loss and LAE reserves	$61,016	$49,908	$59,983
Less unpaid Losses and LAE ceded	2,312	3,189	2,319
Balance Sheet Liability	58,704	46,719	57,664
Add Insurance Apportionment Plan	2	6	17
Intercompany Indemnification	(4,705)	(2,039)	(2,114)
FNIC SAP basis Loss and LAE reserves	$54,001	$44,686	$55,567

The table below sets forth the differences between loss and LAE incurred as disclosed for GAAP basis compared with SSAP basis presentation for the years ended 2013, 2012 and 2011.

	Years Ended December 31,		
	2013	2012	2011
	(Dollars in Thousands)		
GAAP basis Loss and LAE incurred	$56,410	$30,209	$30,896
Intercompany adjusting and other expenses	3,489	3,744	(726)
Insurance apportionment plan	13	(4)	-
SAP basis Loss and LAE incurred	$59,912	$33,949	$30,170

Underwriting results of insurance companies are frequently measured by their Combined Ratios. However, investment income, federal income taxes and other non-underwriting income or expense are not reflected in the Combined Ratio. The profitability of property and casualty insurance companies depends on income from underwriting, investment and service operations. Underwriting results are considered profitable when the Combined Ratio is under 100% and unprofitable when the Combined Ratio is over 100%.

The following table sets forth Loss Ratios, Expense Ratios and Combined Ratios for the periods indicated for the insurance business of FNIC and American Vehicle for 2013, 2012 and 2011, and are inclusive of Unallocated Loss Adjustment Expenses ("ULAE").

	Years Ended December 31,		
	2013	2012	2011
Loss Ratio	54.0%	50.9 %	63.7 %
Expense Ratio	44.2%	53.4 %	62.4 %
Combined Ratio	98.2%	104.3%	126.1%

COMPETITION

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

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

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

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

REGULATION

General

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

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

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

All insurance companies must file quarterly and annual statements with certain regulatory agencies and are subject to regular and special examinations by those agencies. We may be the subject of additional special examinations or analysis. These examinations or analysis may result in one or more corrective orders being issued by the Florida OIR. The most recent balance sheet audit of FNIC by the Florida OIR occurred as of December 31, 2009. There were no material findings by the independent auditors in connection with this examination. FNIC also experienced a regularly scheduled statutory examination by the Florida OIR which occurred during 2010 for the five years ended December 31, 2009. There were no material findings in connection with this examination.

In some instances, various states routinely require deposits of assets for the protection of policyholders either in those states or for all policyholders. As an example, the Florida OIR requires FNIC to have securities with a fair market value of $2.0 million held in escrow. As of December 31, 2013, FNIC held investment securities with a fair value of approximately $2.0 million, as a deposit with the State of Florida. Additionally, as of December 31, 2013 FNIC had cash deposits totaling $370,000 with the State of Alabama, $118,900 with the State of Louisiana and $25,000 with the State of Georgia.

As of December 31, 2012, FNIC held investment securities with a fair value of approximately $2.3 million, as a deposit with the State of Florida. Additionally, as of December 31, 2012 FNIC had cash deposits totaling $415,100 with the State of Alabama, $150,000 with the State of Arkansas, $118,700 with the State of Louisiana and $25,000 with the State of Georgia.

Consent Order

In January 2011, we merged FNIC and our other wholly owned insurance subsidiary, American Vehicle Insurance Company ("American Vehicle"), with FNIC continuing the operations of both entities. As part of its approval of the merger between FNIC and American Vehicle, the Florida Office of Insurance Regulation ("Florida OIR"), the Company, FNIC and American Vehicle entered into a consent order with the Florida OIR dated January 25, 2011 (the "Consent Order"), which was amended in February 2013, due to FNIC's statutory underwriting profit during 2012. Pursuant to the amended Consent Order, the Company and the resulting company in the merger (the "Merged Company") have agreed to the following:

- The Merged Company retained the following licenses: (010) Fire, (020) Allied Lines, (040) Homeowners Multi Peril, (050) Commercial Multi Peril, (090) Inland Marine, (170) Other Liability, (192) Private Passenger Auto Liability, (194) Commercial Auto Liability, (211) Private Passenger Auto Physical Damage and (212) Commercial Auto Physical Damage.

- The Merged Company will not write commercial multi peril policy premium without prior approval from the Florida OIR. The Merged Company has no commercial multi peril policy premium in force.

- The Merged Company surrendered its surety license. The Merged Company has no surety policy premium in force.

- The Merged Company will not write new commercial habitation condominium associations without prior approval from the Florida OIR. The current commercial habitation book of business is fully earned.

- The Merged Company agreed to maintain the total number of its homeowners' policies in Miami-Dade, Broward and Palm Beach counties (the "Tri-County Area") at 35% of its entire homeowners' book. As of December 31, 2013, the Company had approximately 18.3% of its homeowners' policies located within Tri-County Area.

- The managing general agency fees payable by the Merged Company to Federated National Underwriters, Inc. ("FNU"), formerly known as Assurance Managing General Agents, Inc., a wholly owned subsidiary of the Company, which were traditionally 6% of gross written premium, were reduced and will not exceed 4% without prior approval from the Florida OIR. The Merged Company has lowered the fee to amounts varying between 2% and 4% of gross written to further support the FNIC results of operations. This will have no impact on the Company's consolidated financial results.

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The claims service fees payable by the Merged Company to Federated National Adjusting, Inc. (“FNA”), formerly known as Superior Adjusting, Inc., were reduced from the traditional 4.5% of gross earned premium to 3.6% of gross earned premium. This will have no impact on the Company’s consolidated financial results.

The merger of FNIC and American Vehicle will be an ongoing transition, many aspects of which will take effect over time. References to the companies contained herein are intended to be references to the operations of FNIC following the January 2011 merger. References to the historical activities of American Vehicle are appropriately identified throughout this document.

Restrictions in Payments of Dividends by Domestic Insurance Companies

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

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

No dividends were paid by FNIC or American Vehicle in 2013, 2012 and 2011, and none are anticipated in 2014. Although we believe that amounts required to meet our financial and operating obligations will be available from sources other than dividends from our insurance subsidiaries, there can be no assurance in this regard. Further, there can be no assurance that, if requested, the Florida OIR will allow any dividends to be paid by FNIC to us, the parent company, in the future. The maximum dividends permitted by state law are not necessarily indicative of an insurer's actual ability to pay dividends or other distributions to a parent company, which also may be constrained by business and regulatory considerations, such as the impact of dividends on capital surplus, which could affect an insurer's competitive position, the amount of premiums that can be written and the ability to pay future dividends. Further, state insurance laws and regulations require that the statutory capital surplus of an insurance company following any dividend or distribution by it be reasonable in relation to its outstanding liabilities and adequate for its financial needs.

While the non-insurance company subsidiaries (FNU, FNA 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 system may charge any of the insurance companies for service (e.g., management fees and commissions).

NAIC Risk-Based Capital Requirements

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

Based upon the 2013 and 2012 statutory financial statements for FNIC, statutory surplus exceeded the regulatory action levels established by the NAIC's risk-based capital requirements.

