

FEDERATED NATIONAL HOLDING CO
Form 10-K
April 01, 2013

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

FORM 10-K

Annual Report under Section 13 or 15(d) of the Securities Act of 1934
For the fiscal year ended December 31, 2012

or

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
(State or other jurisdiction of
incorporation or organization)

65-0248866
(I.R.S. Employer
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 No

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

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

Indicate by check mark whether the registrant has electronically submitted and posted on its corporate 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 No

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

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

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

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

The aggregate market value of the Registrant's common stock held by non-affiliates was \$29,205,677 on June 30, 2012, computed on the basis of the closing sale price of the Registrant's common stock on that date.

As of March 26, 2013, the total number of common shares outstanding of Registrant's common stock was 8,085,589.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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PART I

SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by words “believes,” “project,” “expects,” “anticipates,” “estimates,” “intends,” “strategy,” “plan,” “may,” “will,” “would,” “will be,” “will continue,” “will likely result,” and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in the section entitled “Risk Factors” in Part I, Item 1A of this Annual Report. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

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 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. We also utilize a select number of general agents for the same purpose.

Our primary 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 insurance regulator for authority to write specific lines of insurance in that state. Through contractual relationships with a network of approximately 3,000 independent agents, of which approximately 900 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 also licensed as an admitted carrier in Alabama, Louisiana, Georgia and Texas, and underwrites commercial general liability insurance in those states and personal automobile insurance in Georgia and Texas.

FNIC operates as a non-admitted carrier in Arkansas, California, Kentucky, Maryland, Missouri, Nevada, Oklahoma, South Carolina, Tennessee and Virginia, 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”), formerly known as Superior Adjusting, Inc. 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”).

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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, Illinois, Louisiana, North Carolina, Mississippi, Missouri, New York, 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.

Although we are authorized to underwrite the various lines described above, our business is primarily underwriting homeowners’ policies. 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 2011, 81.8%, 10.3%, 4.6% and 3.3% of the premiums we underwrote were for homeowners’, commercial general liability, federal flood, and personal automobile insurance, respectively.

During the years ended December 31, 2012, 2011 or 2010, 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.

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.

From time to time, new regulations and legislation are proposed to limit damage awards, to control plaintiffs' counsel fees, to bring the industry under regulation by the Federal government, to control premiums, policy terminations and other policy terms and to impose new taxes and assessments. It is not possible to predict whether, in what form or in what jurisdictions, any of these proposals might be adopted, or the effect, if any, on us.

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.

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RECENT DEVELOPMENTS

The Company anticipates unfavorable pricing terms on our upcoming reinsurance contracts due to reduced Florida Hurricane Catastrophe Fund (“FHCF”) capacity, though we also anticipate that this higher marginal rate will be mitigated by a reduced reinsurance requirement.

The Board of Directors of FNHC declared a regular quarterly dividend of \$0.03 per common share payable on June 3, 2013 to shareholders of record as of May 6, 2013. This is an increase of 50% over the previously declared regular quarterly dividends of \$0.02 per common share payable on March 4, 2013 and December 28, 2012 to shareholders of record as of February 4, 2013 and December 3, 2012, respectively. This action reflects both our commitment to returning capital to our shareholders and the Board’s confidence in our business plan.”

BUSINESS STRATEGY

We expect that in 2013 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 further dispositions of assets, and development of procedures to improve claims history and mitigate losses from claims.

We expect that in 2013 these strategies have poised us to accelerate the 2012 results trajectory in 2013 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.

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INSURANCE OPERATIONS AND RELATED SERVICES

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.

	2012		Years Ended December 31,				2010		
	Premium	Percent	Premium	Percent	Premium	Percent	Premium	Percent	
	(Dollars in Thousands)								
Gross written premiums:									
Automobile	\$2,996	2.5	%	\$3,274	3.3	%	\$3,721	3.9	%
Federal Flood	5,293	4.4	%	4,468	4.5	%	3,951	4.1	%
Homeowners'	101,832	85.3	%	80,403	81.9	%	76,845	79.7	%
Commercial General Liability	9,338	7.8	%	10,125	10.3	%	11,894	12.3	%
Total gross written premiums	\$119,459	100.0	%	\$98,270	100.0	%	\$96,411	100.0	%
Ceded premiums:									
Automobile	\$2,021	4.0	%	\$1,541	3.3	%	\$1,882	3.6	%
Federal Flood	5,293	10.4	%	4,468	9.7	%	3,951	7.5	%
Homeowners'	43,331	84.7	%	40,273	87.0	%	46,893	88.5	%
Commercial General Liability	440	0.9	%			%			%