Based on risk-based capital requirements, the extent of regulatory intervention and action increases as the ratio of an insurer's statutory surplus to its Authorized Control Level ("ACL"), as calculated under the NAIC's requirements, decreases. The first action level, the Company Action Level, requires an insurer to submit a plan of corrective actions to the insurance regulators if statutory surplus falls below 200.0% of the ACL amount. The second action level, the Regulatory Action Level, requires an insurer to submit a plan containing corrective actions and permits the insurance regulators to perform an examination or other analysis and issue a corrective order if statutory surplus falls below 150.0% of the ACL amount. The third action level, ACL, allows the regulators to rehabilitate or liquidate an insurer in addition to the aforementioned actions if statutory surplus falls below the ACL amount. The fourth action level is the Mandatory Control Level, which requires the regulators to rehabilitate or liquidate the insurer if statutory surplus falls below 70.0% of the ACL amount. FNIC's ratio of statutory surplus to its ACL was 312.1%, 474.4% and 409.7% at December 31, 2013, 2012 and 2011, respectively.

Insurance Regulatory Information Systems (“IRIS”) Ratios

The NAIC has also developed IRIS ratios to assist state insurance departments in identifying companies which may be developing performance or solvency problems, as signaled by significant changes in the companies’ operations. Such changes may not necessarily result from any problems with an insurance company, but may merely indicate changes in certain ratios outside the ranges defined as normal by the NAIC. When an insurance company has four or more ratios falling outside “usual ranges”, state regulators may investigate to determine the reasons for the variance and whether corrective action is warranted.

As of December 31, 2013, FNIC was outside NAIC’s usual range for three of thirteen IRIS ratios. These exceptions related to change in net writings, investment yield and estimated current reserve deficiency to policyholders’ surplus.

As of December 31, 2012, FNIC was outside NAIC’s usual range for three of thirteen IRIS ratios. These exceptions related to investment yield, net change in adjusted policyholders’ surplus and estimated current reserve deficiency to policyholders’ surplus.

As of December 31, 2011, FNIC was outside NAIC’s usual range for two of thirteen IRIS ratios. These exceptions related to two-years overall operating ratio and investment yield.

There was no action taken by the Florida OIR in connection with the December 31, 2012 or 2011 IRIS ratio results. We do not currently believe that the Florida OIR will take any significant action with respect to FNIC regarding the 2013 IRIS ratios, although there can be no assurance that will be the case.

Insurance Holding Company Regulation

We, the parent company, are subject to laws governing insurance holding companies in Florida where FNHC is domiciled. These laws, among other things, (i) require us to file periodic information with the Florida OIR, including information concerning our capital structure, ownership, financial condition and general business operations, (ii) regulate certain transactions between us and our affiliates, including the amount of dividends and other distributions, the terms of surplus notes and amounts that our affiliates can charge the holding company for services such as management fees or commissions, (iii) restrict the ability of any one person to acquire certain levels of our voting securities without prior regulatory approval. Any purchaser of 5% or more of the outstanding shares of our Common Stock will be presumed to have acquired control of FNHC unless the Florida OIR, upon application, determines otherwise.

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.

Industry Ratings Services

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

As of December 31, 2013, FNIC is rated by Demotech as "A" ("Exceptional"), which is the third of seven ratings, and defined as “Regardless of the severity of a general economic downturn or deterioration in the insurance cycle, insurers earning a Financial Stability Rating (“FSR”) of “A” possess “Exceptional” financial stability related to maintaining surplus as regards to policyholders”. Demotech’s ratings are based upon factors of concern to agents, reinsurers and policyholders and are not primarily directed toward the protection of investors. Our Demotech rating could be jeopardized by factors including adverse development and various surplus related ratio exceptions. On November 22, 2013, Demotech reaffirmed FNIC’s FSR of “A” (“Exceptional”).

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

EMPLOYEES

As of December 31, 2013, we had 153 employees, including two executive officers. We are not a party to any collective bargaining agreement and we have not experienced work stoppages or strikes as a result of labor disputes. We consider relations with our employees to be satisfactory.

ITEM 1A RISK FACTORS

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

Risks Related to Our Business

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

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

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

Although Florida has not experienced a hurricane during the last eight hurricane seasons, some weather analysts believe that we have entered a period of greater hurricane activity. We are exploring alternatives to reduce our exposure to these types of storms, which may increase operating expenses and may not be successful in protecting long-term profitability. If our loss experience is more adverse than is contemplated by our loss reserves, the related increase in our loss reserves may have a material adverse effect on our results of operations in the period in which the increase occurs.

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

We have a reinsurance structure that is a combination of private reinsurance and the FHCF. Our reinsurance structure is composed of several reinsurance companies with varying levels of participation providing coverage for loss and LAE 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.

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

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

As is common practice within the insurance industry, we transfer a portion of the risks insured under our policies to other companies through the purchase of reinsurance. This reinsurance is maintained to protect our insurance subsidiary against the severity of losses on individual claims, unusually serious occurrences in which a number of claims produce an aggregate extraordinary loss and other catastrophic events. Although reinsurance does not discharge our insurance subsidiary from its primary obligation to pay for losses insured under the policies it issues, reinsurance does make the assuming reinsurer liable to the insurance subsidiary for the reinsured portion of the risk. A credit exposure exists with respect to ceded losses to the extent that any reinsurer is unable or unwilling to meet the obligations assumed under the reinsurance contracts. The collectability of reinsurance is subject to the solvency of the reinsurers, interpretation of contract language and other factors. A reinsurer's insolvency or inability to make payments under the terms of a reinsurance contract could have a material adverse effect on our business, results of operations and financial condition.

Our reinsurance structure has significant risks, including the fact that the FHCF may not be able to raise sufficient money to pay their claims or impair their ability to pay their claims in a timely manner. 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 ability to pay, which may, in turn, be dependent upon the MCP's ability to issue bonds in amounts that would be required to meet its reinsurance obligations in the event of such a catastrophic loss.

Our January 2011 Consent Order with the Florida OIR, as amended in February 2013, limits our business in certain respects and may prevent us from growing our business.

In January 2011, we entered into a Consent Order with the Florida OIR, in connection with our request for approval of the merger of FNIC, into American Vehicle Insurance Company, one of our other subsidiaries at the time. The Consent Order was amended in February 2013 to lessen or eliminate certain of the original requirements, due to FNIC's statutory underwriting profit during 2012. Among other things, the Consent Order as amended requires us to limit the concentration of our homeowners' policies in Miami-Dade, Broward and Palm Beach counties. This reduction in concentration could materially adversely affect us by limiting our ability to write policies in the most populous region of the State of Florida, which could materially adversely affect our results of operations if we are not able to replace those policies with policies elsewhere in Florida or the other states in which we do business.

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

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

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

Our future capital requirements depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. Based on our current operating plan, we believe current capital, together with our anticipated retained earnings, will support our operations without the need to raise additional capital. 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 stockholders’ ownership could result, and in any case such securities may have rights, preferences and privileges that are senior to those of existing shareholders. If we raise additional funds by incurring debt financing, the terms of the debt may involve significant cash payment obligations as well as covenants and specific financial ratios that may restrict our ability to operate our business or pay dividends. If we cannot obtain adequate capital on favorable terms or at all, our business, financial condition or results of operations could be materially adversely affected.

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

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

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

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

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

We may experience financial exposure from climate change.

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

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

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

We maintain reserves to cover our estimated ultimate liabilities for loss 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 unpaid losses and LAE include the estimates made on a claim-by-claim basis known as "case reserves" coupled with bulk estimates known as "incurred but not yet reported." 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 (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that 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 reserves for unpaid losses and LAE 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 reserves for unpaid losses and LAE, could substantially harm our results of operations and financial condition.

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

We operate in a regulatory environment where certain entities and organizations have the authority to require us to participate in assessments. Currently these entities and organizations include, but are not limited to, the Florida Joint Underwriters Association, the Florida Insurance Guaranty Association, Citizens and the FHCF.

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

During December 2012, the Company was assessed $0.8 million by Florida Insurance Guaranty Association (“FIGA”) relating to the recent failures of Florida domestic property and casualty insurance companies. Future assessments are likely, although the impact of these assessments on our balance sheet, results of operations or cash flow are undeterminable at this time.

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

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

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

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

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

We may experience a loss due to the concentration of credit risk.

Financial instruments that potentially subject the Company to significant concentration of credit risk consist of cash and cash equivalents held in a mutual fund money market account. The Company had approximately $12.2 million and $10.7 million invested in the Wilmington Prime Money Market Fund – Class Select (Ticker: VSMXX, CUSIP: 97181C308), for which the NAIC classification is Class 1, as of December 31, 2013 and 2012, respectively. Although this fund is on the Class 1 list, the highest rating available, there can be no assurance that it will remain financially sound. If the MTB Fund were to experience financial difficulty such that it could not repay the money we have invested in the fund, our financial condition and results of operations could be materially and adversely affected.

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

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

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

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

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

An example of such emerging change was the influence public adjusters have had on property claim patterns. Public adjusters represented the vast majority of new and reopened claims filed during 2011 and 2010 where the cause of loss was asserted as hurricane related. Although the legitimacy of the claim may not prevail we are still required to research, review and sometimes mediate these claims. Several legislative actions in of the State of Florida, such as limiting the time a claim can be filed subsequent to the cause of loss, have either passed or remain in legislative sub-committees. Each of these actions is designed to enhance the legitimacy of the public adjusters' influence on the claim process.

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

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

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

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

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

If we fail to meet the applicable risk-based capital or minimum statutory capital requirements imposed by the laws of Florida or other states where we do business, we could be subject to further examination or corrective action imposed by state regulators, including limitations on out writing of additional business, state supervision or liquidation, and may be required to raise additional capital. Similarly, an increase in existing risk-based capital requirements or minimum statutory capital requirements may require us to increase our statutory capital levels. As of December 31, 2013, FNIC was in compliance with the NAIC risk-based capital requirements (see “Business-Regulation” for further discussion).

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

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

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

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

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

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

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

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 approximately 3,600 independent agents, of which approximately 1,800 actively sell and service our products, and a selected number of general agents. Our independent agents are our primary source for our property and liability insurance policies. Many of our competitors also rely on independent agents. As a result, we must compete with other insurers for independent agents' business. Our competitors may offer a greater variety of insurance products, lower premiums for insurance coverage, or higher commissions to their agents. If our products, pricing and commissions do not remain competitive, we may find it more difficult to attract business from independent agents to sell our products. A material reduction in the amount of our products that independent agents sell or a material reduction in the number of independent agents with whom we maintain a relationship could negatively affect our results of operations and financial condition.

In February 2013, we entered into an Insurance Agency Master Agreement with Ivantage Select Agency, Inc., or ISA, an affiliate of Allstate Insurance Company, or Allstate, pursuant to which we are authorized by ISA to appoint Allstate agents to offer our homeowners' and commercial general liability insurance products to consumers in Florida. Since that time, our homeowners' premiums and the percentage of homeowners' premiums attributable to Allstate agents has increased rapidly. During 2013, 25.5% of the homeowners' premiums we underwrote were from Allstate's network of Florida agents, and this concentration may continue to increase. An interruption or change in our relationship with ISA could have a material adverse effect on the amount of premiums we are able to write, as well as our results of operations.

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

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

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

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

Florida's personal injury protection insurance statute contains provisions that favor claimants, causing us to experience a higher frequency of claims than might otherwise be the case if we operated only outside of Florida.

Florida's personal injury protection insurance statute limits an insurer's ability to deny benefits for medical treatment that is unrelated to the accident, that is unnecessary, or that is fraudulent. In addition, the statute allows claimants to obtain awards for attorney's fees. Although this statute has been amended several times in recent years, primarily to address concerns over fraud, the Florida legislature has been only marginally successful in implementing effective mechanisms that allow insurers to combat fraud and other abuses. We believe that this statute contributes to a higher frequency of claims under nonstandard automobile insurance policies in Florida, as compared with claims under standard automobile insurance policies in Florida and nonstandard and standard automobile insurance policies in other states. Although we believe that we have successfully offset these higher costs with premium increases, because of competition, we may not be able to do so with as much success in the future, which could have a material adverse effect on our results of operations and financial condition.

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

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

- the availability of sufficient reliable data and our ability to properly analyze available data;
- the uncertainties that inherently characterize estimates and assumptions;
- our selection and application of appropriate rating and pricing techniques;
- changes in legal standards, claim settlement practices, medical care expenses and restoration costs;
- regulatory restrictions; and
- legislatively imposed consumer initiatives.

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

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

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

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

We operate in highly competitive markets and face competition from national, regional and residual market insurance companies in the homeowners', commercial general liability, and automobile markets, many of whom are larger, have greater financial and other resources, have higher financial strength ratings and offer more diversified insurance coverage. Our competitors include companies that market their products through agents, as well as companies that sell insurance directly to their customers. Large national writers may have certain competitive advantages over agency writers, including increased name recognition, increased loyalty of their customer base and reduced policy acquisition costs. We may be forced to reduce our premiums significantly to compete, which could make us less profitable and have a material adverse effect on our business, results of operations and financial condition. If we do not meet the prices offered by our competitors, we may lose business in the short term, which could also result in a material adverse effect on our business, results of operations and financial condition.

Our ability to compete successfully in states outside of Florida and to expand our business footprint may also be negatively affected by our lack of an A. M. Best rating of our financial strength. Although our insurance subsidiary has 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.

Our participation in the new Florida Property Insurance Clearinghouse may not result in an increase in our premium revenue.

Pursuant to legislation passed by the Florida legislature in 2013 intended to reduce the insurance policy count of Citizens Property Insurance Corporation, a Florida not-for-profit, tax-exempt government corporation (“Citizens”), the Property Insurance Clearinghouse (the “Clearinghouse”) launched during February 2014. This will allow all potentially new and renewal policies of Citizens to be comparatively shopped by participating private market insurers before becoming, or remaining, policies of Citizens. We intend to be a participating insurance company in the Clearinghouse.

Applications to Citizens for new homeowners' policies and existing policies with Citizens up for renewal will be submitted to insurance companies participating in the Clearinghouse. If that process identifies a carrier willing to write a new policy at a premium that is no more than 15% higher than Citizens' premium of comparable coverage or, in the case of a renewal, with a premium equal to or less than the policy's renewal premium with Citizens, then that homeowner will be ineligible for coverage with Citizens. The homeowner may then choose to have an agent bind coverage with the homeowner's choice of the private market insurers that have made the homeowner a qualifying offer of coverage.

There can be no assurance that our policy count or gross premiums will increase as a result of our participation in the Clearinghouse, because our premiums may not be below the threshold required by Citizens, other carriers participating in the Clearinghouse may be willing to oiler similar policies for lower premiums, or we may decide to not provide a quote on these policies if they do not meet our underwriting guidelines.

Our senior 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 Peter J. Prygelski III, our Chief Financial Officer and Treasurer. Our success also will depend in part upon our ability to attract and retain qualified executive officers, experienced underwriting talent and other skilled employees who are knowledgeable about our business. If we were to lose the services of one or more members of our executive management team, our business could be adversely affected. Although we have employment agreements with our executive officers, any unplanned loss of service could substantially harm our business.

We are subject to extensive regulation and potential further restrictive regulation may increase our operating costs and limit our growth.

As an insurance company, we are subject to extensive laws and regulations. These laws and regulations are complex and subject to change. Moreover, they are administered and enforced by a number of different governmental authorities, including state insurance regulators, state securities administrators, the SEC, the U.S. Department of Justice, and state attorneys general, each of which exercises a degree of interpretive latitude. Consequently, we are subject to the risk that compliance with any particular regulator’s or enforcement authority’s interpretation of a legal issue may not result in compliance with another’s interpretation of the same issue, particularly when compliance is judged in hindsight. In addition, there is risk that any particular regulator’s or enforcement authority’s interpretation of a legal issue may change over time to our detriment, or that changes in the overall legal environment may, even absent any particular regulator’s or enforcement authority’s interpretation of a legal issue changing, cause us to change our views regarding the actions we need to take from a legal risk management perspective, thus necessitating changes to our practices that may, in some cases, limit our ability to grow and improve the profitability of our business. Furthermore, in some cases, these laws and regulations are designed to protect or benefit the interests of a specific constituency rather than a range of constituencies. For example, state insurance laws and regulations are generally intended to protect or benefit purchasers or users of insurance products, not holders of securities issued by us. In many respects, these laws and regulations limit our ability to grow and improve the profitability of our business.

In recent years, the state insurance regulatory framework has come under public scrutiny and members of Congress have discussed proposals to provide for federal chartering of insurance companies. We can make no assurances regarding the potential impact of state or federal measures that may change the nature or scope of insurance regulation

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

We plan to continue the expansion of admitted homeowners' property and casualty programs into other states as opportunities avail themselves. Risks associated with execution of our planned operations include the inability to market an adequately priced policy, inadequate commission structures, and overpriced or unavailable catastrophic reinsurance for wind events. Additionally, each state has its own authoritative body designed to regulate the insurance products and operations of new and existing insurance companies under their respective authority. For example, during 2013 Federated National obtained regulatory approval to initiate a new homeowners' property and casualty program in the State of Louisiana.

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

We face risks in connection with potential material weakness resulting from our Sarbanes-Oxley Section 404 management report and any related remedial measures that we undertake.

In conjunction with our ongoing reporting obligations as a public company and the requirements of Section 404 of the Sarbanes-Oxley Act, management reported on the effectiveness of our internal control over financial reporting as of December 31, 2013. In order to identify any material weaknesses in our internal control over financial reporting, we engaged in a process to document, evaluate and test our internal controls and procedures, including corrections to existing controls and implement additional controls and procedures that we may deem necessary. As a result of this evaluation and testing process, no material financial reporting deficiencies were noted.

Although we did not have any material weaknesses in our internal controls for our fiscal year ended December 31, 2013, we cannot be certain that there will be none in the future. In future periods, if the process required by Section 404 of the Sarbanes-Oxley Act reveals significant deficiencies or material weaknesses, the correction of any such significant deficiencies or material weaknesses could require additional remedial measures that could be costly and time-consuming. In addition, the discovery of material weaknesses could also require the restatement of prior period operating results. If a material weakness exists as of a future period year-end (including a material weakness identified prior to year-end for which there is an insufficient period of time to evaluate and confirm the effectiveness of the corrections or related new procedures), our management will be unable to report favorably as of such future period year-end as to the effectiveness of our control over financial reporting and we could lose investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our stock price and potentially subject us to litigation.

Risks Related to an Investment in Our Shares

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

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

- our quarterly operating results, including a shortfall in operating revenue or net income from that expected by securities analysts and investors;
- recognition of large unanticipated accounting charges, such as related to a loss reserve enhancement;
- changes in securities analysts’ estimates of our financial performance or the financial performance of our competitors or companies in our industry generally;
- the limited trading volume and public float of the common stock;
- 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 prospectus supplement, the accompanying prospectus 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.

If we report a material weakness in our internal controls and procedures, we may lose investor confidence and remedial measures may be costly.

In accordance with applicable law, we are required to document, evaluate and test our internal controls and procedures, including corrections to existing controls and implement additional controls and procedures that we may deem necessary, and to identify and report any material weakness in our internal control over financial reporting. As a result of this evaluation and testing process, no material weakness was identified or reported as of December 31, 2013. In fixture periods, if the process required by law reveals significant deficiencies or material weaknesses, the correction of any such significant deficiencies or material weaknesses could require additional remedial measures that could be costly and time consuming. In addition, the discovery of material weaknesses could also require the restatement of prior period operating results. If a material weakness exists and is reported as of a future period year-end (including a material weakness identified prior to year-end for which there is an insufficient period of time to evaluate and confirm the effectiveness of the corrections or related new procedures), we could lose investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our stock price and potentially subject us to litigation.

No system of internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control systems objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. Over time, controls may become inadequate because changes in conditions or deterioration in the degree of compliance with policies or procedures may occur. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. As a result, we cannot assure you that significant deficiencies or material weaknesses in our internal control over financial reporting will be identified in the future.

Our controls and procedures may fail or be circumvented which could have a material adverse effect on our business, results of operations and financial condition.

We regularly review and update our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

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

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

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

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

- prohibit cumulative voting in the election of our directors,
- establish a classified board of directors with staggered three-year terms,
- provide that the written request of shareholders holding not less than one-third of all votes entitled to be cast on an issue is required for shareholders to call special meetings of our shareholders,
- establish advance notice and disclosure procedures for shareholders to bring matters, including nominations for election to our board, before a meeting of our shareholders, and
- eliminate the ability of shareholders to take action by written consent in lieu of a shareholder meeting.

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

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

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

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

Payment of dividends in the future will depend on our earnings and financial position and such other factors, as our board of directors deems relevant. Moreover, our ability to continue to pay dividends may be restricted by regulatory limits on the amount of dividends that our insurance subsidiaries are permitted to pay to the holding company.

The Board of Directors of FNHC declared regular quarterly dividends of $0.02 per common share payable on December 28, 2012 and March 4, 2013 to shareholders of record as of December 3, 2012 and February 4, 2013. The Board of Directors of FNHC declared regular quarterly dividends of $0.03 per common share payable on September 3 and December 2, 2013 and March 3, 2014 to shareholders of record as of August 5 and November 4, 2013 and February 3, 2014.

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

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

Sales of a substantial number of shares of our common stock in the public market or otherwise, by us or by a major shareholder, 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, or the perception that these sales may occur, could adversely impact our stock price.

As of December 31, 2013, there were 313,475 shares issuable upon the exercise of outstanding and exercisable stock options, 251,896 shares issuable upon the exercise of outstanding stock options that are not yet exercisable and 750,500 additional shares available for grant under our equity-based compensation plans. The market price of the common shares may be depressed by the potential exercise of these options or grant of these shares. The holders of these options are likely to exercise them when we would otherwise be able to obtain additional capital on more favorable terms than those provided by the options.

ITEM 1B UNRESOLVED STAFF COMMENTS

None

ITEM 2 PROPERTIES

Our executive offices are now located at 14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323 in an 18,500 square feet office facility and our telephone number is (800) 293-2532. All of our operations are consolidated within this facility. We believe that the facilities are well maintained, in substantial compliance with environmental laws and regulations, and adequately covered by insurance. We also believe that these leased facilities are not unique and could be replaced, if necessary, at the end of the lease term. Our lease for this office space will expire in May 2017.

ITEM 3 LEGAL PROCEEDINGS

See Item 8 of Part II, "Financial Statements and Supplementary Data – Footnote 9 – Commitments and Contingencies".

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". The following table sets out the high and low closing sale prices as reported on The NASDAQ Global Market. These reported prices reflect inter-dealer prices without adjustments for retail markups, markdowns or commissions.

Quarter Ended	High	Low
March 31, 2013	$7.90	$5.35
June 30, 2013	$10.41	$7.05
September 30, 2013	$10.89	$8.43
December 31, 2013	$14.90	$9.80
March 31, 2012	$4.50	$3.02
June 30, 2012	$4.99	$3.81
September 30, 2012	$6.20	$4.25
December 31, 2012	$6.37	$3.02

As of March 6, 2014, there were 56 holders of record of our common stock. We believe that the number of beneficial owners of our common stock is in excess of 2,900.

DIVIDENDS

The Board of Directors of FNHC declared regular quarterly dividends of $0.02 per common share payable on December 28, 2012 and March 4, 2013 to shareholders of record as of December 3, 2012 and February 4, 2013. The Board of Directors of FNHC declared regular quarterly dividends of $0.03 per common share payable on September 3 and December 2, 2013 and March 3, 2014 to shareholders of record as of August 5 and November 4, 2013 and February 3, 2014.

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

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Federated National Holding Company

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The following table summarizes our equity compensation plans as of December 31, 2013. 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 stock holders*	776,021	4.88	750,500

* Includes the 1998 and 2002 Stock Option Plans and the 2012 Stock Incentive Plan.

For additional information concerning our capitalization please see Footnote 14 to our Consolidated Financial Statements included under Item 8 of this Annual Report on Form 10-K.

ISSUER REPURCHASES

During 2013 and 2012, the Company did not repurchase any common stock under previously announced stock repurchase plans.

SALES OF UNREGISTERED SECURITIES

None.

ITEM 6 SELECTED FINANCIAL DATA

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

	As of the Years Ended December 31, (Amounts in Thousands except Book Value Per Share)				
	2013	2012	2011	2010	2009
Balance Sheet Data					

Assets:					
Cash and investments	$262,156	$151,238	$144,672	$138,691	$142,416
Total assets	316,741	185,888	179,980	184,049	202,889
Liabilities:					
Unpaid losses and LAE	61,016	49,908	59,983	66,529	70,611
Unearned premiums	128,343	59,006	47,933	47,136	50,857
Total liabilities	208,247	119,983	121,836	126,118	135,447
Total shareholders' equity	108,494	65,905	58,144	57,931	67,442
Book value per share	$9.95	$8.26	$7.32	$7.29	$8.48
Statutory surplus	76,889	52,012	39,307	40,603	46,810

Federated National Holding Company

	Years Ended December 31, (Amounts in Thousands except EPS and Dividends)				
	2013	2012	2011	2010	2009
Operations Data:					
Revenue:					
Gross premiums written	$243,373	$119,459	$98,269	$96,410	$104,379
Gross premiums ceded	(82,708)	(51,085)	(46,293)	(52,963)	(56,217)
Net premiums written	160,665	68,374	51,976	43,447	48,162
Increase (decrease) in prepaid reinsurance premiums	13,052	2,059	(2,656)	(2,108)	10,163
(Increase) decrease in unearned premiums	(69,336)	(11,074)	(797)	3,721	(10,349)
Net change in prepaid reinsurance premiums and unearned premiums	(56,284)	(9,015)	(3,453)	1,613	(186)
Net premiums earned	104,381	59,359	48,523	45,060	47,976
Commission income	2,646	1,377	994	1,388	1,362
Finance revenue	866	496	518	395	294
Direct written policy fees	6,196	2,007	1,583	1,609	1,620
Net investment income	3,332	3,819	4,079	3,726	3,397
Net realized investment gains	2,881	1,072	2,725	6,777	1,117
Regulatory assessments recovered	-	-	-	857	2,333
Other income	1,435	517	1,741	792	755
Total revenue	121,737	68,647	60,163	60,604	58,854
Expenses:					
Losses and LAE	56,410	30,209	30,896	40,088	43,706
Operating and underwriting expenses	14,474	9,996	9,916	10,835	9,681
Salaries and wages	10,188	8,439	8,004	8,611	7,930
Amortization of deferred policy acquisition costs	21,447	13,255	12,347	13,025	13,747
Total expenses	102,519	61,899	61,163	72,559	75,064
Income (loss) before provision for income tax expense (benefit)	19,218	6,748	(1,000)	(11,955)	(16,210)
Provision for income tax expense (benefit)	6,491	2,435	(570)	(3,959)	(5,921)
Net income (loss)	$12,727	$4,313	$(430)	$(7,996)	$(10,289)
Earnings per share data					
Net income (loss) per share - basic	$1.50	$0.53	$(0.05)	$(1.01)	$(1.29)
Net income (loss) per share - diluted	$1.45	$0.53	$(0.05)	$(1.01)	$(1.29)
Dividends paid per share	$0.11	$0.02	$-	$0.06	$0.36

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

OVERVIEW

Federated National Holding Company ("FNHC", "Company", "we", "us"), formerly known as 21st Century Holding 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. We changed our name on September 11, 2012, pursuant to approval received at our annual shareholders' meeting, from 21st Century Holding Company so that our parent company and other subsidiary companies' names are consistent with our primary insurance subsidiary and the name under which we have been writing insurance for more than 20 years.

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

Our insurance subsidiary is Federated National Insurance Company ("FNIC"). FNIC is licensed as an admitted carrier in Florida. An admitted carrier is an insurance company that has received a license from the state department of insurance giving the company the authority to write specific lines of insurance in that state. These companies are also bound by rate and form regulations, and are strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud. Admitted carriers are also required to financially contribute to the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders. Through contractual relationships with a network of approximately 3,600 independent agents, of which approximately 1,800 actively sell and service our products, FNIC is authorized to underwrite homeowners', commercial general liability, fire, allied lines and personal and commercial automobile insurance in Florida. FNIC is licensed as an admitted carrier in Alabama, Louisiana, Georgia and Texas and underwrites commercial general liability insurance in those states, homeowners' insurance in Louisiana and personal automobile insurance in Georgia and Texas.

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

In January 2011, we merged FNIC and our other wholly owned insurance subsidiary, American Vehicle Insurance Company ("American Vehicle"), with FNIC continuing the operations of both entities. In connection with this merger, the Company, FNIC and American Vehicle entered into a Consent Order with the Florida OIR pursuant to which we agreed to certain restrictions on our business operations. The Consent Order was amended in February 2013 to lessen or eliminate certain of the original requirements, due to FNIC's statutory underwriting profit during 2012. See "Regulation– Consent Order."

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

Until June 2011, we offered premium financing to our own and third-party insureds through our wholly owned subsidiary, Federated Premium Finance, Inc. (“Federated Premium”).

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

FNU earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. FNU earns a $25 per policy fee, and traditionally a 6% commission fee from its affiliate, FNIC. During the fourth quarter of 2010, FNU, pursuant to the Consent Order as discussed above, reduced its fee to earn amounts varying between 2% and 4%, which we anticipate will return to 6% at an unknown future date with approval from the Florida OIR. A formal agreement reflecting this fee modification was executed during January 2011.

The homeowner policy provides FNU the right to cancel any policy within a period of 90 days from the policy's inception with 25 days' notice, or after 90 days from policy inception with 95 days' notice, even if the risk falls within our underwriting criteria.

Although we are authorized to underwrite the various lines described above, our business is primarily underwriting homeowners' policies. During 2013, 89.6%, 4.3%, 2.6% and 3.5% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and personal automobile insurance, respectively. During 2013, $29.7 million or 13.6% of the $218.3 million of homeowners' premiums we underwrote were produced under an agency agreement with Ivantage Select Agency, Inc. ("ISA"), an affiliate of Allstate Insurance Company, that grants Allstate agents the authority to offer certain FNU products. The $29.7 million of homeowners' premiums produced under this agreement with ISA represents 25.5% of the total increase in the sale of homeowners' policies during 2013, compared with 2012. This network of agents began writing for FNIC in March 2013. During 2012, 85.3%, 7.8%, 4.4% and 2.5% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and personal automobile insurance, respectively.

During the years ended December 31, 2013, 2012 or 2011, we did not experience any weather-related catastrophic events such as the hurricanes that occurred in Florida during 2005 and 2004. We are not able to predict how hurricanes or other insurable events will affect our future results of operations and liquidity. Loss and loss adjustment expenses ("LAE") are affected by a number of factors, many of which are partially or entirely beyond our control, including the following.

- the nature and severity of the loss;
- weather-related patterns;
- the availability, cost and terms of reinsurance;
- underlying settlement costs, including medical and legal costs;
- legal and political factors such as legislative initiatives and public opinion;
- macroeconomic issues.

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

We have entered into a Coexistence Agreement effective August 30, 2013 (the "Coexistence Agreement") with Federated Mutual Insurance Company ("Federated Mutual") in response to correspondence received from Federated Mutual's counsel alleging that our use of the name "Federated" infringed certain federal trademarks held by Federated Mutual. Although we believe that we have meritorious defenses to this allegation, we sought to avoid litigation and therefore negotiated and entered into the Coexistence Agreement. Under the Coexistence Agreement, among other things, we may continue to use "Federated" until at least August 30, 2020, after which time we have agreed to either cease using “Federated” in commerce or otherwise adopt and use trade names that are not confusingly similar to Federated Mutual’s trademarks. During this period, we continue to develop our brand under the “FedNat” name, which is the name by which agents generally know us.

Our goal in our reinsurance strategy is to equalize the liquidity requirements imposed by most severe insurable events and by all other insurable events we manage in the normal course of business. Please see “Reinsurance Agreements” under “Item 1. Business” for a more detailed description of our reinsurance agreements and strategy.

Overview of Premium Growth

Gross premiums written increased $123.9 million, or 103.7%, to $243.4 million for 2013, compared with $119.5 million for 2012. Florida homeowners' represents 94% and Texas private passenger automobile represents the remaining 6% of the increased premium volume. We believe that our growth in 2013 reflects management's efforts over several years. Our success today reflects our goal to be an agent-friendly carrier that provides exceptional service. We have invested in our agent relationships and our staff, have created easy to use systems for the agent, and increased our relevance to the agents' operations by providing insurance products that meet their market needs.

Our homeowner business contributed $116.5 million or 94.0% of the increased gross written premiums during the year ended December 31, 2013. This increase was the result of:

- policyholders continuing to renew their FNIC homeowners' policy,
- a "flight to quality" in the market by agents who seek quality carriers to place their business,
- and supporting a marketing team dedicated to promoting the quality and quantity of products and services that we offer.

During 2013, approximately 85% of our policyholders renewed their policies. This high retention rate reflects the confidence that the policyholder and his agent have in our financial stability and strength. Additionally, policyholders have told agents that our professional staff adjusts claims quickly and fairly.

CRITICAL ACCOUNTING POLICIES

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

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with management's evaluation of the determination of (i) liability for unpaid losses and LAE, (ii) the amount and recoverability of amortization of Deferred Policy Acquisition Costs ("DPAC"), and (iii) estimates for our reserves with respect to finance contracts, premiums receivable and deferred income taxes. Various assumptions and other factors underlie the determination of these significant estimates, which are described in greater detail in Footnote 2 in this Form 10-K.

Except as described below, we believe that in 2013 there were no significant changes in those critical accounting policies and estimates. Senior management has reviewed the development and selection of our critical accounting policies and estimates and their disclosure in this Form 10-K with the Audit Committee of our Board of Directors.

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

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

FASB issued guidance addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. The guidance requires that these securities be classified into one of three categories: Held-to-maturity, Trading, or Available-for-sale securities.

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

Overview of Management's Loss Reserving Process

The Company's loss reserves can generally be categorized into two distinct groups. One group is short-tail classes of business consisting principally of property risks in connection with homes and automobiles. The other group is long-tail casualty classes of business which include primarily commercial general liability and to a much lesser extent, homeowner and automobile liability. For operations writing short-tail coverages our loss reserves were generally geared toward determining an expected loss ratio for current business rather than maintaining a reserve for the outstanding exposure. Estimations of ultimate net loss reserves for long-tail casualty classes of business is a more complex process and depends on a number of factors including class and volume of business involved. Experience in the more recent accident years of long-tail casualty classes of business shows limited statistical credibility in reported net losses because a relatively low proportion of net losses would be reported claims and expenses and even smaller percentage would be net losses paid. Therefore, incurred but not yet reported ("IBNR") would constitute a relatively high proportion of net losses.

Additionally, the different methodologies are utilized the same, regardless of the line of business. However, the final selection of ultimate loss and LAE is certain to vary by both line of business and by accident period maturity. There is no prescribed combination of line of business, accident year maturity, and methodologies; consistency in results of the different methodologies and reasonableness of the result are the primary factors that drive the final selection of ultimate loss and LAE.

Methods Used to Estimate Loss and LAE Reserves

The methods we use for our short-tail business do not differ from the methods we use for our long-tail business. The Incurred and Paid Development Methods intrinsically recognize the unique development characteristics contained within the historical experience of each material short-tail and long-tail line of business. The Incurred and Paid Cape Cod Methods reflect similar historical development unique to each material short-tail and long-tail line of business.

We apply the following general methods in projecting loss and LAE reserves:

- Paid and Incurred Loss Development Method

- Paid and Incurred Bornhuetter-Ferguson Incurred Method

·Frequency / Severity Method

Description of Ultimate Loss Estimation Methods

The estimated Ultimate Loss and Defense and Cost Containment Expense ("DCCE") is based on an analysis by line of business, coverage and by accident quarter performed using data as of December 31, 2013. The analysis relies primarily on four actuarial methods: Incurred Loss and DCCE Development Method, Paid Loss and DCCE Development Method, Bornhuetter-Ferguson Incurred Method, and Bornhuetter-Ferguson Paid Method. Each method relies on company experience, and, where relevant, the analysis includes comparisons to industry experience. The following is a description of each of these methods:

Incurred Loss and DCCE Development Method – This reserving method is based on the assumption that the historical incurred loss and DCCE development pattern as reflected by the Company is appropriate for estimating the future loss & DCCE development. Incurred paid plus case amounts separated by accident quarter of occurrence and at quarterly evaluations are used in this analysis. Case reserves do not have to be adequately stated for this method to be effective; they only need to have a fairly consistent level of adequacy at all stages of maturity. Historical "age-to-age" loss development factors were calculated to measure the relative development of an accident quarter from one maturity point to the next. Loss and DCCE development factors ("LDF") are selected based on a review of the historical relationships between incurred loss & DCCE at successive valuations and based on industry patterns. The LDFs are multiplied together to derive cumulative LDF's that, when multiplied by actual incurred loss and DCCE, produce estimates of ultimate loss and DCCE.

Paid Loss & DCCE Development Method – This method is similar to the Incurred Loss & DCCE Development Method only paid loss & DCCE and paid patterns are substituted for the incurred loss & DCCE and incurred patterns.

Bornhuetter-Ferguson Incurred Method – This reserving method combines estimated initial expected unreported loss & DCCE with the actual loss & DCCE to yield the ultimate loss & DCCE estimate. Expected unreported loss & DCCE are equal to expected total loss & DCCE times the expected unreported percentage of loss & DCCE for each policy year. The incurred loss & DCCE emergence pattern used to determine the unreported percentages in our projections is based on the selected LDF's from the Incurred Loss & DCCE Development Method described above. The estimate of initial expected total loss & DCCE is based on the historical loss ratio for more mature accident years. While this approach reduces the independence of the Bornhuetter-Ferguson Method from the loss & DCCE development methods for older policy years, it is used primarily for estimating ultimate loss & DCCE for more recent, less mature, policy years.

Bornhuetter-Ferguson Paid Method – This method is similar to the Bornhuetter-Ferguson Incurred Method only paid loss & DCCE and paid patterns are substituted for the incurred loss & DCCE and incurred patterns.

We select an estimate of ultimate loss & DCCE for each accident quarter after considering the results of each projection method for the quarter and the relative maturity of the quarter (the time elapsed between the start of the quarter and December 31, 2013). Reserves for unpaid losses & DCCE for each quarter are the differences between these ultimate estimates and the amount already paid. The reserves for each quarter and each coverage are summed, and the result is the overall estimate of unpaid losses & DCCE liability for the company.

We also produce an estimate of unpaid Adjusting and Other Expense ("A&O"), as a reserve is required under Statutory Accounting Principles ("SAP") even if this expense has been pre-paid or with an unconsolidated affiliate. Although we do not prepay for A&O, the majority of the A&O incurred is with an affiliated company and eliminated under the accounting principles for consolidation. The unpaid A&O is added to unpaid losses & DCCE, resulting in total unpaid losses and LAE.

The validity of the results from using a loss development approach can be affected by many conditions, such as internal claim department processing changes, a shift between single and multiple claim payments, legal changes, or variations in a company's mix of business from year to year. Also, since the percentage of losses paid for immature years is often low, development factors can be volatile. A small variation in the number of claims paid can have a leveraging effect that could lead to significant changes in estimated ultimate values. Accordingly, our reserves are estimates because there are uncertainties inherent in the determination of ultimate losses. Court decisions, regulatory changes and economic conditions can affect the ultimate cost of claims that occurred in the past as well as create uncertainties regarding future loss cost trends. We compute our estimated ultimate liability using the most appropriate principles and procedures applicable to the lines of business written. However, because the establishment of loss reserves is an inherently uncertain process, we cannot be certain that ultimate losses will not exceed the established loss reserves and have a material adverse effect on our results of operations and financial condition.

Frequency / Severity Method – This method separately estimates the two components of ultimate losses (the frequency, or number of claims and the severity, or cost per claim) and then combines the resulting estimates in a multiplicative fashion to estimate ultimate losses. The approach is valuable because sometimes there is more inherent stability in the frequency and severity data when viewed separately than in the total losses.

We developed reported claim counts to ultimate levels using the development approach. The mechanics of this approach are the same as we described previously for paid and incurred losses. The validity of the results of this method depends on the stability of claim reporting and settlement rates. Then we developed accident year incurred severities (incurred losses divided by reported claim counts) to ultimate levels using the development approach.

We trended these severities to accident year 2013 levels. Trend rates were selected based on a review of historical severities. Selected severity was chosen based on judgment considering the developed severities and the trended severities, considering industry benchmarks for each segment. The loss & ALAE, claim count and severity triangles are evaluated as of 12 months, 24 months, 36 months etc. We selected loss development factors based on the loss development history, to the extent credible, and supplemented with industry data where appropriate.

A key assumption underlying the estimation of the reserve for loss and LAE is that past experience serves as the most reliable estimator of future events. This assumption may materially affect the estimates when the insurance market, the regulatory environment, the legal environment, the economic environment, the book of business, the claims handling department, or other factors (known or unknown) have varied over time during the experience period and / or will vary (expectedly or unexpectedly) in the future. 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. Therefore, the ultimate liability for unpaid losses and LAE will likely differ from the amount recorded at December 31, 2013.

The following describes the extent of our procedures for determining the reserve for loss and LAE on both an annual and interim reporting basis:

Annually - Our policy is to select a single point estimate that best reflects our in-house actuarial determination for unpaid losses and LAE. Our independent actuarial firm, examining the exact same data set, will independently select a point estimate which determines a high point and low point range. Both processes rely on objective and subjective determinations. If our point estimate falls within the range determined from the point estimate of our actuary, then the Company’s policy has been that no adjustments by management would be required. In consideration thereof, the company does not have a policy for adjusting the liability for unpaid losses and LAE to an amount that is different than an amount set forth within the range determined by our independent actuary, although the reserve level ultimately determined by us may not be the mid-point of our independent actuary’s range. Further, there can be no assurances that our actual losses will be within our actuary’s range. Our independent actuary’s report expressly states that the report is based on assumptions developed from its own analysis and based on information provided by management and that notwithstanding its analysis, there is a significant risk of material adverse deviation from its range.

Interim – During 2013 our interim approach was very similar to the annual process noted above.

A number of other actuarial assumptions are generally made in the review of reserves for each class of business.

For each class of business, expected ultimate loss ratios for each accident year are estimated based on loss reserve development patterns. The expected loss ratio generally reflects the projected loss ratio from prior accident years, adjusted for the loss trend and the effect of rate changes and other quantifiable factors on the loss ratio.

In practice there are factors that change over time; however, many (such as inflation) are intrinsically reflected in the historical development patterns, and others typically do not materially affect the estimate of the reserve for unpaid losses and LAE. Therefore, no specific adjustments have been incorporated for such contingencies projecting future development of losses and LAE. There are no key assumptions as of December 31, 2013 premised on future emergence inconsistent with historical loss reserve development patterns.

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The table below distinguishes total loss reserves between IBNR, as discussed above, and case estimates for specific claims as established by routine claims management.

Reserves for unpaid loss and LAE net of reinsurance recoverable as of December 31, 2013	Case Loss Reserves	Case LAE Reserves	Total Case Reserves	IBNR Reserves (Including LAE)	Reinsurance Recoverable on Unpaid Loss and Loss Expenses	Net Reserves
	(Dollars in Thousands)					
Homeowners'	$ 10,106	$ 1,292	$ 11,398	$ 23,749	$ 25	$ 35,122
Commercial General Liability	2,404	1,099	3,503	13,366	-	16,869
Automobile	5,037	3,211	8,248	752	2,717	6,283
Total	$ 17,547	$ 5,602	$ 23,149	$ 37,867	$ 2,742	$ 58,274

Reserves for unpaid loss and LAE net of reinsurance recoverable as of December 31, 2012	Case Loss Reserves	Case LAE Reserves	Total Case Reserves	IBNR Reserves (Including LAE)	Reinsurance Recoverable on Unpaid Loss and Loss Expenses	Net Reserves
	(Dollars in Thousands)					
Homeowners'	$ 6,295	$ 1,430	$ 7,725	$ 8,855	$ 141	$ 16,439
Commercial General Liability	1,197	1,509	2,706	22,677	77	25,306
Automobile	3,456	133	3,589	4,259	3,285	4,563
Fire	5	7	12	83	-	95
Inland Marine	-	-	-	2	-	2
Total	$ 10,953	$ 3,079	$ 14,032	$ 35,876	$ 3,503	$ 46,405

Our reported results, financial position and liquidity would be affected by likely changes in key assumptions that determine our net loss reserves. The table below illustrates the change to equity that would occur as a result of a change in loss and LAE reserves, net of reinsurance.

	Years Ended December 31,			
	2013		2012	
Change in loss and LAE reserves, net of reinsurance	Adjusted loss and LAE reserves, net of reinsurance	Percentage change in equity (1)	Adjusted loss and LAE reserves, net of reinsurance	Percentage change in equity (1)
	(Dollars in Thousands)			

-10.0	%	52,447	3.6	%	41,764	4.5	%
-7.5	%	53,903	2.7	%	42,925	3.4	%
-5.0	%	55,360	1.8	%	44,085	2.3	%
-2.5	%	56,817	0.9	%	45,245	1.1	%
Base		58,274	-		46,405	-	
2.5	%	59,731	-0.9	%	47,565	-1.1	%
5.0	%	61,188	-1.8	%	48,725	-2.3	%
7.5	%	62,644	-2.7	%	49,885	-3.4	%
10.0	%	64,101	-3.6	%	51,045	-4.5	%

(1) Net of tax

For the year ended December 31, 2013, our actuarial firm determined range of statutory loss and LAE reserves on a net basis range from a low of $51.5 million to a high of $60.9 million, with a best estimate of $55.5 million. The Company's net loss and LAE reserves are carried on a statutory basis at $54.0 million, and on a GAAP consolidated basis at $61.0 million which when netted with our $2.7 million reinsurance recoverable totals $58.3 million. The Company's statutory point estimate for its reserves as of December 31, 2013 is 2.6% below our actuary's best estimate, which reflects management's current analysis of the status and expected timing of our anticipated claims, our analysis of expected weather patterns in the regions in which we sell policies, our re-focus of our business growth efforts to areas outside of South Florida, and other factors.

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

Please see Footnote 2 of the Notes to Consolidated Financial Statements for additional discussions regarding critical accounting policies.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 2(n), "Summary of Significant Accounting Policies – Recent Accounting Pronouncements" in the Notes to the Condensed Consolidated Financial Statements for a discussion of recent accounting pronouncements and their effect, if any, on the Company.

ANALYSIS OF FINANCIAL CONDITION
As of December 31, 2013 Compared with December 31, 2012

Total Investments

Total investments increased $90.6 million, or 69.7%, to $220.7 million as of December 31, 2013, compared with $130.1 million as of December 31, 2012. This increase reflected the $123.9 million increase in gross premiums written compared with 2012 and the $28.1 million in net proceeds from the Company's November 2013 offering. The excess cash was invested primarily in the bond portfolio.

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

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

The debt and equity securities that are available for sale and carried at fair value represent 97% of total investments as of December 31, 2013, compared with 94% as of December 31, 2012.

We did not hold any trading investment securities during 2013.

As of December 31, 2013 and 2012, our investments consisted primarily of corporate bonds held in various industries, municipal bonds and United States government bonds. As of December 31, 2013, 83% of our debt portfolio was in diverse industries and 17% is in United States government bonds. As of December 31, 2013, approximately 91% of our equity holdings were in equities related to diverse industries and 9% were in mutual funds. As of December 31, 2012, 69% of our debt portfolio was in diverse industries and 31% is in United States government bonds. As of December 31, 2012, approximately 87% of our equity holdings were in equities related to diverse industries and 13% were in mutual funds.

Below is a summary of net unrealized gains at December 31, 2013 and December 31, 2012 by category.

	Unrealized (Losses) and Gains	
	December 31, 2013	December 31, 2012
	(Dollars in Thousands)	
Debt securities:		
United States government obligations and authorities	$(213)	$ 567
Obligations of states and political subdivisions	180	201
Corporate	467	3,760
International	(33)	106
	401	4,634
Equity securities:		
Common stocks	9,161	1,887
Total debt and equity securities	$9,562	$ 6,521

The net unrealized gain of $9.6 million is inclusive of $1.6 million of unrealized losses. The $1.6 million of unrealized losses is inclusive of $0.1 million unrealized losses from equity securities and $1.5 million unrealized losses from debt securities.

The $0.1 million of unrealized losses from equity securities is from common stocks and mutual funds held in diverse industries as of December 31, 2013. The Company evaluated the near-term prospects in relation to the severity and duration of the impairment. Based on this evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2013.

The $1.5 million of unrealized losses from debt securities is primarily related to US government obligations and obligations of states and political subdivisions. The Company does not expect to settle at prices less than the amortized cost basis. The Company does not consider these investments to be other-than-temporarily impaired at December 31, 2013 because we neither currently intend to sell these investments nor consider it likely that we will be required to sell these investments before recovery of the amortized cost basis.

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

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

- prospects for the issuer’s industry segment;

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

- historical volatility of the fair value of the security.

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

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

In reaching a conclusion that a security is either other-than-temporarily or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as Standard and Poor's ("S&P") and Moody's Investors Service, Inc. ("Moody's"), as well as information released via the general media channels. During 2013, in connection with the process, we have not charged any investment losses to operations. During 2012, in connection with the process, we have charged to operations $44,000 of investment losses.

As of December 31, 2013 and December 31, 2012, respectively, all of our securities are in good standing and not impaired, except as noted above, as defined by FASB issued guidance.

The following table summarizes, by type, our investments as of December 31, 2013 and 2012.

	December 31, 2013		December 31, 2012	
	Carrying Amount	Percent of Total	Carrying Amount	Percent of Total
	(Dollars in Thousands)			
Debt securities, at market:				
United States government obligations and authorities	$27,209	12.33 %	$27,392	21.06 %
Obligations of states and political subdivisions	52,064	23.59 %	3,939	3.03 %
Corporate	91,941	41.66 %	67,313	51.74 %
International	3,698	1.68 %	3,111	2.39 %
	174,912	79.26 %	101,755	78.22 %
Debt securities, at amortized cost:				
United States government obligations and authorities	4,630	2.10 %	6,016	4.62 %
Corporate	2,475	1.12 %	1,203	0.92 %
International	109	0.05 %	140	0.11 %
	7,214	3.27 %	7,359	5.65 %
Total debt securities	182,126	82.53 %	109,114	83.87 %
Equity securities, at market:	38,584	17.47 %	20,982	16.13 %
Total investments	$220,710	100.00%	$130,096	100.00%

Debt securities are carried on the balance sheet at market. At December 31, 2013 and 2012, debt securities had the following quality ratings by S&P and for securities not assigned a rating by S&P, Moody's or Fitch ratings were used.

	December 31, 2013		December 31, 2012	
	Carrying Amount	Percent of Total	Carrying Amount	Percent of Total
	(Dollars in Thousands)			
AAA	$24,904	13.67 %	$10,967	10.05 %
AA	67,374	36.99 %	38,733	35.50 %
A	46,338	25.44 %	31,774	29.12 %
BBB	42,979	23.60 %	27,640	25.33 %
Not rated	531	0.30		